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KPMG
cutting through complexity

“The redeliberations are winding down, with an exposure draft in sight next year. Field and user input will be key in evaluating the operationality of the new model.”

Joachim Kölschbach,
KPMG's global IFRS Insurance leader
KPMG International Standards Group

Moving towards global insurance accounting

This edition of *IFRS Newsletter: Insurance* highlights the results of the IASB and FASB (the Boards) discussions in November 2012 on the joint insurance contracts project. In addition, it provides the current status of the project and an expected timeline for completion.

Highlights

- The Boards clarified that, for cash flows not subject to mirroring that are affected by asset returns:
  - the discount rate would reflect the extent to which the estimated cash flows are affected by the return from those assets; and
  - an insurer would reset the locked-in discount rate that is used to present interest expense for those cash flows when there is any change in expectations of cash flows due to changes in the crediting rate for the insurance contracts.
- The IASB decided:
  - that all rights and obligations for all insurance contracts would be presented on a net basis, with separate line items for insurance and reinsurance contracts in the statement of financial position; and
  - to require additional disclosures on contracts with cash flows contractually linked to underlying items, the earned premium presentation and transition.
- The FASB decided that ceding commissions that are not contingent on claims or benefits experience would be treated as a reduction of premiums ceded to the reinsurer.
- The FASB decided on accounting for business combinations involving insurance contracts and portfolio transfers.
- The IASB intends to undertake fieldwork as part of the re-exposure of the insurance contracts proposals.

KEY DECISIONS MADE THIS MONTH

Contracts affected by expected asset returns (IASB and FASB)

- The Boards clarified that, for cash flows in an insurance contract that are not subject to mirroring and are affected by asset returns, the discount rate that reflects the characteristics of the cash flows would reflect the extent to which the estimated cash flows are affected by the return from those assets.
- An insurer would reset the locked-in discount rate used to present interest expense for those cash flows in an insurance contract that are not subject to mirroring and are affected by asset returns, when there is any change in expectations for the cash flows used to measure the contract liability – i.e. any expected change in the crediting rate.

Presentation and disclosures (IASB only)

- An entity would present all rights and obligations for all insurance contracts on a net basis in the statement of financial position.
- An entity would be required to present separate line items for insurance contracts and reinsurance contracts in the statement of financial position.
- The general requirements of IAS 1 *Presentation of Financial Statements* were deemed sufficient to specify the presentation requirements for insurance contracts in the statement of comprehensive income.
- Additional disclosures would be required for contracts with cash flows contractually linked to underlying items, the earned premium presentation and transition.

Ceding commissions (FASB only)

- The cedant would treat ceding commissions that are not contingent on claims or benefits experience received from the reinsurer as a reduction of the premium ceded to the reinsurer.

Business combinations and portfolio transfers (FASB only)

- At the acquisition date, an insurer would measure insurance liabilities assumed and insurance assets acquired in a business combination at fair value. The components of these assets and liabilities would be measured as follows.
  a) Expected net cash flows would be measured according to the insurer's accounting policies for insurance contracts that it issues using current assumptions. The discount rate determined at the acquisition date would be deemed the locked-in rate at which interest expense is accreted and presented in the statement of comprehensive income.
  b) A single margin would be measured as the difference between the fair value of the insurance contract liability – i.e. the hypothetical premium – and the expected net cash flows determined in (a).
- The FASB decided that an insurer would measure a portfolio of insurance contracts acquired in a portfolio transfer that does not meet the definition of a business combination in accordance with the insurance contracts standard.

Participation features of a mutual insurance company (FASB only)

- On measuring the insurance contracts liability, discretionary payments resulting from a contractual participation feature would be based on the insurers' expectation of payments to policyholders; this would result in equity (deficits) for mutual insurers.

Fieldwork (IASB only)

- The IASB intends to undertake fieldwork as part of the re-exposure of the insurance contracts proposals.

Financial guarantees (FASB only)

- Guarantee contracts within the scope of *FASB Accounting Standards Codification* Topic 944 *Financial Services–Insurance* would be scoped in to the insurance contracts proposals. Guarantee contracts within the scope of Topic 815 *Derivatives and Hedging* would be excluded.

