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**International
Accounting Standards
Board**

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These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: 18 September 2008, London

Project: Insurance Contracts

Subject: Fulfilment value (agenda paper 14A)

Purpose of this paper

1. In reaction to the discussion paper (DP) *Preliminary Views on Insurance Contracts*, several respondents advocate a measurement that reflects the fact that the insurer intends (and in most cases must) settle the liability by paying the policy benefits as they fall due, rather than by transferring the liability to a third party. Some respondents use 'settlement value' or similar terms to describe this notion.
2. This paper:
 - (a) explains why respondents prefer this notion to current exit value (the measurement attribute proposed by the DP).
 - (b) identifies similarities and differences between this notion and current exit value.
 - (c) considers whether this notion corresponds to something that could be described as a measurement attribute.
 - (d) suggests that 'fulfilment value' may be a more helpful description of this notion than 'settlement value'.

3. At this stage, staff does not intend to discuss whether fulfilment value is preferable to current exit value [or any other measurement attribute] or to seek any Board decisions; this will be part of future Board meetings. For the October 2008 meeting, we intend to present a list of measurement attribute candidates to the Board and discuss what their main features are as part of an Education Session. We will then seek feedback from the Insurance Working Group meeting in November 2008. At a subsequent meeting, we will ask the Board to reach a conclusion on the measurement attribute.

The rest of this paper deals with the following subjects:

- (a) Background– the DP and Responses to the DP (paragraphs 5-11)
 - (b) What are constituents aiming for? (paragraphs 12-19)
 - (c) Features of fulfilment value – similarities with current exit value (paragraphs 20-21)
 - (d) Features of fulfilment value – differences from current exit value (paragraphs 22-39)
 - (e) The description of fulfilment value (paragraphs 40-46)
 - (f) Is current fulfilment value an attribute of the insurance liability? (paragraphs 47-48)
 - (g) The next steps (paragraph 49)
4. Agenda paper 14B provides a tabular comparison between current exit value and the fulfilment value notion. Because some have suggested parallels between this notion and value in use, the comparison also covers value in use.

Background– the DP and responses to the DP

5. The discussion paper proposed that insurers should measure insurance liabilities at current exit value. In other words, the measurement attribute for insurance liabilities would be current exit value. Because current exit value would rarely, if ever, be observable, it would be estimated using a building block approach.
6. In very general terms, respondents largely support the three building blocks proposed in the discussion paper, but there is significant opposition to current exit value (and significant support for some sort of fulfilment value), mainly for the following reasons:

- (a) Respondents do not view current exit value as relevant if an entity cannot actually transfer the liability. Many respondents view this as referring to a hypothetical transaction that does not reflect the way the business is managed - users would find such a notion difficult to understand.
- (b) Estimates under current exit value should be consistent with those of a market participant. Current exit value also excludes entity-specific cash flows. However, most respondents believe that the most relevant measure of the liability uses the estimates and cash flows of the insurer, not those of a market participant for the following reasons:
- (i) It would be unreasonable to require insurers to go to exceptional lengths to demonstrate that their own inputs are in line with the market. Moreover, it may be difficult to persuade auditors and regulators that the insurer has done enough work to confirm that its inputs are in line with those incurred by other market participants.
 - (ii) Insurers price contracts by reference to their own inputs. Thus, a measurement based on market-participant inputs could lead to a gain or loss at inception, which would reverse in later periods as the insurer provides the services.
 - (iii) It is often not possible to observe directly what cash flows market participants would incur. Moreover, any apparent differences between those cash flows and entity-specific cash flows may arise from subtle and perhaps undetectable differences between the portfolios of, and products provided by the entity and the product and portfolios of other market participants. Thus, estimates of market participants' cash flows may be less robust than the entity's estimates of its own cash flows.
 - (iv) Differences between market participants' expenses and entity-specific expenses could also relate to different levels of service provided and the approach to claims management. Adjusting the entity's own expenses could therefore lead to inconsistency (asymmetry) with other estimates like mortality and lapses.

