Global Insurance GAAP

IASB and FASB April joint meetings

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Agenda

- Highlights of April joint meetings
- Analysis of Staff recommendations and Boards’ decisions
- Timetable and next steps

Highlights of April joint IASB / FASB meetings

Composite margin approach (21 April)

- Boards in favour of recognising a loss if a negative day one difference emerges
- Boards agree that loss to recognise is difference between expected outflows and inflows
- Boards agree to amortise composite margin over coverage and claim periods

Single and two margin approaches (21 April)

- Boards agreed the composite / residual margin should be part of the insurance liability
- Boards agreed the margins should be disclosed
- IASB tentatively agreed that interest be accreted on the composite / residual margin
- FASB tentatively disagreed with interest be accreted on the composite / residual margin

Discounting (22 April)

- Should not capture the characteristics of the assets backing the liabilities
- Should be based on risk-free rate plus an illiquidity premium
- Discount rate for participating contracts should consider the dependence on asset performance
- Guidance should all be in the insurance standard - not cross-referenced to other IFRS literature

Highlights of IASB 23 April meeting

Contract boundaries

- Outline of contract boundaries to be based on the following criteria:
  - Ability of the insurer to unilaterally cancel the contract
  - Ability of the insurer to re-price the contract for the current risk of a specific policyholder
- Staff will reconsider the wording in view of the Board discussions
- Staff to investigate the effects of ‘no-claims bonuses’ and other formula-driven changes to contract terms

Recognition of an insurance contract

- Board agreed with the revised proposed principle
- Staff to consider recognition based on when the insurer is on risk as a result of providing or agreeing to provide cover and being unable to change the terms of that cover or offer
- Board may need to reconsider the period over which the residual margin is recognised as insurance contracts may be recognised before coverage commences

Details of IASB/FASB joint meeting – 21 April

Paper 3A – Application of risk adjustment and residual margin

Q1 – objective of risk adjustment

Do the boards agree with the proposed objective for the risk adjustment:

"The amount the insurer would rationally pay to be relieved of the risk."

This paper was not discussed at the meeting apart from the questions common to 3B

The Boards will meet on 4th May to attempt a convergent decision between this model and the composite margin model explained under paper 3B

Details of IASB/FASB joint meeting – 21 April

Paper 3B – Composite margin

Q1 – day-one loss

- Do the boards agree that, if the initial measurement of an insurance contract results in a negative day-one difference, the insurer should recognise that difference (loss) immediately in profit or loss?
- In such a case there will be no composite margin to account for.
- For this purpose, a day-one loss exists if at inception the expected present value of the outflows exceeds the expected present value of the premiums.

=> no margin in measurement of contract that is onerous at inception

Recommendation	IASB	FASB
In favour of	unanimous	
Against	n/a	

Details of IASB/FASB joint meeting – 21 April

Paper 3B – Composite margin

Q2 – release of the composite margin

Should the release of the composite margin released to income in a systematic way be based on:

a) The characteristics of that margin by selecting a driver or drivers for release that best depicts performance under the contract over a period that follows from the driver(s) for releasing that margin

b) The insurer's exposure from providing insurance coverage as well as its exposure to uncertainties related to the future cash flows, using a combination of cash flows based on the absolute value of expected premium receipts and expected claim and benefit payments.

Recommendation	IASB	FASB
In favour of amortisation on coverage and claim period	unanimous	
Against	n/a	

Details of IASB/FASB joint meeting – 21 April

Paper 3B – Composite margin

Q2 – release of the composite margin

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- Lengthy discussion on use of multiple drivers and allocation of margin
- Little support for formulaic approach proposed by Staff
- Boards marginally favoured more principles-based approach
- No concrete decision made on specific Staff proposal
- Staff will come back on allocation and measurement over coverage and claim periods.

Details of IASB/FASB joint meeting – 21 April

Paper 3 A&B – Composite and residual margin

Q – margin as part of liability

Do you agree that the composite / residual margin is part of the insurance liability rather than a separate liability outside the insurance liabilities, and that the amount of the composite / residual margin should be disclosed?

- Only two Board members opposed to including the residual margin in liability

Recommendation	IASB	FASB
In favour of	majority	
Against	n/a	

Details of IASB/FASB joint meeting – 21 April

Paper 3 A&B – Composite and residual margin

Q – interest accretion

Do the boards believe that interest should be accreted on the composite / residual margin?

- FASB asked the Staff to follow up on possibility of remeasuring/recalibrating the composite margin
- If the composite margin is remeasured/recalibrated, the FASB is against interest accretion

Recommendation	IASB	FASB
In favour	10	n/a
Against	4	unanimous

Details of IASB/FASB joint meeting – 22 April

Paper 3 D – Discounting

Q 1 – approach to discount rate

Which approach do the boards want to take:

a) Giving the discount rate the objective to adjust estimated future cash flows for the time value of money in a way that captures the characteristics of the rights and obligations from the insurance contract. It should not capture characteristics of assets actually held to back the insurance liability, unless the liability does share those characteristics.

b) Requiring to use a high-grade corporate debt rate.