NOVEMBER ACTIVITIES

What happened in November?

Redeliberations are drawing to an end, with key topics such as the measurement model, presentation, and transition tentatively decided. However, the Boards still have a number of less pervasive items to tackle before composing their exposure drafts.

At this month's meetings, the Boards discussed how to determine the discount rate, and how to present changes in the discount rate for contracts whose cash flows:

- are affected by expected asset returns; but
- are not subject to mirroring, because there is no contractual linkage to the underlying assets.

The Boards clarified that for these contracts, the discount rate that reflects the characteristics of the contract's cash flows would reflect the extent to which the estimated cash flows are affected by the return from those assets. They also decided that the locked-in discount rate that is used to present interest expense for those cash flows would be reset when there is any change in expectations of cash flows used to measure the contract liability due to changes in the crediting rate for the insurance contracts.

The IASB and FASB also held separate meetings during the month to discuss various topics. The IASB made additional presentation decisions, and added disclosure requirements relating to contracts with a contractual linkage to assets, the earned premium presentation and transition. The FASB discussed the presentation of ceding commissions, the accounting for business combinations and portfolio transfers, and the treatment of participating features of contracts issued by mutual insurance companies.

Additionally, the FASB discussed which financial guarantees would be within the scope of the insurance contracts standard. Under current US GAAP, the nature of the guarantee and type of entity issuing the guarantee drive the accounting guidance applied. Guarantees issued by *insurers* are accounted for as insurance under FASB ASC Topic 944 *Financial Services—Insurance*. Also, guarantees meeting the definition of a derivative would follow the accounting guidance in FASB ASC Topic 815 *Derivatives and Hedging*. Other guarantees – including those issued by non-insurance entities and those that do not meet the definition of a derivative – would follow the accounting guidance in FASB ASC Topic 460 *Guarantees*. The accounting guidance under these three topics varies, with different measurement models being applied. The FASB decided to scope those contracts that are currently treated as insurance contracts under US GAAP – i.e. apply the accounting guidance in Topic 944 – into the insurance contracts proposals. Similarly, it confirmed that guarantees that currently apply the guidance in Topic 815 would remain out of scope. However, the FASB did not decide whether the wide range of guarantees currently in scope of Topic 460 that meet the definition of an insurance contract would be subject to the insurance contracts proposals. This is expected to be discussed in future meetings.

Following the September 2012 announcement to issue a targeted re-exposure draft in the first half of 2013, the IASB staff also presented their plan to undertake fieldwork to help in understanding the costs of applying the proposals, and any other issues that may arise from them. The fieldwork will focus on the key areas of change from the 2010 exposure draft (ED), and will take place during the 2013 re-exposure period.

The Boards have a few remaining topics left to deliberate before finalising their proposals. They are expected to discuss the allocation of the residual margin and sweep issues at future meetings.

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CONTRACTS AFFECTED BY EXPECTED ASSET RETURNS (IASB AND FASB)

The discount rate would reflect the extent to which the estimated cash flows are affected by asset returns.

Contracts that are affected by expected asset returns, but to which mirroring does not apply – Determination of the discount rate

What's the issue?

Some insurance contracts provide the policyholder with an investment return that is affected by the performance of assets. For some of these contracts, there is a contractual linkage to specified underlying assets; other contracts, however, do not have such a contractual linkage. In previous meetings, the Boards have tentatively decided that the 'mirroring approach'[1] would apply only to contracts with participation features that provide policyholders with the contractual right to share in the return from specified underlying items.

In this month's meeting, the Boards discussed how to determine the discount rate for contracts to which the mirroring approach does not apply, but where the contracts are affected by expected asset returns. This includes universal life contracts where:

- the interest credited to the policyholder is solely or predominantly at the insurer's discretion; and
- there is no contractually enforceable requirement to pass on the performance of the underlying assets and liabilities to the policyholder.

Another example is an index-linked contract where:

- the right is not contractually linked to underlying assets held by the insurer; but
- the policyholder participates in the market values of items as observed in markets or other external indices.

What did the staff recommend?