- (c) The current exit value of a liability reflects its credit characteristics. Most respondents reject this notion, particularly if it leads to income or expense when the liability is remeasured.
- (d) Whether gains should be recognised at inception of an insurance contract. Views are mixed on this.
7. Some respondents oppose current exit value without making a serious attempt to define a more appropriate measurement attribute. However, a fair number of respondents advocate a measurement that reflects the fact that the insurer intends (and in most cases must) settle the liability by paying the policy benefits as they fall due, rather than by transferring the liability to a third party. Some respondents use ‘settlement value’ or something similar to describe this notion, though none of the comment letters gives anything like a rigorous definition of settlement value.
8. Based on the descriptions in comment letters, the measurement attribute that respondents are looking for seems to be something like: ‘The present economic burden to the insurer of its obligation to pay contractual benefits as they fall due’ [this wording attempts to capture what we believe respondents had in mind. It is not a quote from the responses]. The DP briefly discussed such an approach in paragraphs 102 and 103 and described it as ‘value in settlement with the policy holder’.
9. Since submitting their comment letters, some respondents have given the staff further input to clarify their views on this notion and on the term that could be used to describe it. The following three descriptions provide the most developed descriptions:
- (a) Contract fulfilment value: the present value of all expected cash flows that the insurer anticipates over the life of the contract, taking into account the most relevant and reliable available market and entity-specific information.
- (b) Market-consistent fulfilment cost: the market-consistent fulfilment cost to the insurer to meet its obligations to policyholders over time in the ordinary course of business.
- (c) Production costs: today’s estimate of the production cost to fulfil an entity’s stand ready obligation under the insurance contract [a notion based on the costs of manufacturing is generally associated with the measurement of assets, e.g. inventories.

Those who propose this view see providing insurance coverage as ‘manufacturing’, although ‘manufacturing’ takes place **after** distribution and sales. Consequently, the production costs of an insurance contract are not historic costs but are based on current assumptions relating to future cash flows].

10. Some respondents mentioned value in use as a basis for applying a fulfilment based measurement attribute to insurance contracts because it reflects continuing use and is based on entity-specific cash flows (although pricing of those cash flows is based on the market). A summary of the features of value in use as defined by IAS 36 *Impairment of assets* is included in agenda paper 14B.
11. Respondents had some other concerns about current exit value (and its building blocks). We do not intend to discuss these concerns in this paper as they do not seem to be relevant to the question of whether fulfilment value is more appropriate than exit value. We will address these issues in more detail at a later stage of the project as a part of a broader discussion on the measurement attribute.
 - (a) Discounting for non-life claims liabilities [some respondents favour a separate model for non-life contracts, irrespective of whether the Board ends up choosing fulfilment value or exit value].
 - (b) Policyholder behaviour and policyholder participation.
 - (c) Acquisition costs.
 - (d) The impact of diversification on risk margins.
 - (e) The meaning of service margins.
 - (f) The structure of the performance statement.

What are constituents aiming for?

12. Based on the analysis in the previous section, constituents seem - in general terms - to be looking for measurement attribute that:
 - (a) has an objective based on working out the contract with the policyholder, rather than settling or transferring at the balance sheet date.

(b) has a (slightly) more entity-specific flavour, specifically for estimates of expenses (ie the costs of administering the contracts).

(c) excludes the credit characteristics of the liability.

13. To have a closer look at what constituents are aiming for when they refer to ‘settlement value’, we compare the notion with developments in the Liabilities Project (the project to amend IAS 37).

14. Paragraph 36 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* requires the amount recognised as a provision to be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. Paragraph 37 goes on to say that this is ‘the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time’. Based on the existing IAS 37, Paragraph 29 of the June 2005 Exposure Draft Proposed Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 19 *Employee Benefits* (the ED to revise IAS 37) proposes that:

An entity shall measure a non-financial liability at the amount that it would rationally pay to settle the present obligation or to transfer it to a third party on the balance sheet date.

15. The IAS 37 measurement model is based on settlement; many respondents to the DP have been referring to a notion for insurance contracts based on settlement. The Liabilities Project Team identified three¹ approaches to ‘settle’ a non-financial liability²:

(a) extinguish the obligation by paying the counterparty on the balance sheet date.

(b) transfer the obligation to a third party on the balance sheet date.

(c) fulfil the obligation by using the entity’s own resources at a future date.

¹ One could also argue that there is a fourth way to ‘settle’ a liability: buying back one’s own liability on a market. Although some insurance policies are traded on a secondary market (‘Life Settlement Market’), it is very unlikely that the insurers will be able to (or want to) repurchase their liabilities on this market. Therefore, we do not discuss this approach any further in this paper.

