

The IASB and FASB approach the final Exposure Draft

Overview

This month, the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) (collectively, the Boards) again devoted a significant amount of time to the discussion of insurance contracts. The Boards came to tentative decisions on a number of significant items that will be included in the Exposure Draft (ED) of the new standard for insurance contracts expected in July 2010.

Discussions took place during joint Board meetings on 18 and 19 May 2010 covering:

- ▶ Margins
- ▶ Level of measurement
- ▶ Unbundling
- ▶ Scope
- ▶ Disclosures

These discussions are likely to determine some of the significant components of a new standard. The progress made in resolving open questions, in particular, with respect to margins will have a significant impact on the ultimate Exposure Draft.

As the decisions in the May meeting were so important to the publication of the ED in early July, we chose to publish this alert after the May meeting to include the decisions made at that meeting. We also briefly summarise the papers discussed at these meetings at the end of this publication to keep you informed of their content.

In addition to the content of this alert and whilst not strictly in the scope of the insurance contracts standard, insurers will also need to consider the outcome of ongoing developments with respect to IFRS 9 *Financial Instruments* as these may have a significant impact on insurer balance sheets and income statements.

The story so far

A summary of tentative decisions by the Boards to date (including decisions at the May meetings) are set out in the table below.

Topic	IASB	FASB
Scope	<p>The Boards decided tentatively that the scope of a standard on insurance contracts will exclude:</p> <ul style="list-style-type: none"> ▶ Warranties issued directly by a manufacturer, dealer or retailer ▶ Residual value guarantees embedded in a lease ▶ Residual value guarantees provided by a manufacturer, dealer or retailer ▶ Employers' assets and liabilities under employee benefit plans and retirement benefit obligations reported by defined benefit retirement plans ▶ Contingent consideration payable or receivable in a business combination <p>At the May meeting, the Boards decided tentatively that the scope of the future standard on insurance contracts should:</p> <ul style="list-style-type: none"> ▶ Exclude fixed-fee service contracts ▶ Not exclude financial guarantee contracts, defined as contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument 	
Definition	<p>The Boards decided tentatively to use the current definition of an insurance contract in IFRS 4 <i>Insurance Contracts</i> and the related guidance in Appendix B of IFRS 4. Specifically:</p> <ul style="list-style-type: none"> ▶ That compensation rather than indemnification is to be used in the definition of an insurance contract in describing the benefit provided to the policyholder ▶ That the guidance in IFRS 4 is to be used in determining whether insurance risk is significant, subject to matters discussed below <p>The Boards noted that the proposed definition of an insurance contract:</p> <ul style="list-style-type: none"> ▶ Captures financial guarantee contracts, as defined in the scope above <p>but</p> <ul style="list-style-type: none"> ▶ Does not capture contracts that pay out regardless of whether the counterparty holds the underlying debt instrument <p>and</p> <ul style="list-style-type: none"> ▶ Does not capture contracts that pay out on a change in credit rating or change in credit index, rather than on the failure of a specified debtor to make payments when due. Thus, financial guarantee contracts, as defined above, would be within the scope of the standard on insurance contracts. 	
Definition – timing risk	<p>On timing risk, the Boards decided tentatively:</p> <ul style="list-style-type: none"> ▶ To change the factors considered in evaluating the significance of insurance risk from absolute amounts to present values. ▶ To amend the guidance in IFRS 4 to explain that contractual terms that delay timely reimbursement to the policyholder can significantly reduce insurance risk. This would mean that some contracts containing such terms might not meet the definition of an insurance contract. 	
Definition – assessment of possible outcomes	<p>For determining when insurance risk exists, the IASB expressed an initial preference for considering the range of possible outcomes.</p>	<p>For determining when insurance risk exists, the FASB expressed an initial preference for considering whether there are outcomes in which the present value of the net cash outflows can exceed the present value of the premiums.</p>
Unbundling – account-driven contracts	<p>The Boards decided tentatively that account balances of account-driven contracts should be unbundled. For this purpose, the characteristics of these contracts will be defined in accordance with the guidance in US GAAP in ASC Topic 944-20-15.</p>	
Unbundling – embedded derivatives	<p>The IASB decided tentatively that embedded derivatives should be unbundled when the IASB's existing standards on financial instruments would require this.</p>	<p>The FASB decided tentatively that embedded derivatives should be unbundled using the unbundling principle being developed for insurance contracts.</p>
Unbundling – requirements	<p>The Boards decided tentatively that unbundling should be prohibited, except in cases where it was required.</p>	