The staff considered the previous tentative Board decisions for discounting cash flows under the building-block approach, and the appropriate discount rate for participating contracts where there is a contractual linkage to specified underlying assets. To be consistent with these previous tentative decisions, the staff recommended that the Boards make the following clarification – that for cash flows in an insurance contract that:

- are not subject to mirroring; and
- are affected by asset returns,

the discount rate that reflects the characteristics of the cash flows would reflect the extent to which the estimated cash flows are affected by the return from those assets. This would be the case regardless of whether:

- the transfer of the expected returns of those assets are the result of the exercise of insurer's discretion; or
- the specified assets are not held by the insurer.

The staff did not recommend that a prescriptive method be required for determining the extent to which the asset risk is factored into the discount rate; however, they recommended instead that application guidance should highlight the need to make an explicit adjustment, reflecting the asset returns expected to be passed through to policyholders.

1 The mirroring approach refers to the Boards' tentative decisions that the measurement of the fulfilment cash flows related to policyholders' participation should be based on the measurement in the financial statements of the underlying items in which the policyholders participate – i.e. to measure and present the part of the obligation that relates to the underlying items on the same basis as the underlying items.

What did the Boards discuss?

Some Board members noted that the staff recommendation was consistent with the principles of the measurement model, and with previous Board decisions. As a result, many Board members thought that it should remain as a principles-based approach, and that judgement would need to be applied when determining the extent to which cash flows are affected by expected asset returns.

However, other Board members thought that further clarification was needed, because insurers could apply different methodologies to determine the discount rate for these types of contracts. The staff agreed that the recommendation did not represent a new principle, and that the decision on this agenda item should be added to the implementation guidance for such contracts.

What did the Boards decide?

The Boards agreed with the staff recommendation.

An insurer would reset the locked-in discount rate used to present interest expense when there is any change in expectations of the crediting rate.

Contracts that are affected by expected asset returns, but to which mirroring does not apply – Presentation of changes in the discount rate

What's the issue?

In previous meetings, the Boards agreed:

- how changes in the insurance liability arising from changes in the discount rate would be presented; and
- how the mirroring decision for participating contracts interacts with the use of other comprehensive income (OCI).

Based on these decisions, the effect of changes in the discount rate would be required to be presented in OCI for those cash flows affected by expected asset returns to which the mirroring decision does not apply. In addition, interest expense would be presented in profit or loss using the discount rate *locked-in at inception* of the contract.

In contrast to the cash flows for non-participating contracts, the cash flows of contracts impacted by asset returns are affected by movements in market interest rates in a similar manner to a variable-rate debt instrument. Those movements also affect the discount rate used to measure the insurance contract. Presenting the interest expense in profit or loss at the discount rate locked-in at inception may be less useful when the cash flows are affected by changes in the performance of assets – particularly changes in crediting rates. Therefore, inconsistency would arise between:

- the amounts recognised as interest expense when the discount on the insurance liability unwinds; and
- the variable-rate nature of the financing.

What did the staff recommend?

The staff recommended a modification to the tentative decisions regarding OCI – specifically for cash flows affected by expected asset returns for which the mirroring decision does not apply. The staff noted that cash flows of these contracts are analogous to those of variable-rate debt instruments. The discount rate applied to determine the interest expense in profit or loss for these financial instruments, if it is not measured at fair value through profit or loss, is reset when there is a change in interest rates. The staff thought that more useful information could be obtained by periodically resetting the discount rate applied in determining the interest expense for cash flows that are affected by the return from assets (to which mirroring does not apply).

The staff considered the following alternatives:

Alternative 1a	Reset the discount rate upon any change in the crediting rate.
Alternative 1b	Reset the discount rate upon any *change in expectations* of the crediting rate.
Alternative 2	Reset the discount rate upon any change in book yield to the current book yield.

The staff supported pursuing Alternative 1b, believing that this alternative most usefully aligns:

- the presentation in the statement of comprehensive income; and
- the change in the liability recognised in the statement of financial position.