² February 2008, Agenda paper 6

16. In reviewing responses to the ED to revise IAS 37, the Board tentatively decided to give additional guidance on measurement of non-financial liabilities. This guidance clarifies that:
- (a) 'settle' means paying the counterparty at balance sheet date ((a) of paragraph 15) and
 - (b) if the entity would have to pay different amounts to settle the obligation and to transfer the obligation to a third party ((b) of paragraph 15), it would rationally pay the lower of these two amounts³.
17. We now look at how the three approaches to 'settle' ((a) through (c) of paragraph 15) addressed in the Liabilities project fit into the context of insurance contracts.
- (a) Settling the obligation with the counterparty means extinguishing the obligation by paying the counterparty on the measurement date. If the obligation is an insurance contract, such a transaction is often known as a commutation. However, commutations are rare and often arise because the insurer or policyholder is in distress. Thus, it seems unlikely that most respondents would favour commutation value as the measurement attribute for insurance contracts.
 - (b) Transferring the obligation to a third party on the balance sheet date results in a lay-off of the obligation by the transferor without the obligation being extinguished; a transferee will assume the obligation and is expected to fulfil it with the policyholder. This is consistent with current exit value, the measurement attribute proposed in the DP.
 - (c) Fulfilling the obligation looks at working out the insurance contracts with the policyholder over time using the entity's own resources at a future date. This approach would require a measurement based on the entity's own estimates of the future cash flows that are required to discharge the obligation. Most respondents agree that, at least for life contracts, these cash flows should be adjusted for the time value of money (consistent with the existing IAS 37).
18. Option (c) seems, at least conceptually, to be consistent with the measurement approach that those who opposed current exit value are looking for: measuring the present

economic burden to the insurer of its obligation to pay contractual benefits as they fall due by working out the contract over time.

19. However, for non-financial liabilities the Board tentatively decided that ‘settle’ means paying the counterparty or a third party at balance sheet date and does not mean fulfilling the obligation at a future date. The term ‘settlement value’ does not seem consistent with what the respondents propose; it could also cause confusion. Given its direct reference to fulfilling the obligation, the term ‘fulfilment value’ provides in our view a better understanding of what respondents are aiming. We therefore choose ‘fulfilment value’ as a working label throughout this paper. In paragraph 43 we consider in more detail whether ‘fulfilment value’ is the most appropriate description.

Features of fulfilment value - similarities with current exit value

20. Respondents generally agreed that the three building blocks discussed in the paper provided a useful framework for thinking about the measurement of insurance liabilities (although virtually all respondents had significant concerns about important aspects of the building blocks). Respondents largely supported the following main aspects of the building blocks:

- (a) using current estimates of cash flows, rather than locked in estimates. (although there may be some subtle differences between respondents on how to apply current estimates).
- (b) consistency with observable market prices for factors such as interest rates and equity prices⁴.
- (c) using expected value (ie probability-weighted average) rather than a single outcome. Some respondents expressed concerns about using expected value. Although most respondents seem to agree with the principle of using expected cash flows, some have expressed some concerns about how this principle would be applied in practice.
- (d) reflecting the time value of money (though as noted in paragraph 11(a), some disagree with this for non-life insurance).

³ February 2008, Agenda paper 6

(e) including a risk margin, and recognising income in line with the release from risk. In the DP, the Board expressed the preliminary view that the objective of a risk margin is to convey decision-useful information to users about the uncertainty associated with future cash flows. In the comment letters, most respondents agreed with that objective.

21. These aspects are not likely to cause any difference between current exit value as proposed by the DP and how respondents would define the features of a fulfilment value. Moreover, a fair number of respondents believe that, in practice, a fulfilment value and a transfer value may very well come up with a similar answer in some, perhaps many, cases, with both calculations probably using the same main inputs.

Features of fulfilment value - differences from current exit value

22. In the Board's preliminary view as expressed in the DP, a measurement using the three building blocks represents faithfully an attribute of an insurance liability. The DP suggested that an informative and concise name for that measurement attribute is 'current exit value'. In the DP the Board acknowledged that a measurement of insurance liabilities at current exit value is not intended to imply that an insurer can, will or should transfer the liability to a third party. Indeed, in most cases, insurers cannot transfer the liabilities to a third party and would not wish to do so. Rather, the purpose of specifying this measurement attribute is to provide useful information that will help users make economic decisions.