The story so far (continued)

Topic	IASB	FASB
Recognition	<p>The Boards decided tentatively that an insurer should recognise an insurance obligation at the earlier of:</p> <ul style="list-style-type: none"> ▶ The entity being <i>on risk</i> to provide coverage to the policyholder for insured events ▶ The signing of the insurance contract. 	
Derecognition	<p>The IASB discussed derecognition of insurance liabilities and decided tentatively that an insurer should derecognise an insurance liability when it no longer qualifies as a liability of the insurer, applying the derecognition principle in IAS 39 <i>Financial Instruments: Recognition and Measurement</i>.</p>	<p>The FASB decided tentatively on a principle that an insurance liability should be derecognised by an entity when that obligation no longer qualifies as a liability. The liability is eliminated when the entity is no longer on risk and is no longer required to transfer any economic resources for that obligation.</p>
Measurement approach	<p>The Boards decided tentatively that the measurement approach should portray a current assessment of the contract, using the following building blocks:</p> <ul style="list-style-type: none"> ▶ The unbiased, probability-weighted average of future cash flows expected to arise as the insurer fulfils the obligation ▶ Incorporation of time value of money ▶ A margin <p>The Boards also decided tentatively that:</p> <ul style="list-style-type: none"> ▶ The building blocks should be used to measure the combination of rights and obligations arising from an insurance contract rather than to measure the rights separately from the obligations. Furthermore, the combination of rights and obligations should be presented on a net basis. ▶ The objective for measuring an insurance contract should refer to a value rather than cost. The Staff will refine the description of that objective. 	
Measurement approach – decomposition of margins	<p>The IASB decided tentatively that the measurement of an insurance contract should include:</p> <ul style="list-style-type: none"> ▶ A risk adjustment for the effects of uncertainty about the amount and timing of future cash flows ▶ An amount that eliminates any gain at inception of the contract (residual margin). <p>The IASB decided tentatively that the risk adjustment should be the amount the insurer would rationally pay to be relieved of the risk.</p>	<p>The FASB decided tentatively that the measurement of an insurance contract should include one single composite margin.</p>
Risk adjustments	<p>Despite differences in preferred measurement approaches noted above, the Boards discussed the objective for a risk adjustment, together with draft supporting guidance, and decided tentatively:</p> <ul style="list-style-type: none"> ▶ That the objective is to reflect the maximum amount that an insurer would rationally pay to be relieved of the risk, taking into consideration that the amount of benefits and claim costs actually paid may exceed the amount expected to be paid. ▶ That the guidance accompanying this objective should clarify that a risk adjustment would capture the level of uncertainty inherent in the cash flows from the insurance liability from the perspective of the insurer, rather than from the perspective of a market participant. ▶ To limit the range of available techniques to measure the risk adjustment. Staff will bring back at a future meeting a discussion on which techniques would be available for measuring the risk adjustment, including a further analysis on whether a cost of capital approach would meet the objective of the risk adjustment. 	

The story so far (continued)

