

IASB Timeline

The staff of the IASB proposed moving the release date of an Exposure Draft from December 2009 to January 2010. Comments on the Exposure Draft are due in May 2010. It is likely the release date will be pushed back even further. The IASB is still planning on an adoption date of June 2011. Canada, Korea and India will all move to IFRS in 2011.

Measurement of Liabilities

In September, the IASB voted narrowly in favor of a Modified IAS 37 measurement attribute. A minority of the IASB supports a Fulfillment Value measurement attribute.

- 1) **Modified IAS 37** (IAS 37 modified to exclude day one gains)
 - a) Liabilities would be measured as the amount an entity would rationally pay to be relieved of the present obligation, or the lower of:
 - i) the value to the entity of not having to fulfill the obligation,
 - ii) the amount that the entity would have to pay to the counterparty to cancel the obligation, or
 - iii) the amount that would have to be paid to a third party to transfer it to a third party.
 - b) Typically, an insurance company would use “i) the value to the entity of not having to fulfill the obligation.”
 - c) An entity estimates the value of not having to fulfill an obligation using the three building blocks that were part of the original insurance discussion paper:
 - i) Probability weighted cash flows,
 - ii) Time value of money, and
 - iii) Risk margins – the amount the entity would pay on top of the discounted cash flows to be rid of the uncertainty of the cash flows.
 - d) For insurance policies, a residual margin is added so there is no gain at issue.
- 2) **Fulfillment Value**
 - a) Liabilities would be measured as the expected present value of the cost of fulfilling the obligation to the policyholder over time.
 - b) Fulfillment Value has a composite margin, which is the amount needed on top of the discounted cash flows to avoid a gain at issue. There is no separately calculated risk margin.

An Exposure Draft would likely explain both methods.

The FASB is working with the IASB toward a single standard.

The FASB and the IASB will have a joint discussion of insurance and the timetable on Wednesday, October 28, 2009. The FASB supports a Fulfillment Value model, but it is different from the Fulfillment Value model supported by the IASB. The IASB and the FASB disagree on how the composite margin should be handled after issue. The IASB and the FASB will likely produce different Exposure Drafts but maintain the goal of a single, final insurance standard.

The IASB might not release an Exposure Draft.

If the IASB cannot reach an agreement on a new insurance standard, it is likely the current insurance standard, IFRS4, (which essentially says to use a company's current, national standard) will be withdrawn. Insurance contracts would likely be subject to the accounting standards defined by "Financial Instruments" or "Revenue Recognition" or both.

The IASB has reached tentative decisions on some topics.

- The cash flows, discount rates, and risk margins should be current assumptions for each reporting period.
- The residual, or composite margin, is released over the contract period.
- The Exposure Draft will not give detailed guidance on discount rates. All assumptions should be as market consistent as possible. This means the discount rates will probably be the risk free rates or the risk free rates plus a liquidity margin.
- Acquisition costs are expensed in the period they are incurred, and there is no DAC. When a policy is issued, the IASB will allow revenue to be recognized to offset incremental acquisition costs. The FASB will not recognize revenue to offset acquisition costs. While there is no DAC, the liability can be thought of as current GAAP net liability.

Other IASB topics have not yet been decided:

Unbundling

The IASB wants to make a decision on whether insurance contracts should be unbundled. Unbundling refers to the splitting of an insurance contract into pieces and valuing the different pieces under different standards.

The insurance company will need to allocate every contract between three different accounting models: Financial Instruments, Insurance, and Service Contracts. Financial Instruments are valued at either fair value or amortized cost. The Service Contract would be accounted for under the "Revenue Recognition" standard they are drafting. Under the "Revenue Recognition" standard, earned revenue is proportionate to the services provided. Insurance accounting is modified IAS 37.

Many of our clients are probably already selling products that fall under the "Financial Instrument" category.

Presentation

Presentation is the geography of the income statement. The IASB discussions have focused on how an insurance company recognizes revenue. There were five proposals about what to recognize as revenue:

1. Use the current FAS60 life presentation of premium, meaning premium is recognized when it is due.
2. Recognize premium when it is due but subtract the increase in the unearned premium.
3. Recognize premium when it is due and subtract the increase in unearned premium as well as the increase in active life reserves.

4. Create a FAS97-type presentation where amounts are comparable to COIs. Loads would have to be computed from the arithmetic that rolls one reserve forward to the next. PolySystems is well positioned for this with our LifeSOE and HealthSOE systems.
5. Treat everything as a deposit, so revenue is the release of the risk margin and residual margin, where the risk margin is the PV of profits.

The decisions made here will impact what is recognized as costs or expenses. In each of these models, supposedly, the annual profit would not be affected. These are geography questions. Each of these would require changes to PolySystems' Projection Reports.

Deposit Floor

If a policy has a cash value, a deposit floor would mean the liability can never be less than the cash value even if no one is expected to lapse. We would have to compare the otherwise computed liability to the cash value and pick the higher amount.

No decisions were made at the October 2009 IASB Board Meeting regarding Unbundling, Presentation, and Deposit Floors, so these topics will likely be discussed at future Board Meetings along with:

- Participating contracts, unit-linked (a.k.a. variable) contracts, index-linked contracts, and universal life contracts,
- Business combinations (PGAAP), and
- Embedded derivatives.

The FASB has an even longer list of topics that have to be decided, so an Exposure Draft in January looks ambitious.