The interest expense for these contracts would then reflect the variable-rate nature of the financing implicit in the insurance contract cash flows. The cash flow features are such that both the actual amount of policyholder benefits and the discount rate on these cash flows would be affected by interest rates or other asset risks. These two changes may have an offsetting effect on the measurement of insurance contract liabilities.

Under this alternative, the timing of the reset of the locked-in discount rate aligns with the timing of:

- the recognition of the changes in expected cash flows; and
- the change in the discount rate used to measure the liability in the statement of financial position. The change in the expected asset returns will affect this discount rate, as well as the discount rate used to present the interest expense in profit or loss.

As a result, the effects of changes in discount rate for these cash flows are expected to be fully presented in profit or loss rather than in OCI.

The staff recommended that an insurer would reset the locked-in discount rate used to present interest expense for contracts whose cash flows:

- are not subject to mirroring; and
- are affected by asset returns,

when there is any change in the expectations of cash flows used to measure the insurance contracts liability due to changes in crediting rates.

What did the Boards discuss?

Several Board members commented that some parts of the contracts' cash flows may be affected by asset returns, while other parts may not. As a result, they believed that it would be appropriate to split the cash flows into two components:

- cash flows that are affected by asset returns – changes in the discount rate for these cash flows would be reflected in profit or loss – i.e. in interest expense; and
- cash flows that are not affected by asset returns – changes in the discount rate for these cash flows would be reflected in OCI.

These Board members thought that the recommendation should be clarified to distinguish the cash flows that are affected by asset returns from those that are not – rather than referring to the contract as a whole. Therefore, the staff proposed to revise the recommendation as reflected in the final decision below.

What did the Boards decide?

The Boards agreed that an insurer would reset the locked-in discount rate that is used to present interest expense for cash flows in an insurance contract that:

- are not subject to mirroring; and
- are affected by asset returns,

when there is any change in the expectations of cash flows used to measure the insurance contracts liability – i.e. any expected change in the crediting rate.

PRESENTATION AND DISCLOSURES (IASB ONLY)

All rights and obligations for all insurance contracts would be presented on a net basis.

Insurance and reinsurance contracts would be presented as separate line items in the statement of financial position.

The general requirements of IAS 1 were deemed sufficient to specify the presentation of insurance contracts in the statement of comprehensive income.

Presentation of insurance contracts in the financial statements

What's the issue?

The IASB's 2010 ED proposed certain presentation requirements for insurance contracts in the statement of financial position and the statement of comprehensive income. In their redeliberations, the Boards have tentatively decided to present separate line items in the statement of financial position for contracts measured using the building-block approach and those measured using the premium-allocation approach. Also, the Boards have decided to apply an earned premium presentation for contracts measured using both the building-block and premium-allocation approaches in the statement of comprehensive income.

The IASB compared its tentative decisions with the requirements in IAS 1.

What did the IASB staff recommend?[2]

Statement of financial position	Statement of comprehensive income
All rights and obligations for all insurance contracts would be presented on a net basis. Insurance contracts and reinsurance contracts would be presented as separate line items.	The general requirements of IAS 1 are sufficient to specify the presentation requirements for insurance contracts in the statement of comprehensive income.

The IASB's 2010 ED proposed that an insurer would present all rights and obligations within each portfolio of insurance contracts as a single net liability or single net asset. The IASB's 2010 ED also proposed that an insurer would present portfolios of insurance contracts in a liability position separately from portfolios of insurance contracts in an asset position.

The IASB staff recommended requiring all rights and obligations arising from an insurance contract to be presented on a net basis in the statement of financial position. The proposal to separate portfolios in an asset position from portfolios in a liability position would remain. The IASB staff recommendations for presentation proposals were consistent with the presentation approach in the IASB's 2010 ED.

IAS 1 does not require insurance contracts or reinsurance contracts to be presented as separate line items in the statement of financial position. The IASB staff believed that insurance and reinsurance contracts were sufficiently distinct to warrant separate presentation in the statement of financial position from other assets and liabilities that an entity may hold. The IASB staff paper and IASB discussions relating to the separate presentation of reinsurance and insurance contracts in the statement of financial position did not distinguish between reinsurance contracts assumed and reinsurance contracts ceded.