Topic	IASB	FASB
Level of measurement	<p>The Boards decided tentatively:</p> <ul style="list-style-type: none"> ▶ That an entity should measure any risk adjustment at a portfolio level of aggregation ▶ To retain the definition of portfolio of contracts in the existing IFRS 4 as, "Contracts that are subject to broadly similar risks and managed together as a single portfolio" ▶ That residual or composite margins should be determined at a cohort level of aggregation, by grouping insurance contracts by portfolio and, within the same portfolio, by date of inception of the contract and by length (or life) of the contract <p>The Boards asked the Staff to investigate and recommend whether to require or permit the insurer to determine a composite margin on an individual contract basis rather than on a cohort basis.</p>	
Measurement at inception	<p>The Boards decided that:</p> <ul style="list-style-type: none"> ▶ The initial recognition of an insurance contract should not result in the recognition of an accounting profit ▶ If the initial recognition of an insurance contract results in a loss, the insurer should recognise that loss in profit or loss at inception <p>For this purpose, a day-one loss exists only if at inception:</p> <ul style="list-style-type: none"> ▶ Risk adjustment approach: the expected present value of the outflows plus the risk adjustment exceeds the expected present value of the premiums ▶ Composite margin approach: the expected present value of the outflows exceeds the expected present value of the premiums 	
Acquisition costs	<p>The IASB decided tentatively to exclude from the initial measurement of the residual margin an amount equal to the incremental acquisition costs. The Staff will investigate whether that tentative decision is best implemented by:</p> <ul style="list-style-type: none"> ▶ Excluding the acquisition costs from the premium to which the contract liability is calibrated <p>or</p> <ul style="list-style-type: none"> ▶ Including the acquisition costs in the contract cash flows at the inception of the contract 	<p>The FASB decided tentatively that an insurer should:</p> <ul style="list-style-type: none"> ▶ Expense all acquisition costs when incurred ▶ Not recognise any revenue (or income) to offset those costs incurred
Subsequent treatment of margins – risk adjustment	<p>The Boards decided tentatively that, if the measurement of an insurance contract were to include a separate risk adjustment and residual margin:</p> <ul style="list-style-type: none"> ▶ The risk adjustment should be updated (remeasured) each reporting period ▶ The insurer should release the residual margin over the coverage period in a systematic way that best reflects the exposure from providing insurance coverage, as follows: <ul style="list-style-type: none"> ▶ On the basis of passage of time <p>but</p> <ul style="list-style-type: none"> ▶ If the insurer expects to incur benefits and claims in a pattern that differs significantly from passage of time, the residual margin should be released on the basis of the expected benefits and claims <p>▶ The insurer should not adjust the residual margin in subsequent reporting periods for changes in estimates</p>	
Subsequent treatment of margins – composite margin	<p>The Boards considered the application of two possible factors to amortise a composite margin:</p> <ul style="list-style-type: none"> ▶ The insurer's exposure from the provision of insurance coverage ▶ The insurer's exposure from uncertainties related to future cash flows <p>The Boards decided tentatively that these factors should be implemented using the following formula:</p> $\frac{\text{Premium allocated to current period} + \text{current period claims and benefits}}{\text{Total expected and contractual premium} + \text{total expected claims and benefits}}$ <p>The Boards also affirmed that an insurer should not adjust a composite margin for changes in cash flow estimates.</p>	

The story so far (continued)

