

Executive Summary

The IASB and FASB held a joint meeting December 15–18, 2009. During that meeting, the IASB and FASB decided on a measurement objective. It does not have a name, but if you have been following these discussions, I would call it the Modified IAS 37 value that the IASB had previously supported.

The insurance liability will be the present value of unbiased probability weighted future cash flows plus a risk margin plus a residual margin. The risk margin is the maximum the insurance entity would pay to be relieved of the risk. The residual margin is the amount needed so there is no day one profit.

The current timetable for publishing the Exposure Draft is April 2010, with comments due in September 2010. A final standard would be published in June 2011.

November 16 Meeting of the IASB and November 17 Joint Meeting of the IASB and FASB

I did not listen to the meetings in November. Following is an excerpt from the “Insurance Contracts” section of the IASB Update released by the IASB staff summarizing the tentative decisions reached by the IASB in November:

Participating insurance contracts

The boards discussed participating features in insurance contracts. Staff presented two views on how to deal with such contracts:

View 1: All cash flows that arise from a participating feature should be included in the measurement of the insurance liability on an expected present value basis. The participating feature is not considered separately for recognition, classification and measurement, but rather as part of the whole contract.

View 2: The cash flows expected to arise from a participating feature are analysed [sic] to determine whether those flows are required (e.g., by the contract or by a statute) or are discretionary. Required cash flows (if there are any) will be included in the measurement of the insurance liability. Discretionary cash flows will be recognised [sic] when the entity has an obligation to make payments.

The IASB tentatively decided on view 1 and the FASB tentatively decided on view 2.

Next steps

The boards will continue their discussion of this project at the joint board meeting in December.

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Tuesday, December 15, 2009 Meeting of the IASB

Today's meeting considered the question of whether some or all of the change in insurance liabilities should flow through Other Comprehensive Income (OCI) versus profit and loss. The conversation centered on whether there were accounting mismatches that could be avoided through the use of OCI. The first question was if there should be special accounting for assets held to back insurance liabilities. This was unanimously rejected.

In the response to the 2007 Discussion Paper, some responders had advocated that the change in insurance liability that was due to changes in financial inputs, such as interest rates, should flow through OCI. The Board did not support this idea. All changes will go through profit and loss. The assumption is that insurance companies will value their assets at fair value. This will minimize (but probably not eliminate) accounting mismatches with the liabilities which will be on a current basis. The liabilities will not be adjusted for "own credit risk." This discussion was scheduled for 90 minutes and only took 30 minutes.

Wednesday, December 16, 2009 Joint meeting of IASB/FASB

They could have used the extra 60 minutes from yesterday today. They had a very long agenda and only 90 minutes to cover it. They started with a "short" presentation that wasn't even on the agenda and ended up taking 50 minutes. The crux of the presentation was to convince the FASB that the Revenue Recognition standard gave confusing results for many insurance contracts, especially life contracts.

The first paper on the agenda (7A) was to settle on the measurement objective for insurance. The first question in this paper was whether the measurement should be done using building blocks. The IASB had approved this in the past but the view of the FASB wasn't as clear. In the discussion, the Board skipped past the first question and moved directly to the second question, the wording of the measurement objective.

The measurement objective is described on pages 8–9 of Agenda Paper 7A for the IASB/FASB Meeting in December 2009:

A reporting entity should measure an insurance contract equal to its current estimate of the cost to fulfil [sic] the present obligation created by that contract.

A reporting entity should estimate that cost using present value techniques that consider:

- i. the unbiased, probability-weighted average of future cash flows;
- ii. the time value of money;
- iii. a risk adjustment for the effects of uncertainty about the amount and timing of future cash flows; and
- iv. an amount to eliminate any positive day one difference [or a residual margin].

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In previous meetings, the IASB had been closely split on whether items iii and iv should be combined and the FASB was not in favor of splitting iii and iv. Today the IASB approved this measurement objective by a vote of 10 to 5 and the FASB approved it on a vote of 3 to 2. This is progress.

The second paper (7B) was on margins. The only question they got to before time ran out was whether the risk margin should be measured as the maximum amount an insurer would rationally pay to be relieved of the risk. This wording is a simplification of the wording in the Modified IAS 37 measurement that the IASB had narrowly approved previously. The IASB agreed with the wording again today, but I didn't get a count of the hands. The FASB approved 4 to 1, with one board member explaining that even though he was on the losing vote on measurement objective, he thought that this wording was correct for risk margin if there was going to be one.

After this vote, one Board member asked if they could at least address the timetable, paper 7F, but it was 6:30 PM London time and the Board members had already started to scatter. The new timetable has the Exposure Draft being published in April. The chairman said that they would have extra meetings if necessary to meet this deadline. They have discussed having extra meetings previously, but this time, they might actually do it. The chairman wasn't sure if they could find time on Thursday to address the rest of paper 7B and papers 7C, 7D, and 7E.

The question that the Board didn't get to in paper 7B was how the residual margin should be released.

Paper 7C was on embedded derivatives. The majority of the staff recommended that embedded derivatives not be bifurcated but instead be valued on the same basis as the rest of the insurance contract.

Paper 7D was on unbundling. In this context, unbundling means to separate the contract into pieces that would get insurance accounting treatment and pieces that would not get insurance accounting treatment. The majority of the staff recommends that an insurance contract be unbundled only if there are parts of the contract that are not interdependent. They don't want companies getting insurance treatment on a feature just because it has been tacked onto an insurance contract. They do not recommend unbundling the deposit element.

Paper 7E was on presentation. The paper has examples of five different presentations and discusses the pluses and minuses of the different examples. The bottom line and the balance sheet are the same for all five presentations, but revenue and what is presented in the income statement are different. The paper doesn't prescribe a specific method. It does recommend that revenue be on an earned, not written, basis and premium be related to expected repayments to the same policyholder not be included in revenue. So while paper 7D recommended no unbundling, the revenue may look like unbundling.

Paper 7F was on the timetable. The January agenda already anticipated that margins and presentation would have to be discussed. Also on the agenda for January are policyholder participation, variable contracts, universal life contracts, and disclosures. The agenda for February includes business

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combinations, reinsurance, and a summary of the IASB field testing. March includes transition rules and any unfinished business so that the Exposure Draft can be published in April. Comments are due in September and they anticipate publishing a final standard in June 2011. Since there will be major turnover on the IASB on July 1, 2011, they are really hoping to finish this in June 2011.

If you would like a complete copy of the IASB staff papers that I reference in these notes, please email me at DVanDam@polysystems.com.

Douglas S. Van Dam, FSA, MAAA, CLU, ChFC
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