IAS 1 requires an entity to present only one line item for revenue in the statement of comprehensive income. In addition, IAS 1 requires an entity to present additional line items in profit or loss and OCI when this is relevant to an understanding of the entity's financial performance. IAS 1 also requires an entity to disclose material income or expenses (and their nature) separately in the statements of profit or loss and OCI or in the notes. The IASB staff believed that those requirements were sufficient to specify the presentation requirements for the statement of comprehensive income for entities with insurance contracts.

The IASB staff considered requiring acquisition costs to be presented as a separate line item in the statement of comprehensive income. However, they commented that many users of financial statements were interested in acquisition costs to assess the amount of expected acquisition costs in relation to premiums written in the period, rather than their related amortisation. As

2 Staff Paper 3A *Presentation and disclosures: Proposed drafting* (pages 21-23) illustrates how the IASB's tentative decisions and recommendations for the presentation of insurance contracts might be applied.

a result, the staff believed that information about acquisition costs would be more clearly conveyed in the recommended disclosure of acquisition costs rather than in the statement of comprehensive income.

What did the IASB discuss?

The IASB members generally supported the staff recommendation. One IASB member thought that they should include the specific disclosure requirements for insurance contracts in the statement of comprehensive income in the insurance standard, rather than refer to IAS 1. Another IASB member proposed including a specific requirement to present the unbundled investment components of insurance contracts in a separate line item in the statement of financial position. Although investment components would fall under the financial instruments guidance rather than insurance, the IASB member thought that this should be explicitly addressed. The IASB staff noted that the general aggregation principle would not preclude separate presentation, and that IAS 1 requires separate presentation of financial liabilities in the statement of financial position.

In addition, one IASB member thought that the insurance receivables line item in the statement of financial position should clearly distinguish insurance receivables subject to credit risk – i.e. relating to past performance – from insurance receivables that are not subject to credit risk.

What did the IASB decide?

The IASB agreed with the IASB staff recommendations.

Additional disclosures would be required for contracts with cash flows contractually linked to underlying items, earned premium presentation and transition.

Disclosures for participating contracts (i.e. contracts with cash flows contractually linked to underlying items), earned premium presentation and transition

What's the issue?

At the September 2012 meeting, the IASB tentatively approved a proposed disclosure package. The IASB noted that additional disclosures might be appropriate based on later decisions. The IASB has subsequently reached decisions on the following topics, for which additional disclosures might be appropriate:

- participating contracts;
- measurement of premiums and claims in the statement of comprehensive income; and
- transition.

What did the IASB staff recommend?

Topic	IASB staff recommendations
Participating contracts[3]	An insurer would disclose the carrying amounts of participating insurance contracts. If an insurer measures those contracts on a basis other than fair value, and discloses the fair value of the underlying items, then it would disclose the extent to which the difference between the fair value and carrying value of underlying assets is passed to policyholders.

Topic	IASB staff recommendations
Earned premium presentation	**Reconciliation of contract balances[4]** For all insurance contracts, insurers would disclose a reconciliation from the opening to the closing balance of the aggregate carrying amount of insurance contract liabilities and insurance contract assets, showing separately: • the remaining balance of liabilities for remaining coverage but excluding any amounts attributable to losses on initial recognition (for the premium-allocation approach, this would be the unearned premium); • liabilities for remaining coverage attributable to losses on initial recognition and subsequent changes in estimates recognised immediately in profit or loss (for the premium-allocation approach, this would be the additional liabilities for onerous contracts); and • the liability for incurred claims.
	Explanation of recognised amounts For contracts accounted for using the building-block approach, an insurer would disaggregate the insurance contract revenue into the inputs to the measure of insurance contract revenue in the period – for example: • the probability-weighted claims, benefits and expenses expected to be incurred in the period; • an allocation of expected acquisition costs; • the risk margin relating to that period's coverage; and • the margin allocated to that period. **Activity measures** For contracts accounted for using the building-block approach, insurers would disclose the effect of contracts written in the period on the insurance contract liability, showing separately the effect on: • the expected present value of fulfilment cash outflows, showing separately the amount of acquisition costs; • the expected present value of future cash inflows; • the risk adjustment; and • the residual margin.