Topic	IASB	FASB
Interest accretion for residual and composite margins	The IASB decided tentatively that interest should be accreted to the residual and composite margin.	The FASB decided tentatively that interest should not be accreted to the residual and composite margin.
Classification and disclosure of residual and composite margins	The Boards decided tentatively that both residual and composite margins should be part of the insurance liability, rather than a separate liability outside the insurance liability. The Boards also decided tentatively that the residual margin should be disclosed separately.	
Discount rates	<p>The Boards decided tentatively that the discount rate should reflect the characteristics of the contracts, rather than the characteristics of assets actually held to back the contracts, unless the contracts share those characteristics.</p> <p>More specifically:</p> <ul style="list-style-type: none"> ▶ If the cash flows for the insurance contracts do not depend on the performance of specific assets, the discount rate should be a risk-free rate including an adjustment for illiquidity ▶ If the amount, timing or uncertainty of cash flows for the insurance contracts depends, wholly or partly, on the performance of specific assets, the measurement of these contracts should consider that fact. <p>Other discussion points on the discount rate include:</p> <ul style="list-style-type: none"> ▶ The Boards asked the Staff to incorporate the existing requirements on discount rates from other standards when developing guidance for estimating a discount rate for insurance contracts. For example, the guidance should specify that the discount rate should not include any risk that is included in other parts of the measurement. ▶ During the discussion, the Boards considered concerns raised by some commentators about the discount rate, particularly for long-duration non-participating insurance contracts. Those concerns include the possibility of significant losses at the inception of some contracts and possible accounting mismatches if the discount rate for insurance contracts does not change in response to changes in market credit spreads. ▶ The Boards discussed whether these concerns would diminish if they revisited their previous tentative decision that the measurement of an insurance liability should not be updated for changes in the risk of non-performance by the insurer. After the discussion, the Boards did not change that tentative decision, but they decided that the forthcoming ED on insurance contracts should ask for specific input on this issue. 	
Exclude discounting and margins in some instances	The IASB noted the arguments for and against an approach that uses an estimate of future cash flows with no margins and no discounting. The IASB considered whether to use such an approach for non-life claims liabilities and decided tentatively not to add it to the list of candidates.	The FASB will consider at a future meeting whether, in certain instances, a measurement of insurance contracts would use future cash flows with no margins and no discounting.
Participating features in insurance contracts	The IASB decided tentatively that payments arising from the participating features should be included in the measurement of insurance contracts in the same way as any other contractual cash flows (that is, on an expected present value basis).	The FASB decided tentatively that the insurer should recognise a liability for participating benefits to the extent that it has a legal or constructive obligation to pay those benefits.
Non-performance risk	The Boards decided tentatively that the measurement of an insurance liability should not be updated for changes in the risk of non-performance by the insurer.	
Use of inputs	<p>The Boards decided tentatively that the measurement should:</p> <ul style="list-style-type: none"> ▶ Consider all available information that relates to the fulfilment of the insurance contract. Available information includes, but is not limited to, industry data, historical data of an entity's costs, and market inputs where those inputs are relevant to the fulfilment of the contract. ▶ Use current estimates of financial market variables that are as consistent as possible with observable market prices. 	

The story so far (continued)

Topic	IASB	FASB
Unearned premium	<p>The IASB decided tentatively:</p> <ul style="list-style-type: none"> ▶ An unearned premium approach would provide decision-useful information about pre-claims liabilities of short-duration insurance contracts ▶ To require rather than permit the use of an unearned premium approach for those liabilities 	<p>The FASB will discuss an unearned premium approach at a future meeting.</p>
Policyholder behaviour	<p>The Boards decided tentatively that the policyholder options, as well as options, forwards and guarantees related to existing coverage, should be included in the measurement of the insurance contract on a look-through basis using the expected value of future cash flows (to the extent that those options are within the boundary of the existing contract). As a consequence, no deposit floor would apply.</p> <p>The Boards also discussed how to treat options, forwards, and guarantees that do not relate to the existing insurance contract coverage. The Boards decided tentatively to exclude such features from the measurement of that contract. Instead, those features should be recognised and measured as new insurance contracts or other stand-alone instruments, according to their nature.</p>	
Contract boundary	<p>The Boards decided tentatively that the boundary of an insurance contract is the point at which the insurer either:</p> <ul style="list-style-type: none"> ▶ Is no longer required to provide coverage <p>or</p> <ul style="list-style-type: none"> ▶ Has the right to reassess the risk of the particular policyholder and, as a result, can set a price that fully reflects that risk. 	
Assets associated with unit-linked contracts	<p>The Boards decided tentatively that assets and related liabilities associated with unit-linked contracts (including those sometimes described as separate accounts), should be reported as the insurer's assets and liabilities in the statement of financial position.</p> <p>The Boards also decided tentatively not to address in this project issues involving the consolidation of investment funds associated with unit-linked contracts (including separate account contracts). Such issues are within the scope of the project on consolidation.</p>	
Presentation of the performance statement	<p>The Boards decided tentatively:</p> <ul style="list-style-type: none"> ▶ The measurement approach should drive the presentation model for the performance statement ▶ The Staff should develop further an expanded margin approach 	
Other comprehensive income (OCI)	<p>The Boards decided tentatively:</p> <ul style="list-style-type: none"> ▶ Not to change the accounting for an insurer's assets ▶ Not to permit or require the use of OCI for insurance contracts 	
Disclosures	<p>The Boards tentatively approved disclosure requirements for the forthcoming ED, including a principle on the level of disaggregation for disclosure purposes. The Boards provided some comments for the Staff to consider in drafting the proposed requirements.</p>	

Source: IASB Staff Paper 2, Ernst & Young.

