

September Insurance Accounting Meetings of the IASB and FASB

Amortization of the Single Margin in the FASB Model

The FASB met on September 7 to discuss how to amortize the single composite margin that they prefer over the IASB-preferred two margin approach. Since the single margin approach includes an amount for risk, the FASB would like to reflect risk in how the margin is amortized. The FASB tentatively decided that an insurer is released from risk for the purpose of recognizing the single margin in profit:

1. If the variability of the cash flows is primarily due to timing, e.g., most life contracts, an insurer is released from risk on the basis of reduced uncertainty in the timing of the specified event. While not included in their notes of the meeting, they discussed that the release from risk may follow a YRT pattern for life insurance.
2. If the variable of the cash flows is primarily due to frequency and severity, e.g., health and P/C, an insurer is released from risk as the information about expected cash flows, including claim liabilities, becomes more known over time. However, this will not apply to the large number of health and P/C contracts which qualify for the Premium Allocation Approach. Those contracts will not have any margin in their claim liabilities.

FASB/IASB Discussion of Disclosures

At their joint meeting on September 19th, the FASB and IASB decided to require the insurer to disclose separately the effect of each change in inputs and methods. They also decided to go with a more principles based approach to aggregation than was contained in the Exposure Draft (ED) and that the yield curve (or range of yield curves) used should be disclosed.

The two boards split on liquidity disclosure with the IASB adopting rules for insurance and the FASB relying on its risk disclosures for financial institutions. They also split on disclosure of uncertainty, with the IASB relying on its (yet to be written) fair value disclosures and the FASB sticking with the wording in the ED.

IASB Risk Adjustment

At the same joint meeting of the FASB and IASB, the IASB tentatively decided that:

- a. the objective of the risk adjustment should be the 'compensation the insurer requires for bearing the uncertainty inherent in the cash flows that arise as the insurer fulfills the insurance contract'; and that
- b. the application guidance should clarify that:

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- i. the risk adjustment measures the compensation that the insurer would require to make it indifferent between (1) fulfilling an insurance contract liability that would have a range of possible outcomes or (2) fulfilling a fixed liability that has the same expected present value of cash flows as the insurance contract. For example, the risk adjustment would measure the compensation the insurer would require to make it indifferent between (1) fulfilling a liability that has a 50% probability of being 90 and a 50% probability of being 110 or (2) fulfilling a liability of 100.
- ii. in estimating the risk adjustment, the insurer should consider both favorable and unfavorable outcomes in a way that reflects its degree of risk aversion. The boards noted that a risk-adverse insurer would place more weight on the unfavorable outcomes than on the favorable ones.
([Page 5, IASBupdateSept2011.pdf](#))

The IASB tentatively decided not to limit the range of available techniques and inputs to estimate the risk adjustment but to continue to show the three techniques in the ED (confidence levels, conditional tail expectation, and cost of capital) as examples. The ED proposes that all companies disclose the equivalent confidence level of the risk adjustment irrespective of how the risk adjustment is calculated. The IASB staff proposed that this disclosure be eliminated, but 11 of the 15 members of the IASB voted to keep the disclosure.

Douglas S Van Dam, FSA, MAAA

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