23. Moreover, the Board argued that, in determining an acceptable price to take on an insurance liability, a transferee would necessarily consider the cash flows that would arise under the contract. Therefore, in estimating current exit value, an insurer would estimate the cash flows that would arise for a hypothetical transferee, including the ultimate cash flows to the policyholder. The Board expected that an insurer would make similar estimates of the cash flows if it retained the obligation⁵.

⁴ Choosing estimates based on information that is observable in market is also referred as 'market-consistent'.

⁵In its February 2008 meeting, the Board tentatively reached a similar conclusion for the Liabilities project. The Board noted that there is not a market for most liabilities within the scope of IAS 37 and entities therefore would have to estimate the amount that a third party would demand to take over an obligation.

24. However, most respondents argue that a fulfilment value is a more relevant and reliable objective than current exit value, even if the actual outcome of the two measurements is very close or identical. Respondents believe that a fulfilment notion has a clear measurement objective: the burden to the insurer that comes from working out the insurance contract with the policyholder.
25. In paragraph 6 we already summarised some of the concerns that respondents have with current exit value; the concerns mentioned in paragraph 6 seem to be directly related to the debate between fulfilment value and exit value. These concerns will probably result in respondents defining some features of fulfilment in a way that is different from current exit value; these features are:
- (a) Estimates
 - (b) Risk Margins
 - (c) Day one profit
 - (d) Own credit risk
26. **Estimates.** The DP took the position that estimates should be consistent with the estimates that market participants would face. Current exit value also excludes cash flows that are specific to the insurer and would not arise for other market participants holding an obligation that is identical in all respects (entity-specific cash flows). The DP mentioned that this principle does not mean that the measurement of an insurance contract should exclude the cash flows that the entity expects, but it requires an entity to adjust those cash flows to make them consistent with the cash flows that would arise for market participants⁶. To further clarify this principle, the DP makes a distinction between:
- (a) cash flows arising from the characteristics of the contract. The DP characterises such cash flows as portfolio-specific and expects those to be considered by market participants; examples are lapses and mortality. The DP took the position that the level

⁶ In practice, the Board expects, according to the DP, that an insurer would use its own estimates of (servicing) expenses, unless there is clear evidence that the insurer is significantly more or less efficient than other market participants

of service provided and the approach to claims management reflect the characteristics of the contracts being measured and that those characteristics (therefore) affect the future cash flows that market participants would consider.

(b) cash flows specific to the entity that go beyond the characteristics of the contract.

Some cash flows, mainly expenses, may be affected by the company's efficiency in providing services or any other unique advantages or disadvantages the company has. A market participant is not expected to take these cash flows into account since they do not come from the characteristics of the contract, but instead relate to synergies with other recognised or unrecognised assets or liabilities that are specific to the entity. Those cash flows would not arise for other market participants.

27. Respondents generally agreed with using market participants' estimates to the extent that cash flows are determined by observable market prices. However, for estimates that cannot be determined by observable inputs, many respondents objected to using market participants' estimates. Respondents also objected to excluding entity-specific cash flows for reasons mentioned in paragraph 6. They propose that an insurer should use its own inputs without adjusting them to reflect the estimates that a market participant would make.

28. The respondents who propose looking at the production costs of insurance contracts (see paragraph 9 (c)), believe that challenges about how to estimate expected future costs (e.g. whether to include only the direct incremental costs or also an allocation of fixed costs and overheads) can be addressed by using a standard production cost method (similar to that allowed by IAS 2) for insurance contracts. The proponents of this approach believe that deploying a standard production costs for insurance contracts would require entities to take into account best practices for product development, standard costing and cost control. In this way, an insurer would force neutrality and verifiability to its entity-specific components.

29. In practice, we expect that estimates determined under current exit value and estimates determined under a fulfilment value will be similar in many cases:

- (a) For some estimates, observable market information is available. Those who favour a fulfilment notion generally agree that those estimates should be based on the market information.
- (b) For most estimates that cannot be based on observable inputs (eg. mortality, lapses), we do not expect any differences between the estimates of a market participant and the entity's own estimates since these estimates directly relate to the characteristics of the contract.
- (c) Expenses can be subject to a difference between estimates of a market participant and the entity's own estimates because of the insurer's efficiency or any other unique advantages or disadvantages the insurer has. However, as explained in paragraph 26, the level of service provided and the approach to claims management cannot give rise to any difference. Furthermore, the Board expected that – in practice - an insurer would use estimates of its own expenses, unless there is clear evidence that the insurer is significantly more or less efficient than other market participants.