The following sections provide an overview of papers discussed by the Boards during the May meetings. Decisions made at those meetings are included below, as well as in the table on the previous pages.

Margins

At the May meetings, the Staff presented three papers (Agenda Papers 2A - 2C) to the Boards that relate to the ongoing discussion of the use of a separately identified risk adjustment (plus a residual margin) versus the use of a composite margin as part of the measurement of insurance contracts.

Previously, the IASB tentatively concluded that the measurement of an insurance contract should include a separate risk adjustment (decided tentatively by the IASB as the amount the insurer would rationally pay to be relieved of the risk) plus a residual margin. The FASB tentatively concluded that the measurement of an insurance contract should include a single composite margin. A summary of some of the differences in tentative conclusions with respect to residual and composite margins to date is set out in the table below.

Topic	Residual margin (IASB)	Composite margin (FASB)
Definition	The difference between: <ul style="list-style-type: none"> ▶ The expected premiums (IASB: premiums less acquisition costs) and <ul style="list-style-type: none"> ▶ The expected claims and expenses plus a risk adjustment 	The product of a calibration that eliminates the day-one difference between: <ul style="list-style-type: none"> ▶ The expected premiums and <ul style="list-style-type: none"> ▶ The expected claims, benefits and claims handling expenses
Treatment of day-one losses	Recognise a negative day-one loss immediately in profit or loss.	
Period for release of the margin	Coverage period.	Coverage and claims handling periods.
Accrete interest on the margin	Accrete interest.	No accretion of interest.
Part of the insurance liability	Included in the insurance liability but separately disclosed.	

The Staff Agenda Paper 2A presents the benefits of each approach for consideration of the Boards, summarised below:

Consideration area	Risk adjustment (IASB)	Composite margin (FASB)
Simplicity and understandability	The risk adjustment is more complex and requires subjective methods to measure risk, which may be less easily understood by users of financial statements.	A composite margin is simpler to calculate and the methods for amortisation are likely to be easily calculated and transparent to users of financial statements.
Unbiased versus conservative	A risk adjustment adds conservatism in addition to the unbiased probability-weighted cash flows.	A composite margin is comparatively unbiased without a risk adjustment.
Depiction of uncertainty in possible outcomes	A risk adjustment provides a means for depicting uncertainty, especially about the risk inherent in the tail of the insurance contract, as well as management's perception of risk.	The risks associated with the uncertainty in cash flows is included in the composite margin, and additional information on dispersion of the expected outcomes could be disclosed.
Explicit measure of risk	The risk adjustment is re-measured each period, reflecting changes in uncertainty as they occur.	The composite margin is assumed to be sufficient to depict the amount of risk.
Explicit pattern of run-off	The risk adjustment is explicit and the resulting residual margin is not designed to capture risk, so run-off during the coverage period is based on: <ul style="list-style-type: none"> ▶ Passage of time or <ul style="list-style-type: none"> ▶ The expected benefits and claims at inception if significantly different from passage of time 	The composite adjustment is a composite of risk and other factors (so is run-off in proportion to risk), but relies on an allocation either between two components or two drivers, which may be arbitrary to some extent.
Consistency with other standards	More consistent with fair value and liability measurement in IAS 37, as well as consistency with option pricing models.	More consistent with the allocated transaction price approach in the revenue recognition project.

The Staff asked the Boards to select a preferred method and, consistent with prior tentative conclusions, the Boards remained split in their decisions, with the IASB tentatively selecting the risk adjustment method and the FASB tentatively selecting the composite margin approach. The ED will therefore present both approaches.

In order to further develop the approach that includes a risk adjustment, the Staff asked the Boards whether the ED should:

- ▶ Require entities to select a technique for measuring risk adjustments by reference to criteria specified by the Boards

or

- ▶ Limit the range of permitted techniques.

