



**Summary of Major Discussions
IASB/FASB Insurance Working Group
London Meeting of 29-30 June
Presentation
to the
Economic Balance Sheet Task Force
Bermuda Monetary Authority
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Douglas Wm. Barnert
Executive Director
Group of North American Insurance Enterprises
www.gnaie.net
40 Exchange Place, Suite 1707
New York, NY 10005
+1.212.480.0808
doug.barnert@гнаie.net

Meeting

The IASB Insurance Working Group (IWG) met in London 29-30 June to discuss the current status of the Joint IASB/FASB Phase 2, *Insurance Contracts* project. FASB Board Member Leslie Seidman attended and actively participated in the discussions. This was the first IWG meeting held since FASB joined the project.

Timing

At its June IASB meeting, the staff proposed an extension of time for the Exposure Draft to be released in April 2010.

But, the Board made it clear it wants an Exposure Draft published by December 2009 and final adoption by June 2011. This is an extremely ambitious agenda, considering:

- 1) The IASB extensive discussions taken to consider a measurement basis.
- 2) The remaining major issues of determination of the boundaries of a contract, when to recognize an asset or liability, presentation and disclosure and coordination with the Financial Instruments, Revenue Recognition, Financial Statement Presentation, and Conceptual Framework Projects;
- 3) The need to make decisions so the project can move forward.
- 4) Willingness of the Boards to simplify the project.
- 5) Pressure to move according to an artificial deadline based on the transition of seven IASB members in June 2011.

Measurement Basis

- 1) The use of Exit Value has been clearly eliminated by both boards (FASB 5-0, IASB 10-2)
- 2) The Boards have concluded the Measurement Basis will not recognize gain at the issuance of a contract (No Gain at Issue).
- 3) Therefore, Measurement Candidates 1,2 & 3 have been eliminated.
- 4) Remaining Candidates
 - a. Candidate 4 – Contract Fulfillment Value – Composite Risk Margin
 - i. Still has most industry support
 - ii. Contains a Composite Risk Margin – Europeans would like to switch to separate risk margins for profit and risk to be consistent with the Solvency II framework recently adopted.
 - b. Candidate 5 – Unearned Premium Reserve (UPR) as a proxy – pre-claim liability for measuring short-term contracts
 - i. Which contracts would be eligible?
 - ii. How do you draw the line between short and long-term?
 - iii. Unless the standard says it is a proxy, you would have to do all the work anyway to determine whether it was a proxy.
 - c. Candidate 6 (previously unnumbered) Undiscounted claim reserves with no risk margin
 - i. Future FASB agenda item
 - ii. IASB does not plan to discuss

- d. New Candidate 7 – Consideration of a measurement method based on IAS 37, *Liabilities*, as it is being rewritten by the IASB
 - i. IASB made some “final” amendments to IAS 37 at June meeting
 - ii. Not clear in IASB staff papers how these would translate into an insurance contracts standard.
 - iii. Uses a valuation based on what a preparer would be willing to pay a third party to fulfill the obligations.
 - iv. Appears to be a new version of fair value.
 - v. Could drag the project on.
 - vi. No support from FASB since Exit Value has already been rejected.
 - vii. IASB will decide at July meeting if IAS 37 changes need to be re-exposed. This could further delay the insurance contracts project.

Acquisition Costs

Questions for Consideration:

- 1) Are there certain acquisition costs that should be eligible for special treatment?
- 2) Should certain acquisition costs be fully expensed on Day 1?
- 3) If acquisition costs are expensed, should there be offsetting revenue or creation of an asset?
- 4) If an asset is created, should it be tangible or intangible?

Industry Concerns

- 1) Large Day 1 losses if acquisition costs are expensed on first day with no offsetting accounting.
- 2) Could have negative impact on agent compensation structures.

Standard Setter Concerns

- 1) Similar expenses for other industries require similar accounting of insurance contracts.
- 2) Objective of measurement of a liability should not include the acquisition costs.
- 3) Most frequent cause for restatement is the measurement of revenues.

Two Different Answers:

- 1) FASB
 - a. Full expense on Day 1
 - b. No offsetting revenue or asset
- 2) IASB
 - a. Full expense of certain acquisition costs on Day 1
 - b. Offsetting revenue entry

Field Testing

June staff papers suggest targeted field-testing on limited items. Indicating a serious interest in timely completion of the testing, the IASB retained former IWG member Phil Arthur (Ernst & Young - Canada, ret.) to assist them in the development and analysis of the targeted tests.

At the meeting, companies indicated a willingness to become involved but concern over the lack of specifics on the testing. Staff was confident that a limited set of targeted tests could be performed in a short time that would be decision useful for the Boards.

Being considered for the tests are:

- 1) Estimation of cash flows (focusing on those aspects of cash flow estimation that are likely to depend on the particular approach tested, rather than aspects that are likely to be common to most feasible approaches);
- 2) Determination of discount rates;
- 3) Determination of risk margins;
- 4) Other application issues of the measurement approach;
- 5) Treatment of acquisition costs;
- 6) Features of participating contracts;
- 7) Investment contracts; and
- 8) The effects of policyholder behavior, including boundaries of a contract.

Additional items are being considered by the staff and could be the subject of additional tests.

Financial Instruments

Extensive discussions on the relationship between the potential decisions of the Boards on the rewrite of IAS 39, *Financial Instruments*, its consequences for the insurance industry and its relationship the accounting for insurance contracts.

- 1) Implementation of the new standard for early adopters in 2009 considering current insurance accounting requirements of IFRS 4.
- 2) Implementation of the new standard after Phase 2 is adopted.
- 3) Creation of serious mismatch depending on outcome of decisions on Classification and Measurement amendments to IAS 39.
 - a. Creation of Amortized Cost and Fair Value Classification
 - b. Uncertainty about retention of the use of Available for Sale for Debt Instruments with the changes taken through Other Comprehensive Income.
 - c. Uncertainty about the ability to take interest, dividend, and realized capital gains into Net Income.
- 4) Decision tree for Boards calls for a September discussion of whether changes in financial assumptions of insurance contracts can go through Other Comprehensive Income.