30. **Risk Margins.** In the comment letters, most respondents agreed that the objective of a margin should be to provide information on the uncertainty of future cash flows. But they argued that it would be difficult to establish the margin that a hypothetical market participant would require; many were concerned about the lack of observable benchmarks for risk margins. However, the comment letters did not provide a clear principle for establishing the objective of such a margin under a fulfilment notion. For current exit value, this is reasonably clear – it is the amount market participants would require. But it is not immediately clear what the principle for a risk margin would be for a fulfilment notion.

31. The overall objective under a fulfilment value will obviously be to convey decision-useful information to users about the uncertainty associated with future cash flows. We have so far not identified any arguments why this principle would be different under a fulfilment value. From the initiatives provided by respondents, broadly two different approaches can be observed on how to apply the risk margin for a fulfilment notion. The two approaches differ in the way they treat the margin, both the initial and the subsequent.

32. One approach (approach A) is to establish the risk margin based on the cost of bearing risk⁷. This approach sees the cost of bearing risk as a component of the total cost to meet the obligations to the policyholder over time in the ordinary course of business. The cost of risk approach distinguishes between risks that can be hedged through financial markets (also referred to as hedgeable risks) and other (non-hedgeable) risks.
- (a) For some risks, the financial markets provide inputs for the cost of risk (hedgeable risks). The market price of these risks is included in the liability based on the prices of hedging instruments or other market consistent valuation techniques, e.g. by calculating the liability based on a portfolio of replicating asset.
 - (b) However, many risks that an insurer faces are non-hedgeable, e.g. mortality risk, operational risk, risk involving policyholder behaviour and risk involving very long term financial instruments. An insurer's ability to sell new business to policyholders depends on it having sufficient assets to pay all valid claims and other policyholder benefits. It can only do this if it holds sufficient capital to enable it to cope with adverse events; part of this capital relates to non-hedgeable risks. Some see the cost of holding capital related to non-hedgeable risk is seen as one way to express (or estimate) the market price of risk associated with the uncertainty of future cash flows. The cost of capital is calculated by charging a capital rate to the capital held for non-hedgeable risks.
 - (c) Another way to look at the cost of bearing risk is to consider this cost as part of the production costs of an insurance contract. When buying the insurance contract, the policyholder has firm expectations that the insurance company will ultimately be able to meet the obligations coming from the contract [otherwise the policyholder would probably not have bought the insurance contract from the insurance company]. The costs of providing a high level of certainty to the policyholder (e.g. the costs of hedging risks in the market or the cost of holding capital) are considered to be part of the production costs of insurance contracts. Those who propose this view do not prefer a specific method for estimating the risk margin - the cost of capital may be a proper proxy for the price of risk when no replicating instruments are available, but other methods can also be appropriate.

⁷ This subject was discussed in an Education Session with the Board in January 2008.

(d) The principles for establishing the initial risk margin for both the hedgeable and non-hedgeable risks also provide the basis for any subsequent measurement. Changes in the risk margin would reflect both the changes in the quantity of risk and the price of risk.

33. Others propose an approach (approach B) that sets the initial margin to the premium.

Under this approach the margin reflects the present value of the amount that an actual market participant (the insurer that issues the contract) expects to earn from an insurance contract that it sells, based on the price that another actual market participant (the policyholder) pays for this contract.

(a) Applying this approach results in calibrating the initial margin directly to the actual premium. This implies that the initial margin not only includes a margin for risk coverage, but also a margin for any other services provided under the contract. This approach does not flow from how those respondents would define fulfilment value, but would instead follow from combining two measurement models:

(i) Fulfilment value - updated expected cash flows.

(ii) Customer consideration – calibrate the initial margin to the premium.

(b) For subsequent measurement, the margin would be released to the income statement as the insurance company is released from risk. Some proponents of approach B would use the remaining margin to absorb subsequent adverse changes in estimates⁸.

34. **Day one profit.** In the DP the Board expressed the preliminary view that if the contract provides a margin higher than required by market participants, the insurer would recognise a profit at inception through profit and loss. However, the discussion paper also took the position that net⁹ day one profits would be rare, except in special cases (for example, if the insurer is in a niche market protected by barriers to entry or if the insurer has superior distribution systems).

