



Contact(s)	<b>Hans van der Veen</b>	hvanderveen@iasb.org	+44 (0)20 7246 6464
	<b>Mark Trench</b>	metrench@fasb.org	+1 (0)203 956 3455

Project **Insurance Contracts**

Topic **Cover note**

### Agenda papers for this meeting

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

Agenda Paper No.	Title	Objective
10	Cover note	Outlines objectives for this meeting and next steps.
10A	Participating contracts	Discusses participating insurance contracts.
10B	Recognition of insurance contracts	Discusses recognition of rights and obligations arising under insurance contracts.
10C	Derecognition of insurance liabilities	Discusses derecognition of insurance liabilities.
10D	Timetable	Gives the time table for Board discussions.

This paper has been prepared by the technical staff of the FASB and the IASCF for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

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The tentative decisions made by the FASB or the IASB at public meetings are reported in FASB *Action Alert* or in IASB *Update*. Official pronouncements of the FASB or the IASB are published only after each board has completed its full due process, including appropriate public consultation and formal voting procedures.

## Objective of the meeting

2. The purpose of agenda paper 10A is to provide material for a discussion on participating (features included in) insurance contracts. This paper will be discussed at the November joint meeting. Agenda paper 10A is accompanied by two appendices, Appendix A and Appendix B, in separate papers. Appendix A gives an overview of some participating contracts in practice and Appendix B provides some examples to support the discussion in agenda paper 10A.
3. The following papers will be discussed at meetings of the individual boards:
  - (a) Agenda paper 10B discusses 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.
  - (b) Agenda paper 10C discusses derecognition of insurance liabilities.
  - (c) Agenda paper 10D includes the updated time table for Board discussions.

## Tentative decisions to date

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

Appendix: Overview of topics discussed at previous meetings

<b>Topic</b>	<b>IASB</b>	<b>FASB</b>
Building Blocks	<p>The IASB tentatively decided that the measurement for insurance contracts should include three building blocks:</p> <ul style="list-style-type: none"> <li>• current estimates of expected (that is, probability-weighted) future cash flows,</li> <li>• incorporation of time value of money, and</li> <li>• an explicit margin.</li> </ul>	<p>The IASB tentatively decided that the measurement for insurance contracts should include three building blocks:</p> <ul style="list-style-type: none"> <li>• current estimates of expected (that is, probability-weighted) future cash flows,</li> <li>• incorporation of time value of money, and</li> <li>• an explicit margin.</li> </ul>
Candidate measurement approaches	<p>The IASB tentatively selected the approach being developed in the project to amend IAS 37, modified to exclude day one gains.</p> <p>Nevertheless, a significant minority of Board members supported the approach based on current fulfilment value. Therefore, the exposure draft will explain both approaches.</p>	<p>The FASB tentatively selected a current fulfilment approach with a composite margin.</p>
Exclude discounting and margins in some instances?	<p>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.</p>	<p>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.</p>

**Staff paper**

<b>Topic</b>	<b>IASB</b>	<b>FASB</b>
Use of inputs	<p>A measurement approach for insurance contracts conceptually should use current estimates of financial market variables that are as consistent as possible with observable market prices</p> <p>The measurement of cash flows should be discounted and the discount rate should be updated each reporting period.</p>	<p>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.</p> <p>The measurement of cash flows should be discounted and the discount rate should be updated each reporting period.</p>
Unearned Premium	<p>The IASB decided tentatively that:</p> <ul style="list-style-type: none"> <li>(a) an unearned premium approach would provide decision-useful information about pre-claims liabilities of short-duration insurance contracts.</li> <li>(b) to require rather than permit the use of an unearned premium approach for those liabilities.</li> </ul>	<p>The FASB will discuss an unearned premium approach at a future meeting.</p>
Measurement of margins at inception	<p>The margin at inception should be measured by reference to the premium. Therefore no day one gains should be recognised in profit or loss.</p> <p>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.</p>	<p>In principle the initial recognition of an insurance contract should not result in the recognition of an accounting profit.</p> <p>The FASB will continue to discuss this issue (day-one loss) at a future meeting.</p>

**Staff paper**

<b>Topic</b>	<b>IASB</b>	<b>FASB</b>
Subsequent treatment of margins	<p>On the residual margin, the IASB decided tentatively that:</p> <ol style="list-style-type: none"> <li>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.</li> <li>b) the residual margin should be released over the period during which the insurer is standing ready to accept valid claims (the coverage period).</li> <li>c) the insurer should not adjust the residual margin in subsequent reporting periods for changes in estimates.</li> </ol>	The FASB will discuss the subsequent treatment of margins at a future meeting.
Discount rates	<p>The IASB decided tentatively that:</p> <ol style="list-style-type: none"> <li>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</li> <li>b) the standard should not give detailed guidance on how to determine the discount rate</li> </ol>	The FASB will discuss this issue further at a future meeting.
Acquisition costs	<p>An insurer:</p> <ul style="list-style-type: none"> <li>• should expense all acquisition costs when incurred.</li> <li>• should not recognize any revenue (or income) to offset those costs incurred.</li> </ul>	<p>An insurer:</p> <ul style="list-style-type: none"> <li>• should expense all acquisition costs when incurred.</li> <li>• should not recognize any revenue (or income) to offset those costs incurred.</li> </ul>

**Staff paper**

<b>Topic</b>	<b>IASB</b>	<b>FASB</b>
Policyholder behaviour and contract boundaries	<p>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.</p> <p>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.</p>	The FASB will discuss this issue further at a future meeting.
Deposit floor	The IASB confirmed that, applying tentative decisions it has already made on policyholder behaviour, no deposit floor applies in measuring insurance contracts.	The FASB will discuss this issue at a future meeting.
Policyholder accounting	<p>The IASB asked the staff to prepare an analysis of policyholder accounting with the goals of</p> <ul style="list-style-type: none"> <li>• Identifying possible issues arising from lack of symmetry between policyholder accounting and the accounting by the issuer of the insurance contract and</li> <li>• Any similarities with accounting for reinsurance contracts from the perspective of the policyholder.</li> </ul>	<p>The FASB asked the staff to prepare an analysis of policyholder accounting with the goals of</p> <ul style="list-style-type: none"> <li>• Identifying possible issues arising from lack of symmetry between policyholder accounting and the accounting by the issuer of the insurance contract and</li> <li>• Any similarities with accounting for reinsurance contracts from the perspective of the policyholder.</li> </ul>