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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 September meeting:

Agenda Paper No.	Title	Objective
17	Cover note	Outlines objectives for this meeting and next steps.
17A	Measurement approach for Insurance contracts	Asks the IASB to conclude on the measurement approach.
17B	Candidate measurement approaches – tabular comparison	Provides a tabular overview of the candidate measurement approaches under consideration by the IASB.
17C	Treatment of residual and composite margins	Discusses the treatment of residual and composite margins for insurance contracts.
17D	Discount rate	Discusses discount rates.
17E	Timetable	Gives the time table for Board discussions.

Objective of the meeting

2. In its July meeting, the IASB did not reach a clear consensus on what the objective for the measurement approach should be. Agenda paper 17A discusses the two measurement approaches that are considered by the IASB and asks it to select one of these two approaches.

3. The table in paper 17B compares the two measurement candidates the IASB is considering; this table will be used as reference material.

4. In paper 17C, the staff discusses the accounting for differences at inception between the premium (IASB: premium less acquisition costs) and a current measure (we use 'residual and composite margin' as a working title for these differences).

5. Paper 17D discusses the objective of discount rates and gives a high-level outline of possible guidance for determining discount rates.

6. Agenda paper 17E includes the updated time table for Board discussions and recommends not to address policyholder accounting in the exposure draft. This timetable aims at publishing an exposure draft in December 2009. In order to achieve this, it is critical that:

   (a) The IASB concludes on the measurement approach during the September meeting.

   (b) The boards reach conclusions on the treatment of residual and composite margins and the discount rate.

Tentative decisions to date

7. In previous meetings, the boards discussed a list of candidate measurement approaches for insurance liabilities. An overview of the topics that were addressed is included in the appendix to this paper.

Next steps

8. In October, staff will discuss the issue of presentation, particularly presentation of the performance statement and, in connection with that, the use of other comprehensive income for changes in insurance liabilities.

9. Other issues that the staff are likely to bring to the boards in October are participating contracts and unbundling.

Appendix: Overview of topics discussed at previous meetings

Topic	IASB	FASB
Candidate measurement approaches	The IASB decided tentatively to include in the list of candidates a measurement approach based on the updated model being developed in the project to amend IAS 37 (modified to exclude day one gains). The Board also tentatively removed the following candidates from that list: (a) a fulfilment value that includes a margin for the cost of bearing risk and a residual margin (former candidate 3) (b) a current exit price (modified to exclude day one gains, former candidate 1) 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. The IASB asked the staff to analyse further whether to apply measurement approaches used in other existing and future standards, notably those on revenue recognition, financial instruments and non-financial liabilities.	The FASB decided tentatively to select a current fulfilment approach with a composite margin as the measurement approach for insurance contracts The FASB will consider at a future meeting whether an approach for measuring insurance contracts would include using future cash flows with no margins and no discounting in certain instances.

Topic	IASB	FASB
Features of a measurement approach	A measurement approach for insurance contracts conceptually should: (a) use estimates of financial market variables that are as consistent as possible with observable market prices (b) use explicit current estimates of the expected cash flows (c) reflect the time value of money (d) include an explicit margin.	A measurement of the fulfilment value of an insurance contract should use expected cash flows rather than a best estimate of cash flows. Those expected cash flows should be updated each period. The measurement of cash flows should consider all available information that represents the fulfilment of the insurance contract. All 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. The measurement of cash flows should be discounted and the discount rate should be updated each reporting period. The FASB will discuss what discount rate should be used at the September Board meeting.
Unearned Premium	The IASB decided tentatively that: (a) an unearned premium approach would provide decision-useful information about pre-claims liabilities of short-duration insurance contracts. (b) to require rather than permit the use of an unearned premium approach for those liabilities.	The FASB will discuss an unearned premium approach at a future meeting.

Topic	IASB	FASB
Measurement of the margin at inception	The margin at inception should be measured by reference to the premium and therefore no day one gains should be recognised in profit or loss (except for the part of the premium that covers acquisition costs, as discussed in more detail below). If the initial measurement of an insurance contract results in a day-one loss, the insurer should recognise that day-one loss in profit or loss.	In principle the initial recognition of an insurance contract should not result in the recognition of an accounting profit. The FASB will discuss this issue (day-one loss) at the September Board meeting.
Acquisition costs	The Board discussed an example in which two insurers issue identical insurance contracts but incurred different acquisition costs and, as a result, charged premiums that differ by the same amount. The Board decided tentatively that those contracts should have the same initial measurement. As a follow up, the Board decided tentatively that at inception an insurer should recognise as revenue the part of the premium that covers acquisition costs. For this purpose, acquisition costs should be limited to the incremental costs of issuing (ie selling, underwriting and initiating) an insurance contract and should not include other direct costs. Incremental costs are those costs that the insurer would not have incurred if it had not issued those contracts.	An entity: • should expense all acquisition costs when incurred. • should not recognize any revenue (or income) to offset those costs incurred.

Topic	IASB	FASB
Policyholder behaviour and contract boundaries	The measurement should include the expected (ie probability-weighted) cash flows (future premiums and other cash flows resulting from those premiums, eg benefits and claims) resulting from those contracts, including those cash flows whose amount or timing depends on whether policyholders exercise options in the contracts. To identify the boundary between existing contracts and new contracts, the starting point would be to consider whether the insurer can cancel the contract or change the pricing or other terms. The staff will develop more specific proposals for identifying the boundary.	The FASB will discuss this issue further at a future meeting.