Summary of FASB/IASB Project on Insurance Contracts – Relevant Recognition & Measurement (*Tentative Decisions*[1])

***Project Objective**: The objective of the joint IASB/FASB insurance contracts project is to develop common, high-quality guidance that will address recognition, measurement, presentation, and disclosure requirements for insurance contracts (including reinsurance), even if the contracts are not issued by an insurance entity. Specifically, the project is intended to improve, simplify, and converge the financial reporting requirements for insurance contracts and to provide investors with decision-useful information.*

I. Recognition

A. Definition of an Insurance Contract -- A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

B. General -- An insurer would recognize an insurance obligation when it becomes a party to the contract, which is defined as the earlier of the date on which the insurer is bound by either of the following:

-- The terms of the contract

-- Initial exposure to risk under the contract (that is, when the insurer can no longer withdraw from its obligation to provide insurance coverage to the policyholder for insured events and when it no longer has the right to reassess the risk of the particular policyholder and, as a result, cannot set a price that fully reflects that risk).

C. Scope -- All insurance contracts (life and nonlife, and reinsurance) would be accounted for under the proposed model(s) regardless of the type of entity issuing the contract, which differs from current U.S. GAAP.

D. Exclusions

1. Certain fixed-fee service contracts that provide service as their primary purpose are excluded from the scope of the project.

2. Certain financial guarantee contracts:

a) *IASB* – excludes financial guarantee contracts (as defined in IFRSs) if the issuer had not previously asserted that it regards the contract as an insurance contract.

b) *FASB* – excludes financial guarantee contracts within the scope of *Derivatives and Hedging* (*Topic 815*).

3. Certain financial instruments with discretionary participation features:

a) *IASB* – excludes financial instruments with discretionary participation features issued by entities other than insurers.

[1] All of the information provided from FASB and IASB summaries are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final FASB/IASB standard.

b) *FASB* -- excludes investment contracts with discretionary participation features unless the contract meets the definition of insurance.

4. Charitable gift annuities which posses a donation element and are issued by not-for-profit entities are excluded from the scope of the project.

5. Certain guarantee contracts are excluded from the scope of the project:

a) The insurer is not exposed to risk throughout the term of the guarantee.

b) A guarantee or an indemnification is of an entity's own future performance.

c) Guarantees issued by an entity that are both (i) unusual or nonrecurring and (ii) unrelated to the type of risk that is the subject of other guarantees issued by the entity.

d) Guarantees addressed in *Leases* (*Topic 840*).

e) A contract that provides for payments that constitute a vendor rebate (by the guarantor) (*Topic 605 Revenue Recognition*).

f) A guarantee or an indemnification whose existence prevents the guarantor from being able to either account for a transaction as the sale or an asset that is related to the guarantee's underlying or recognize in earning that profit from the sale transaction.

g) Guarantees address in *Topic 360 Property, Plant, & Equipment*.

h) Related party guarantees, unless issuance of such guarantees is the primary business purpose of issuing entity.

E. Unbundling – Separating insurance contracts into noninsurance components and insurance components.

1. Unbundling Goods and Services Components

2. Unbundling Investment Components

F. Contract Boundaries – Knowing when an existing insurance contract ends and a new contract begins.

1. Contract Renewals

G. Onerous Contracts – A contract having or involving obligations or responsibilities, especially legal ones that outweigh the advantages.

1. Insurers should perform an onerous contract test when facts and circumstances indicate that the contract might be onerous.

2. Comparing expected cash outflows to future cash inflows.

H. Gain and Losses at Inception – An insurer should not recognize any gain at inception of an insurance contract, however the insurer should recognize any loss on day one immediately when it occurs, in earnings.

II. Measurement

A. Initial Measurement

1. Building-Block Approach -- The proposed measurement approach depicts a current assessment of an insurance contract and would provide information about the main drivers of profitability in the current period.

   a) Expected Value Cash Flow – Expected value (that is, explicit, unbiased, and probability-weighted estimate) of future cash outflows, less future cash inflows that will arise as the insurer fulfills the insurance contract.

   b) Single Margin -- An amount that recognizes profit as the insurer satisfies its performance obligation to stand ready to compensate the policyholder in the event of an occurrence of a specified uncertain future event that adversely affects that policyholder. An insurer satisfies its performance obligation as it is released from exposure to risk as evidenced by a reduction in the variability of cash outflows. An insurer should not remeasure or recalibrate the single margin to recapture the previously recognized margin.

2. Discount Rate -- The discount rate used to measure all insurance contracts should be a current rate that is updated at each reporting period (that is, not to lock in the discount rate for any insurance contract).

3. Premium Allocation Approach – Possibly a modified approach for short duration insurance contracts that may not reflect the time value of money.

B. Subsequent Measurement

1. Expected Value Cash Flow – This amount would be remeasured at the end of each reporting period.

2. Claims Liability -- As insured events occur, an insurer would separately recognize a claims liability. That liability would be measured as the probability-weighted estimate of the net cash flows under the building-block approach at the end of each reporting period. The liability would include claims incurred whether or not reported to the insurer.

III. Comparisons

A. Current U.S. GAAP vs. Proposed New Approaches to Relevant Recognition and Measurement

1. Insurance Entity Orientation
2. Definition of an Insurance Contract
3. Assumptions for Traditional Long Duration Contracts
4. Discount Rate for Traditional Long Duration Contracts
5. Lack of Discounting of Liabilities for Short Duration Contracts

B. FASB vs. IASB Proposed Approaches to Relevant Recognition and Measurement

1. Risk adjustment

   a) *FASB:* Implicit & no remeasuring

b) *IASB:* Explicit & remeasured each reporting period

2. Single Margin (*FASB*) vs. Residual Margin (*IASB*)
3. Premium Allocation Approach
   a) *FASB*: Required if criteria is met
   b) *IASB*: Permitted