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Project **Insurance Contracts**

Topic **Cover note**

Agenda papers for this meeting

1. We have prepared the following agenda papers for the April joint meeting:

Agenda Paper No. / (FASB Memorandum)	Title
3 (43)	Cover note
3A (43A)	Application of risk adjustment and residual margins
3B (43B)	Application of composite margins
3C (43C)	Level of measurement
3D (43D)	Discount rate
3E (43E)	Time table
11A (44A)	Contract Boundaries
11B (44B)	Recognition

Objective of the meeting

2. Staff has several meetings scheduled for the insurance project at the April joint meetings. We will discuss those topics in the following sequence:

3. **Tuesday, April 20th.** Agenda papers 3A (FASB Memorandum 43A) and 3B (FASB Memorandum 43B) further explain the two approaches that the boards are looking at for margins: the former paper discusses risk adjustments and residual margins and the latter deals with composite margins. Based on these two papers, we ask the boards to agree on some aspects of each of the two approaches. We will not ask the boards to make a choice between the two approaches; that will be part of a follow-up meeting (currently scheduled for May 4th).

4. **Wednesday, April 21st**. Agenda paper 3D (FASB Memorandum 43D) on level of measurement.

5. **Thursday, April 22nd**. Agenda paper 3C (FASB Memorandum 43C) on the discount rate for insurance contracts.

6. Agenda papers 11A (FASB Memorandum 44A) on contract boundaries and 11B (FASB Memorandum 44B) on recognition will be discussed at meetings of the individual boards. The IASB will discuss these papers at its meeting on **Friday April 23rd**. The FASB will discuss these papers at a future meeting.

Tentative decisions to date

7. The appendix to this paper gives an overview of the boards' previous discussions.

8. The table in the appendix shows one single decision for those issues on which the boards reached a similar tentative conclusion. If the boards reached different tentative conclusions or one of the boards has an outstanding discussion for a particular topic, a status update is presented for each Board separately.

Appendix: Overview of topics discussed at previous meetings

<table>
<tr><th>Topic</th><th>IASB</th><th>FASB</th></tr>
<tr><td>Definition</td><td colspan="2">The boards tentatively decided to use the current definition of an insurance contract in IFRS 4 Insurance Contracts and the related guidance in Appendix B of IFRS 4. Specifically:
that compensation rather than indemnification be used in the definition of an insurance contract in describing the benefit provided to the policyholder;
that the guidance in IFRS 4 be used in determining whether insurance risk is significant, subject to matters discussed below.</td></tr>
<tr><td>Definition-timing risk</td><td colspan="2">On timing risk, the boards decided tentatively:
to change the factors considered in evaluating the significance of insurance risk from absolute amounts to present values; and
to amend the guidance in IFRS 4 to explain that contractual terms that delay timely reimbursement to the policyholder can significantly reduce insurance risk, so that some contracts containing such terms might not meet the definition of an insurance contract.</td></tr>
<tr><td>Definition-assessment of possible outcomes</td><td>For determining when insurance risk exists, the IASB expressed an initial preference for considering the range of possible outcomes.</td><td>For determining when insurance risk exists, the FASB expressed an initial preference for considering whether there are outcomes in which the present value of the net cash outflows can exceed the present value of the premiums.</td></tr>
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Scope	The boards tentatively decided that the scope of a standard on insurance contracts will exclude: • warranties issued directly by a manufacturer, dealer or retailer; • residual value guarantees embedded in a lease; • residual value guarantees provided by a manufacturer, dealer or retailer; • employers' assets and liabilities under employee benefit plans and retirement benefit obligations reported by defined benefit retirement plans; and • contingent consideration payable or receivable in a business combination. The boards expressed an initial preference that the scope of the standard should exclude fixed-fee service contracts, but noted that it would be undesirable to exclude contracts merely because they pay benefits in kind rather than in cash. The boards will consider this initial preference at a future meeting at which they will they discuss whether to include health contracts within the scope of the standard. The boards will also discuss at a future meeting whether financial guarantee contracts should be within the scope of the standard.	
Recognition	The IASB discussed the recognition of rights and obligations arising under insurance contracts, including the treatment of the contract in the period (if any) between entering into the contract and the start of the coverage period. No clear consensus emerged. The Boards will return to the topic of recognition at their April meeting.	The FASB tentatively decided that an entity should recognize an insurance obligation at the earlier of (1) the entity being on risk to provide coverage to the policyholder for insured events and (2) the signing of the insurance contract.
Derecognition	The IASB discussed derecognition of insurance liabilities and decided tentatively that that an insurer should derecognise an insurance liability when it no longer qualifies as a liability of the insurer, applying the derecognition principle in IAS 39 *Financial Instruments: Recognition and Measurement*.	The FASB tentatively decided on a principle that an insurance liability should be derecognized by an entity when that obligation no longer qualifies as a liability. The liability is eliminated when the entity is no longer on risk and no longer required to transfer any economic resources for that obligation.

