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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 October meeting:

Agenda Paper No.	Title	Objective
4	Cover note	Outlines objectives for this meeting and next steps.
4A	Unbundling	Discusses whether to account for components of an insurance contract as if they were separate contracts.
4B	Presentation of the performance statement	Provides material for a preliminary discussion on the presentation of the performance statement.
4C	Deposit Floor	Discusses whether the measurement of an insurance liability should include a deposit floor.
4D	Timetable	Gives the time table for Board discussions.

Objective of the meeting

2. An insurance contract may contain insurance, deposit (or financial) and service components. Agenda paper 4A discusses whether to account for those components of a contract as if they were separate contracts (unbundling).

3. The purpose of agenda paper 4B is to provide material for a preliminary discussion on the presentation of the statement of comprehensive income. This paper will also be re-used for a discussion on presentation at the October joint meeting. [Staff will prepare a separate paper for the October joint meeting that deals with measurement and acquisition costs].

4. In its May 2009 meeting, the IASB decided tentatively that the measurement of insurance contracts should include the expected cash flows resulting from those contracts, including those cash flows whose amount or timing depends on whether policyholders exercise options in the contracts. In staff's view, one consequence of that approach is that the measurement of insurance contracts can be less than the amount payable on demand (ie does not include a deposit floor). The purpose of paper 4C is to ask the IASB for confirmation of that consequence.

5. Agenda paper 4D includes the updated time table for Board discussions.

Tentative decisions to date

6. In previous meetings, the boards discussed a list of candidate measurement approaches for insurance liabilities. The appendix to this paper gives overview of the topics that were addressed.

Appendix: Overview of topics discussed at previous meetings

Topic	IASB	FASB
Candidate measurement approaches	The IASB tentatively selected the approach being developed in the project to amend IAS 37, modified to exclude day one gains. Nevertheless, a significant minority of Board members supported the approach based on current fulfilment value. Therefore, the exposure draft will explain both approaches.	The FASB tentatively selected a current fulfilment approach with a composite margin. 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.
Features of a measurement approach	A measurement approach for insurance contracts conceptually should: (a) use current 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 continue to discuss at a future meeting what discount rate should be used.

Topic	**IASB**	**FASB**
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.
Measurement of margins at inception	The margin at inception should be measured by reference to the premium. 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 continue to discuss this issue (day-one loss) at a future meeting.

Topic	IASB	FASB
Subsequent treatment of margins	On the residual margin, the IASB decided tentatively that: a) the driver selected for releasing the residual margins should result in recognising those margins in income in a systematic way that best depicts the insurer's performance under the contract. b) that the residual margin should be released over the period during which the insurer is standing ready to accept valid claims (the coverage period). c) that the insurer should not adjust the residual margin in subsequent reporting periods for changes in estimates.	The FASB will discuss the subsequent treatment of margins at a future meeting.
Discount rates	The IASB decided tentatively that: a) 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 b) the standard should not give detailed guidance on how to determine the discount rate	The FASB will discuss this issue further at a future meeting.

Topic	IASB	FASB
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.
Policyholder accounting	The IASB decided tentatively not to address policyholder accounting in the exposure draft, but clarified that the exposure draft should address how both parties - the cedant and the reinsurer - should account for reinsurance contracts.	The FASB will discuss this issue at a future meeting.