Recommendation	IASB	FASB
In favour of A	unanimous	
In favour of B	n/a	

Details of IASB/FASB joint meeting – 22 April

Paper 3 D – Discounting

Q 2 – liquidity

Given choice of A in question 1, do the boards agree to acknowledge liquidity as one of the characteristics of an insurance liability that, where relevant, should be considered in determining the discount rate for that liability?

- Although supportive of Staff proposal, some members were concerned with lack of agreed methodology
- Could lead to inconsistency between companies => lack of comparability

Recommendation	IASB	FASB
In favour	unanimous	
Against	n/a	

Details of IASB/FASB joint meeting – 22 April

Paper 3 D – Discounting

Q 3 – participating contracts

Do you agree that the measurement of participating contracts should consider the fact that the amount, timing and certainty of the insurance contract's cash flows depend on performance of specific assets?

- Some Board members questioned the relevance of this question in context of discounting => more relevant to determining cash flows
- Staff noted that a replicating portfolio could be used assuming it exactly replicates the liability cash flows
- However there are many features in a participating contract that would not be matched by a replicating portfolio

Recommendation	IASB	FASB
In favour	majority	
Against	n/a	

Details of IASB/FASB joint meeting – 22 April

Paper 3 D – Discounting

Q 4 – guidance

Do you agree not to provide specific guidance on how to estimate a discount rate for insurance liabilities, beyond providing a cross-reference to the guidance on fair value measurements?

- Concerns that reference to FV guidance may create confusion

Recommendation	IASB	FASB
In favour	n/a	
Against	majority	

Details of IASB/FASB joint meeting – 23 April

Paper 11 A – Contract boundaries

Q 1 – contract boundary definition

Do you agree that the contract boundary is defined as including all cash flows arising under the contract as a result of events occurring during the period ending on the earlier of:

- the contract coverage period (as extended by any renewal options available to the policyholder); and
- the point at which the insurer has an unrestricted ability to cancel or re-underwrite and re-price coverage of the individual contract (restrictions with no commercial substance are ignored).

- Proposed wording is too wide to meet the Staff's intended principle. Board discussions provided a better framework from the staff to develop the principle into wording.

Recommendation	IASB
In favour of principle	unanimous
Against	n/a

Details of IASB/FASB joint meeting – 23 April

Paper 11 A – Contract boundaries

Q 1 – contract boundary definition

- Outline of contract boundaries to be based on the following principle:
  - Ability of the insurer to unilaterally cancel the contract
  - Ability of the insurer to re-price the contract to reflect the current assessment of insurance risks applicable to a specific policyholder
- Board prefers key criteria to be assessment of current insurance risks
- Discussion about use of formulae or rate tables
- Board prefers to focus on end result of what has changed
- Staff will reconsider and return with revised wording reflecting the principle above
- Staff to investigate the effects of 'no-claims bonuses' and other formula-driven changes to contract terms

Details of IASB/FASB joint meeting – 23 April

Paper 11 B – Recognition

Q 1 – When to recognise

Do you agree that the insurer should recognise the rights and obligations arising from an insurance contract when the insurer becomes a party to the contract which is the earlier of:

- the insurer being "on risk" to provide coverage to the policyholder for insured events; and
- the signing of the insurance contract.

- FASB had already agreed to this principle at an earlier meeting
- The IASB agreed with the general principle although issues raised with wording
  - The signing may not always commit the insurer
  - Insurer may be committed to provide cover before contracts are signed or premium is paid

Recommendation	IASB
In favour of principle	unanimous
Against	n/a

Outstanding issues to be discussed before the ED

Outstanding issues tabled for May

- Unearned premiums approach (IASB decision as the starting point)
- Investment contracts with DPF (scope allocation IFRS 4 v. IFRS 9)
- Scope (financial guarantee, fixed fee and health insurance contracts)
- Receivables related to acquisition costs
- Reinsurance (ceding commission)
- Disclosures
- Business combinations

Outstanding issues still to be discussed

- Divergence between the Boards (acquisition costs and risk adjustment)
- Unbundling and embedded derivatives (FASB request)
- Presentation (detailed guidance on expanded margin)
- Level of aggregation – diversification benefits
- Contract boundaries detailed guidance and final wording
- Transition in conjunction with financial instruments project
- Recognition and derecognition (follow-up issues)

Timetable

Commitment to an exposure draft in 2010

- Officially delayed to June:
  - Exposure draft issue date June 2010
  - 4 month comment period to October 2010
  - Standard remains due in June 2011

Future meetings

- Additional joint and individual meetings are scheduled in May

Will the timetable be met?

- Given the areas of disagreement and the numerous issues still to be resolved, we consider it unlikely that the ED will be issued in June

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Insurance Accounting Newsletter
Insurance Working Group meeting

Link to **Deloitte Insurance Accounting Newsletter:**

http://www.deloitte.com/view/en_GB/uk/industries/financial-services/sector-focus/insurance/article/ac9955baf1001210VgnVCM100000ba42f00aRCRD.htm

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