The Boards decided tentatively to limit the range of permitted techniques to measure the risk adjustment. The Staff also specifically identified the three available risk adjustment techniques that could be permitted as follows:

- a) Confidence level technique (or Value at Risk)
- b) Conditional Tail Expectation technique (or Tail Value at Risk)
- c) Cost of Capital technique

Definitions of the above techniques (and other discarded techniques) were included in the April Agenda Paper 3A and are repeated in the May Agenda Paper 2B.

The Staff proposed that the confidence level at which an insurer determined its risk adjustment should be disclosed, and if b) and c) are used, the insurer should disclose the confidence level to which the risk adjustment determined under those methods corresponds. Insurers must also disclose the technique used and the rationale underlying its selection.

With respect to a composite margin, the Boards decided tentatively to amortise a composite margin based on a formula that divides current period absolute premiums, claims and benefits by total expected and contractual premiums, claims and benefits. The Boards also affirmed that an insurer should not adjust a composite margin for changes in cash flow estimates.

Level of measurement

The basic question discussed in Agenda Paper 2D and at the May meetings was whether insurance contracts should be measured individually or at some higher level of aggregation. The Staff recommended that insurance contracts are measured based on a portfolio notion (that is, contracts that are subject to broadly similar risks and managed together as a single portfolio).

In principle, the level of measurement does not affect expected cash flows, provided that estimates of cash flows reflect all relevant inputs. However, separate risk adjustments and margins would typically be measured at a higher level than the individual contract.

If a separate risk adjustment is used, the Staff also recommended that an adjustment should be determined for a portfolio, as such, not reflecting the effects of diversification or negative correlation between portfolios. The Staff's belief that capturing all diversification and offsetting effects would generate practical

difficulties if capital is not fully fungible, requires a reliable basis to determine the effects and may require allocations down to portfolios, which may be difficult in some cases.

The Boards decided tentatively that the level of measurement should be at the portfolio level, with no diversification or negative correlation benefits between portfolios allowed. The Boards decided tentatively to retain the definition of portfolio (as reflected in the current standard IFRS 4) as "contracts that are subject to broadly similar risks and managed together as a single portfolio".

In order to take into account the time variable of residual and composite margins, the Staff recommended that they be determined initially and subsequently at a cohort level that groups insurance contracts:

- ▶ By portfolio
- ▶ Within the same portfolio, by date of contract inception
- ▶ By length (or life) of the contract

The Boards agreed with the approach described.

Unbundling

The Staff identify two alternative approaches to unbundling, as follows:

- ▶ Unbundle components only when they function independently using existing bifurcation guidance

or

- ▶ Unbundle a component if it is not significantly interdependent with other components (incorporating the definition below, this might be said as "unbundle components only if they can be measured separately without the need for allocation")

The Staff recommended to the Boards that a component of an insurance contract be unbundled if it functions independently, meaning that it is not significantly interdependent. The Staff asked whether the Boards agree. Significant interdependence is described in the appendix to Agenda Paper 2E as, "components [that] are so interdependent that they cannot be measured separately".

In addition to the general principle of unbundling, the Staff considered two specific applications:

- a) Account-driven contracts (e.g., unit-linked, universal life, participating) vs. non-account driven (e.g., non-life)
- and
- b) Embedded derivatives

With respect to unbundling of account-driven contracts, the Staff did not recommend an approach, but asked the Boards whether unbundling should be required for all account-driven balances or only those that are explicit. The Boards tentatively concluded that all account-driven balances (implicit and explicit) should be unbundled.

Similarly, the Staff did not recommend an approach to embedded derivatives, but instead, asked the Boards whether to unbundle embedded derivatives based on presently existing requirements

or using the proposal outlined at the beginning of this section. The IASB and FASB were split on their decisions with respect to embedded derivatives, with the IASB tentatively deciding to retain existing bifurcation guidance and the FASB tentatively deciding to use principles being developed for insurance contracts.

Finally, the Boards concluded that insurers should be prohibited from unbundling, except in cases where it was required.

Scope

The Staff addressed the potential scope of the upcoming standard in two agenda papers on financial guarantees (Agenda Paper 2G) and fixed-fee service contracts (Agenda Paper 2F).

