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Project **Insurance Contracts**

Topic **Candidate measurement approaches – tabular comparison**

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 the approaches considered for selection in this meeting; see agenda papers 11A and 11B.

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)

	Measurement approach based on updated IAS 37 model	Current fulfilment value	Unearned premium
Definition	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 amount the entity would rationally pay is the lowest of: a) the value to the entity of not having to fulfil the liability (an entity-specific measure); b) the price that the market would demand to assume the liability; and c) the price that the counterparty would demand to cancel the liability, if cancellation is possible.	The expected present value of the cost of fulfilling the obligation to the policy holder over time. Plus a "composite margin", based on the day one difference. [Possible variation: including an explicitly prescribed risk margin of some form, plus a "residual 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.

[*] This variation may be particularly relevant for consideration by the FASB. The IASB decided tentatively in its June 2009 meeting to remove a current fulfilment value that includes a separate risk margin from the list of candidates.

Scope	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 Unless the insurer has objective evidence that it can transfer with a third party or can settle with the counter party at a lower amount. In that case, the insurer measures the liability at the lower of the transfer amount and the amount at which it can settle.	- 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.

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.	Not applicable unless onerous.
Other inputs	The entity's estimate of the cash flows it would incur in fulfilling the liability. In some cases the amount required by a subcontractor for other services [often to be estimated by the amount the insurer requires for other services].	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.	Not applicable unless onerous.
Cash flows that arise from the characteristics of the entity (entity-specific)	Included.	Included.	Not applicable unless onerous.

Subsequent measurement of cash flows	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.	Included in profit or loss if contract becomes onerous.
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.	At inception, arguably implicit in the premium.
Components of the margin***	- risk margin - service margin - residual margin (calibrated to premium)	- composite margin [Possible variation: risk margin plus a residual margin calibrated to the premium].	No explicit margin. Implicit margin at inception, as implied by the premium
Risk margin	The value to the entity of not having to bear the risk in the expected cash flows.	No explicit risk margin. Implicit in the "composite margin". [Possible variation: explicitly prescribed risk margin, based on a principle still to be decided].	No explicit margin. Implicit margin at inception, as implied by the premium

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* 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.

** The IASB has decided tentatively that the measurement for an insurance liability uses 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.

Risk margin – initial measurement	Estimates the value to the entity of not having to bear the risk in the expected cash flows.	Uses premium as basis for determining the initial composite margin. [Possible variation: explicitly prescribed risk margin, based on a principle to be decided yet].	Not applicable.
Risk margin – subsequent measurement	Remeasured at each reporting date.	Not applicable. (Implicit release as the composite margin runs off) [Possible variation: risk margin remeasured at each reporting date].	Not applicable. (Implicit release as the premium becomes earned)
Service margin	The profit the insurer requires for undertaking services. [Sometimes already included in the amount a subcontractor would charge for undertaking a service].	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.	Not applicable. (Implicit release as the composite margin runs off)	Not applicable. (Implicit release as the premium becomes earned)
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; "composite margin" recognised as a separate item (presumably within the insurance liabilities). [Possible variation: "residual margin" recognised as a separate item].	No profit at inception. Loss at inception if onerous.
Liability adequacy test	Not applicable.	Not applicable.	Required at inception and each subsequent reporting date.

Acquisition costs	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 composite margin.	IASB: Recognised as revenue on day one. FASB: Included in unearned premium.
Own credit risk	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).