⁸ Staff will seek further clarification from the advocates of approach B on this subject.

⁹ A net day one profit refers to a day one profit taking into account the acquisition costs associated with issuing the contract.

35. A fair number of respondents believe that, under current exit value or other measurement attributes that do not calibrate the initial margin to the premium, net day one profits would be common and significant. But respondents were divided (as was the Board) on whether it would be acceptable to recognise a net day one profit
36. It is somewhat difficult to find terminology to discuss day one profit without appearing to prejudge a discussion in one direction or the other. In an attempt to use neutral terminology, we use the term 'day one difference' to describe the difference between the premium and the expected present value of cash flows. Most of the debate centres on what happens if the day one difference is a credit. From the initiatives provided by respondents, broadly two different approaches to the day one difference can be observed.
37. One view – consistent with approach A as mentioned in paragraph 32 - makes a clear distinction between market-consistent valuation and observed pricing practices in the insurance market. Since the insurance markets are not considered sufficiently deep and liquid, using premium pricing for estimating the risk margin will reduce comparability. Risk margins should therefore be established independently from premiums charged for an insurance policy. Any margin in excess of the risk margin - the difference between the premium and the fulfilment cost including a margin for the cost of risk – is considered not to be part of the fulfilment costs arising from the insurance contracts. Proponents of approach A expect the day one difference on (between the premium and the fulfilment value) to be significant in many cases. Some proponents of approach A do not favour the recognition of the day one difference in profit or loss, but instead would recognise the day one difference as a liability, separate from the current fulfilment value, or in other comprehensive income. Other proponents of approach A have not taken a position on day one differences.
38. Another view – consistent with approach B as mentioned in paragraph 33 - considers the actual premium to be the best (and only) evidence of a real market transaction. The point of sale is the only point at which a real life calibration of margins is possible; but proponents of approach B consider that it is not possible to spit profit margins reliably from risk margins at this stage. This approach therefore calibrates the initial margin directly to the premium and does not allow for day one profits. Margins should be reported in the income statement only as the insurer is released from risk. Proponents of

this view consider it to be irresponsible, without further testing and analysis, to allow day one difference to be recognised as profit.

39. **Own credit risk.** In the DP the Board took the preliminary view that the current exit value of a liability is the price for a transfer that neither improves nor impairs its credit characteristics. The Board also expected that in practice the effects of the insurer's own credit risk would normally be small, especially at inception. From the perspective of fulfilment value, respondents mentioned that credit characteristics should not be part of such a value because an insurance company would not be able to realise such gains and remain a going-concern. Respondents therefore find it difficult to see how reporting such gains could be of value to investors or other users of financial information.

The description of fulfilment value

40. Staff believes that, if a fulfilment value is to be a viable measurement attribute candidate, it needs to be described in a rigorous and concise way for the following reasons¹⁰:
- (a) A clearly described measurement attribute provides a coherent framework to resolve new and emerging issues. Conversely, if separate building blocks are selected with no underlying coherent principle, they are likely to conflict with each other in some cases and so arbitrary rules may be needed to deal with emerging issues.
 - (b) It should be easier to communicate with users with a concise and easily understandable measurement attribute, rather than a disparate collection of building blocks that may have no unifying theme.
 - (c) Phase C, Measurement, of the Conceptual Framework Project could conclude that measurements should always aim to be a faithful representation of some real-world economic attribute of the item being measured. An assembly of disparate building blocks may not meet that need.
41. The objective of Phase C, Measurement, of the Conceptual Framework Project is to select a set of measurement bases (or attributes) that satisfy the objectives and qualitative characteristics of financial reporting. During milestone I of this project, a set of measurement basis candidates has been defined. The Boards have agreed that most of the

¹⁰ February 2008, Agenda paper 2C

measurement basis candidates are either prices or values. In addition, each candidate primarily provides information about a specific time frame (either past, present or future). The Boards furthermore concluded tentatively that all of the primary measurement candidates could be relevant for both assets and liabilities¹¹.