The Staff recommended to the Boards (and asked for their agreement) that the following contracts meet the definition of an insurance contract:

- ▶ Financial guarantee insurance contracts
- ▶ Mortgage guarantee insurance contracts
- ▶ Credit insurance contracts
- ▶ Fixed-fee service contracts that provide a service for a fixed fee that indemnifies the buyer from future price increases.

The Staff noted, in both papers, the previous tentative decision to specifically exclude the following contracts from the scope of an insurance contracts standard:

- ▶ Warranties issued directly by a manufacturer, dealer or retailer
- ▶ Residual value guarantees embedded in a lease
- ▶ Residual value guarantees provided by a manufacturer, dealer or retailer
- ▶ Employers' assets and liabilities under employee benefit plans and retirement benefit obligations reported by defined benefit retirement plans
- ▶ Contingent consideration payable or receivable in a business combination

The Staff did not propose any changes to the tentative decision above and the Boards agreed. The Boards specifically excluded fixed-fee service contracts from the scope of the insurance contracts standard.

Disclosures

The Staff proposed the following disclosure principle:

“To help users of the financial statements understand the amount, timing and uncertainty of future cash flows arising from insurance contracts, an entity shall disclose qualitative and quantitative information about:

- ▶ The amounts recognised in its financial statements arising from insurance contracts

and

- ▶ The nature and extent of risks arising from those contracts.”

The Staff proposed a principles-based approach to level of aggregation as follows:

- ▶ Aggregate disclosures so that useful information is not obscured either by the aggregation of items that have significantly different insurance risk characteristics or by the inclusion of a large amount of insignificant detail
- ▶ Sufficient information to permit reconciliation to line items in the statement of financial position
- ▶ Aggregation level should not be less than an operating segment as defined by IFRS 8 *Operating Segments*
- ▶ Appropriate disclosure level might be type of contract or, if only one type of contract, one layer below, consistent with how management manages the business or geography.

The Boards did not disagree with the principles provided by the Staff. The Boards discussed additional considerations that will be addressed through the drafting of the ED.

Other standards

In addition to the content of this alert, and whilst not strictly in the scope of the insurance contracts standard, insurers will also need to consider the outcome of ongoing developments with respect to IFRS 9 *Financial Instruments*, as these may have a significant impact on insurer balance sheets and income statements.

Next steps

The Boards will continue their discussion at a joint meeting on 1 June 2010. Look out for our future publications of Insurance Accounting Alert – particularly a special edition that will be issued when the ED is published.

Area IFRS insurance contacts

We welcome your feedback on *Insurance Accounting Alert*.

Please get in touch with your local Ernst & Young insurance contact with any enquiries.