<table>
<tr><td>Measurement approach</td><td colspan="2">The boards decided tentatively that the measurement approach should portray a current assessment of the contract, using the following building blocks:
• the unbiased, probability-weighted average of future cash flows expected to arise as the insurer fulfils the obligation;
• incorporation of time value of money;
• a margin. [The IASB and FASB reached different tentative positions on margins during the March joint meeting].

The boards also tentatively decided that:
• the building blocks should be used to measure the combination of rights and obligations arising from an insurance contract rather than to measure the rights separately from the obligations. That combination of rights and obligations should be presented on a net basis.
• the objective for measuring an insurance contract should refer to a value rather than cost. The staff will refine the description of that objective.</td></tr>
<tr><td>Measurement approach- decomposition of margins</td><td>The IASB decided tentatively that the measurement of an insurance contract should include:
• a risk adjustment for the effects of uncertainty about the amount and timing of future cash flows; and
• an amount that eliminates any gain at inception of the contract (residual margin).

The IASB decided tentatively that the risk adjustment should be the amount the insurer would rationally pay to be relieved of the risk.</td><td>The FASB tentatively decided that the measurement of an insurance contract should include one single composite margin. [The staff are developing this approach further for discussion at the April joint meeting.]</td></tr>
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<tr><td>Measurement at inception</td><td colspan="2">The boards decided that :
the initial recognition of an insurance contract should not result in the recognition of an accounting profit.
if a loss may arise at inception because the residual margin or composite margin cannot be negative. The insurer should recognise that loss in profit or loss at inception. Such losses will be less frequent, and smaller, in the composite margin approach than in the approach that uses a risk adjustment with a residual margin.
[The boards will discuss at their April joint meeting how to apply their tentative decisions on measurement at inception to composite margins]</td></tr>
<tr><td>Acquisition costs</td><td>The IASB decided tentatively to exclude from the initial measurement of the residual margin an amount equal to the incremental acquisition costs. The staff will investigate whether that tentative decision is best implemented by:
excluding the acquisition costs from the premium to which the contract liability is calibrated; or
including the acquisition costs in the contract cash flows at the inception of the contract.</td><td>The FASB decided tentatively that an insurer should:
expense all acquisition costs when incurred.
not recognize any revenue (or income) to offset those costs incurred.</td></tr>
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<td>Subsequent treatment margins</td>
<td colspan="2">The boards decided tentatively that, if the measurement of an insurance contract were to include a separate risk adjustment and residual margin:

the risk adjustment should be updated (remeasured) each reporting period.
the insurer should release the residual margin over the coverage period in a systematic way that best reflects the exposure from providing insurance coverage, as follows:

on the basis of passage of time; but
if the insurer expects to incur benefits and claims in a pattern that differs significantly from passage of time, the residual margin should be released on the basis of the expected benefits and claims.

