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The IASB's project on Insurance Contracts

Peter Clark

Overview



- Background
- Insurance contracts (phase II)
- Other relevant IASB projects
- Convergence and US GAAP




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Background

- Before 2004:
 - ✧ No IFRS on insurance contracts
 - ✧ Scope exclusions from other IFRSs
- Diversity
 - ✧ between insurers
 - ✧ from other sectors
- Need to open up the ‘black box’
- IFRS 4 Insurance Contracts (2004)

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Phase II timetable

Discussion paper	First quarter 2007
Exposure Draft	Late 2008?
Standard	Late 2009?
Implementation	?

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Three building blocks



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- Estimates of future cash flows
- Time value of money
- A margin

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Future cash flows



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- Current estimates
- Unbiased
- Probability-weighted (expected value)
- Use observable market inputs, where they exist
- Principles, not detailed guidance

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Time value of money



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- Even for non-life
- Current market discount rates
- Expected returns on actual assets are not relevant
 - ✧ *unless they affect liability cash flows*

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Margin



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- As required by market participants, for
 - ✧ *bearing risk (risk margin)*
 - ✧ *other services (service margin)*
- Not intended as a shock absorber
- How calibrated?
 - ✧ *Gain or loss at inception?*

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Putting the building blocks together



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- A measurement attribute that users can understand, and use for economic decisions
 - ☆ *not just a computation*

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A measurement attribute users can understand?



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Current exit value:

- amount the insurer would expect to have to pay today to another entity if it transferred all its remaining contractual rights and obligations immediately to that entity
- ... excluding any payment for other rights and obligations

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Current exit value



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- Best meets objectives discussed earlier
- Relevant and reliable information to help users with economic decisions
- Does not imply that an insurer can will or should actually transfer the liability to a third party
- In most cases, insurers cannot transfer the liabilities and do not want to do so

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Advantages (1)



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- Information on contractual cash flows:
 - ☆ *amount, timing and uncertainty*
- Explicit margins, reflect release from risk
- Consistent approach to changing estimates

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Advantages (2)



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- Coherent way to resolve new issues
- Consistent with IFRSs on other liabilities
- Clear reporting of economic mismatches

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Focus on contractual rights and obligations



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- Definitions of assets and liabilities
- Policyholder cancellation options
- Acquisition costs
- Participating contracts

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Definition of an asset



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- A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity

IASB Framework, paragraph 49

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Definition of a liability



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- A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits

IASB Framework, paragraph 49

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Possible new definitions: working draft



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- Asset: a present economic resource to which an entity has a present right or other privileged access
- Liability: a present economic burden for which an entity has a present obligation

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Is it an asset? (1): unenforceable premiums



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- Obligation to 'stand ready' to accept future remaining premiums
 - ✧ *Clearly can be a liability*
- What if insurer benefits from remaining premiums?
 - ✧ *Include if policyholder must pay to maintain guaranteed insurability*

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Is it an asset? (2): acquisition costs



Example

- Insurer charges 90 for insurance cover plus 10 for acquisition costs
- Assume other insurers would charge the same premium and have the same costs
- On day 1, insurer receives 100 pays 10

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Acquisition costs (2)



Example (continued)

On day 1, what does the insurer have?

- Obligation of 90?
- Obligation of 100 and intangible asset of 10?

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Policyholder participation



- Is there an enforceable obligation?

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Other points



- Unearned premium:
 - ☆ *sometimes (often?) a reasonable proxy*
- Unit of account?
- Embedded options and guarantees
- Investment contracts

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Other relevant projects



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- Conceptual Framework
- Revenue
- Liabilities / equity
- Presentation of financial statements
- Financial instruments

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Convergence – general



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- A high priority
- SEC 'roadmap'
 - ✧ *eliminate reconciliation to US GAAP?*
- Memorandum of Understanding between the IASB and FASB
- A two-way process

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Convergence – insurance contracts



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- A 'modified joint' project. FASB expects :
 - ★ *to issue Discussion Paper (not deliberated)*
 - ★ *to review the responses in assessing whether to join in a joint project*
- US mini projects on insurance:
 - ★ *Risk transfer*
 - ★ *Financial guarantees*
 - ★ *Life settlements FASB Staff Position FTB85-4-1*