Global Centre of Excellence

James Dean
+44 20 7951 1404
jdean1@uk.ey.com

Kevin Griffith
+44 20 7951 0905
kgriffith@uk.ey.com

Christine Holmes
+31 88 407 3876
christine.holmes@nl.ey.com

Americas

Jennifer Weiner
+1 617 585 0347
jennifer.weiner@ey.com

Richard Lynch
+1 212 773 5601
richard.lynch@ey.com

Actuarial

Jim Christie (Property and Casualty)
+1 416 943 3468
jim.k.christie@ca.ey.com

Mark Freedman (Life)
+1 215 448 5012
mark.freedman@ey.com

Far East

Kieren Cummings
+85 2 2846 9888
kieren.cummings@hk.ey.com

Japan

Kenji Usukura
+81 3 3503 1191
usukura-knj@shinnihon.or.jp

Peter Gaydon
+81 3 3503 2998
gaydon-ptr@shinnihon.or.jp

Oceania

Christina Habal
+61 3 9288 8192
christina.habal@au.ey.com



Europe, Middle East, India and Africa

Cornea De Villiers (South Africa)
+27 21 443 0364
cornea.devilliers@za.ey.com

Gabriele Pieragnoli (Italy)
+39 027 221 2434
gabriele.pieragnoli@it.ey.com

James Lenton (UK)
+44 20 7951 1993
jlenton@uk.ey.com

Loic Moan (France)
+33 1 46 93 42 02
loic.moan@fr.ey.com

Nicole Verheyen (Belgium)
+32 3 270 1394
nicole.verheyen@be.ey.com

Niek de Jager (The Netherlands)
+31 88 407 3849
niek.de.jager@nl.ey.com

Pedro Garcia Langa (Spain)
+34 915 727 812
pedro.garcialanga@es.ey.com

Ralf Widmann (Germany)
+49 711 9881 15142
ralf.widmann@de.ey.com

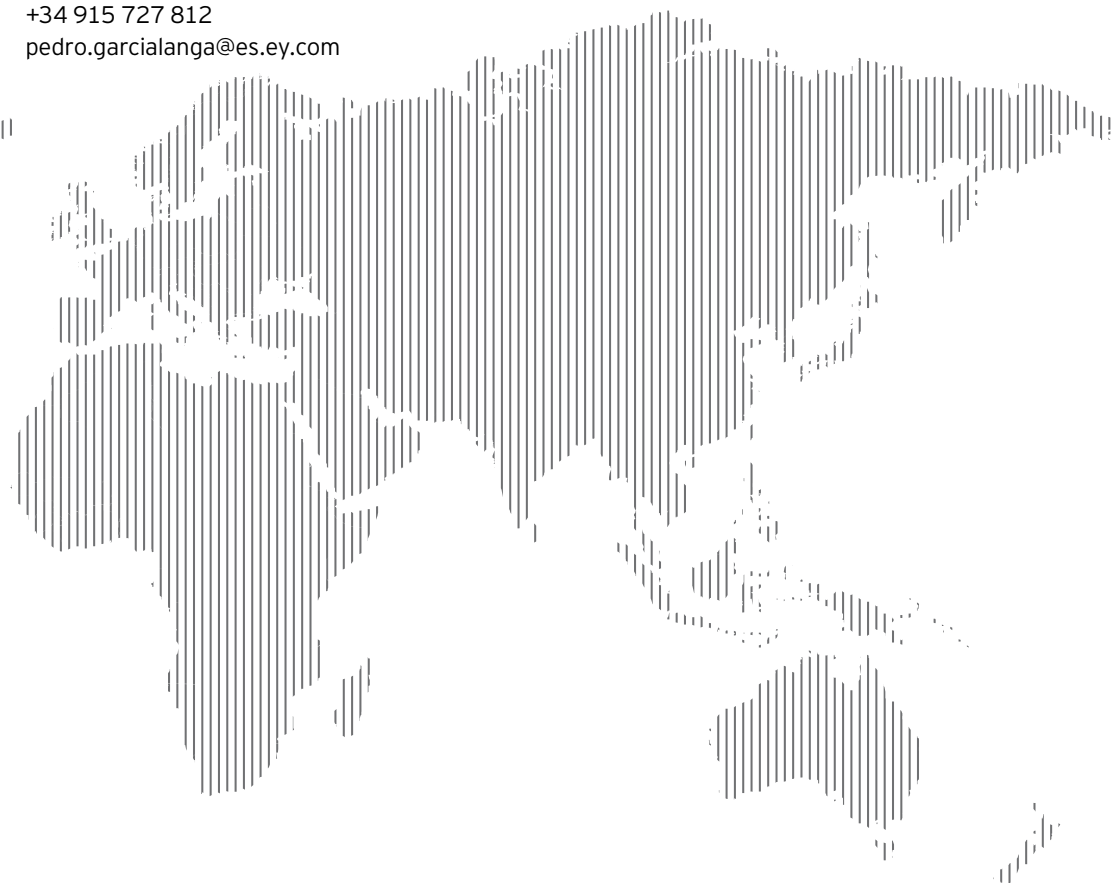
Rohan Sachdev (India)
+91 22 4035 6300
rohan.sachdev@in.ey.com

Rolf Bächler (Switzerland)
+41 58 286 44 95
rolf.baechler@ch.ey.com

Actuarial

Alex Lee (Property and Casualty)
+44 20 7951 1047
alee6@uk.ey.com

Brian Edey (Life)
+41 58 286 4224
brian.edey@ch.ey.com



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