42. Based on the discussion so far, we can determine some of the key elements that a description of fulfilment value should include if it is to be a viable candidate for selection as a measurement attribute:

- (a) Price or value: the fulfilment notion does not attempt to define a price. However, as already discussed, it does attempt to quantify the economic burden that an insurance contract imposes on the insurer. This implies that a fulfilment notion can be described as a **value** [which confirms the proposed working label of ‘fulfilment **value**’].
- (b) Past, present or future: as mentioned in paragraph 17, the measure is generally expected to include the time value of money in order to give today’s economic burden. The measure will therefore reflect the **present** time frame. One way offered within the Conceptual Framework project to express a present time frame is to include term ‘current’ in the label. For fulfilment value, the term ‘current’ has two implications:
 - (i) estimates should be based on all available information, including the most recent actual experience (as proposed by the DP and acknowledged by most of the respondents).
 - (ii) the future cash flows should be adjusted for the time value of money.
- (c) A label like ‘current value’ will not be precise enough; it refers to ‘when’ and ‘how’, but not to ‘what’; the label would become more rigorous if it includes a reference to the principle - working out the insurance contract with the policyholder over time. As mentioned earlier, this reference could be achieved by including ‘fulfilment’ in the label.

43. In the previous sections we used ‘fulfilment value’ as a working label. Based on the analysis in this section, we – tentatively - identify ‘**current fulfilment value**’ as an

¹¹ November 2007, Agenda paper 3A

appropriate label for a measurement attribute based on working out the insurance contract with the policyholder over time.

44. The label provides information on some of the key elements of a measurement attribute. But for a more precise description of the thing the attribute is aiming at, we need a definition. Input by respondents provides a reasonable basis for identifying a number of elements of a definition, e.g. present value, based on cash flows and expected by the insurer. Based on this input, a definition of fulfilment value could be:

the expected present value of the cost of fulfilling the obligation to the policyholder over time

45. However, respondents seem to have mixed views on the margin and day one profits. From these mixed views we – broadly - identified two approaches on how fulfilment value would deal with risk margins and day one profits.
- (a) Approach A treats the cost of bearing risk as one of the costs of fulfilling the obligation. The cost of bearing risk is a form of risk margin. Thus, under approach A, fulfilment value includes one form of risk margin (the cost of bearing risk) and this flows fairly naturally from the definition.
- (b) Approach B does not treat the cost of bearing risk as a cost. Approach B does require a margin, computed at inception as the difference between the premium and the expected present value of cash flows. Proponents of view B have stated that they view the margin as part of fulfilment value (rather than a **separate**) item. However, in the staff's view, the inclusion of that margin does not seem to flow naturally from the above definition. Thus, an additional rule is required to stipulate that the margin is included and to prescribe how it is determined.
46. As mentioned in paragraph 36, most of the debate on day one differences centres on what happens if the day one difference is a credit:
- (a) In Approach A, current fulfilment value on day one does not include the day one difference. Proponents of approach A have mixed views on how to treat this difference.

- (b) In approach B, the current fulfilment value of the liability includes the day one difference.

Is current fulfilment value an attribute of the insurance liability?

47. One of the main objectives of this paper was to investigate whether the fulfilment notion – what we are now tentatively calling current fulfilment value – represents an attribute of the insurance liability or whether it is merely the result of a computation. In the staff’s view:

- (a) Current fulfilment value as described in approach A is an attribute of the liability.
- (b) For approach B, the treatment of the margin is problematic. If approach B treated the margin as separate from current fulfilment value, the result would, in the staff’s view, be an attribute of the liability. (It is not the same attribute as in approach A. Approach A includes the cost of bearing risk, but approach B does not). However, approach B treats the margin as part of the liability. The staff does not view the result as an attribute of the liability. Nevertheless, the staff will continue to seek input from advocates of approach B to see whether they can identify an alternative description that could be viewed as an attribute.

48. It is beyond the scope of this paper to assess:

- (a) whether current fulfilment value would be a more appropriate measurement attribute than other candidate measurement attributes.
- (b) whether approach A or approach B would be a more relevant approach to current fulfilment value.

The next steps

49. The staff believes that current fulfilment value is one of the viable candidates for selection as a measurement attribute for insurance contracts. At the October 2008 meeting, the staff will provide a description of all the candidates. We will then seek feedback from the Insurance Working Group meeting in November 2008 before asking the Board at a subsequent meeting to reach a conclusion on the measurement attribute.

Question for the Board

50. Do you need more information on current fulfilment value?