The boards also decided tentatively that the insurer should not adjust the residual margin in subsequent reporting periods for changes in estimates.

[The boards will discuss the subsequent treatment of composite margins at their April joint meeting.]</td>
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<td>Discount rates</td>
<td>The IASB decided tentatively that:

the discount rate for insurance liabilities should conceptually adjust estimated future cash flows for the time value of money in a way that captures the characteristics of that liability rather than using a discount rate based on expected returns on actual assets backing those liabilities
the standard should not give detailed guidance on how to determine the discount rate
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<td>The FASB will discuss the discount rate further at this meeting.</td>
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<td>Exclude discounting and margins in some instances?</td>
<td>The IASB noted the arguments for and against an approach that uses an estimate of future cash flows with no margins and no discounting. The IASB considered whether to use such an approach for non-life claims liabilities and tentatively decided not to add it to the list of candidates.</td>
<td>The FASB will consider at a future meeting whether, in certain instances, a measurement of insurance contracts would use future cash flows with no margins and no discounting.</td>
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<tr><td>Participating features in insurance contracts</td><td>The IASB tentatively decided that payments arising from the participating feature should be included in the measurement of insurance contracts in the same way as any other contractual cash flows (ie on an expected present value basis).</td><td>The FASB decided tentatively that the insurer should recognise a liability for participating benefits to the extent that it has a legal or constructive obligation to pay those benefits.</td></tr>
<tr><td>Non-performance risk</td><td colspan="2">The boards decided tentatively that the measurement of an insurance liability should not be updated for changes in the risk of non-performance by the insurer.</td></tr>
<tr><td>Use of inputs</td><td colspan="2">The boards decided tentatively that the measurement should:
• consider all available information that relates to the fulfilment of the insurance contract. Available information includes, but is not limited to, industry data, historical data of an entity’s costs, and market inputs when those inputs are relevant to the fulfilment of the contract, and
• should use current estimates of financial market variables that are as consistent as possible with observable market prices.</td></tr>
<tr><td>Unearned Premium</td><td>The IASB decided tentatively that:
• an unearned premium approach would provide decision-useful information about pre-claims liabilities of short-duration insurance contracts.
• to require rather than permit the use of an unearned premium approach for those liabilities.</td><td>The FASB will discuss an unearned premium approach at a future meeting.</td></tr>
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<tr><td>Policyholder behaviour and contract boundaries</td><td colspan="2">The boards decided tentatively that the policyholder options, as well as options, forwards, and guarantees related to existing coverage, should be included in the measurement of the insurance contract on a look through basis using the expected value of future cash flows (to the extent that those options are within the boundary of the existing contract). As a consequence, no deposit floor would apply. The staff have developed a proposal to identify the boundary of an existing contract, which will be discussed at the April meeting.

The boards also discussed how to treat options, forwards, and guarantees that do not relate to the existing insurance contract coverage. The boards tentatively decided to exclude such features from the measurement of that contract. Instead, those features should be recognised and measured as new insurance contracts or other stand-alone instruments, according to their nature.</td></tr>
<tr><td>Assets associated with unit-linked contracts</td><td colspan="2">The boards decided tentatively that assets and related liabilities associated with unit-linked contracts, including those sometimes described as separate accounts, should be reported as the insurer's assets and liabilities in the statement of financial position.

The boards also decided tentatively not to address in this project issues involving the consolidation of investment funds associated with unit-linked contracts (including separate account contracts). Such issues are within the scope of the project on consolidation</td></tr>
<tr><td>Presentation of the performance statement</td><td colspan="2">The boards decided tentatively that:
• the measurement approach should drive the presentation model for the performance statement.
• the staff should develop further an expanded margin approach.</td></tr>
<tr><td>Other comprehensive income (OCI)</td><td>The IASB decided tentatively:
• not to change the accounting for an insurer’s assets.
• not to permit or require the use of OCI for insurance contracts.</td><td>The FASB will discuss OCI on April 14.</td></tr>
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