3 The staff recommendation was amended during the meeting to refer to "contracts with cash flows contractually linked to underlying items" rather than "participating contracts".

4 Staff Paper 3A *Presentation and disclosures: Proposed drafting* (pages 24-28) illustrates how the IASB's tentative decisions and recommendations with respect to reconciliation disclosures might be applied.

Topic	IASB staff recommendations
Transition	Disclosure of the current period and prior period line item amounts that would have been reported in accordance with previous accounting policies in IFRS 4 *Insurance Contracts* would not be required in the period in which the new insurance contracts standard is initially applied.

What did the IASB discuss?

The IASB members discussed whether the general disclosure requirements of the proposed insurance standard were too extensive. Some IASB members thought that further consideration should be given to the balance between:

- usefulness of the proposed disclosures; and
- feasibility of developing those disclosures.

In particular, some IASB members thought that the proposed disclosure disaggregating earned premium amounts may not provide useful information for financial statement users.

The original IASB staff recommendation relating to the disclosure for contracts with cash flows contractually linked to underlying items referred to participating contracts. One IASB member thought that the staff should clarify the wording, because some participating contracts may not qualify for the mirroring approach. As a result, the staff amended the recommendation, to clarify that the disclosure requirement would apply to all contracts with a contractual link to underlying items.

Another IASB member proposed adding a disclosure on premiums due, although this had not originally been recommended by the IASB staff. Premiums due is a commonly used metric in financial reporting for insurers today, and is used in analysing volume information. Nine IASB members voted in favour of adding this disclosure.

What did the IASB decide?

The IASB agreed with the IASB staff recommendations as amended to refer to contracts that have a contractual linkage to underlying items. Also, the IASB tentatively decided to require disclosure of a reconciliation between premium receipts and revenue in addition to the disclosures recommended by the staff.

CEDING COMMISSIONS (FASB ONLY)

Ceding commissions received from the reinsurer that are not contingent on claims or benefits experience would be treated as a reduction of premiums ceded.

Accounting for ceding commissions for reinsurance contracts

What's the issue?

Many reinsurance contracts include a ceding commission paid by the reinsurer to compensate the cedant for part or all of its acquisition and other administrative costs and operating expenses. Ceding commissions are negotiated by the parties to the reinsurance contract, and can be determined using flat rates or variable rates based on the profits of the underlying reinsured business. The proposals in the IASB's 2010 ED required that ceding commissions would be recognised as a reduction of the premiums ceded to the reinsurer. The proposals in the FASB's Discussion Paper (DP) did not address the presentation of ceding commissions. The IASB has not yet redeliberated the presentation of ceding commissions, and it is not clear whether it will be able to do so before releasing the next exposure draft.

In this month's meeting, the FASB discussed how ceding commissions for reinsured contracts should be presented by the cedant in the statement of comprehensive income. In previous meetings, the Boards tentatively decided that acquisition costs would be recognised in the statement of comprehensive income consistent with the proposed allocation of the residual/ single margin. In other words:

- *For the IASB:* in a way consistent with the pattern of transfer of services provided under the contract.
- *For the FASB:* when the insurer is released from exposure to risk as evidenced by a reduction in the variability of cash outflows.

What did the FASB staff recommend?

The FASB staff considered the following alternatives to account for ceding commissions.

Alternative 1	Reduce ceded premiums by the amount of the ceding commissions. This alternative is consistent with the proposals in the IASB's 2010 ED.
Alternative 2	Account for ceding commissions in the same manner as the cedant's acquisition costs – i.e. as a reduction of the single margin.
Alternative 3	Account for ceding commissions in the same manner as the cedant's acquisition costs to the extent that the commissions reimburse the cedant for its acquisition costs; any amounts in excess of acquisition costs would reduce ceded premiums.

The FASB staff recommended Alternative 3, because they believed that it effectively compared the cedant's cost of acquiring policies with the cost of reinsuring those policies. Under this approach, the component of ceding commissions, if any, that exceeds the actual acquisition and other costs incurred by the cedant – e.g. the embedded profit component – would be presented against premiums ceded. Although this alternative may present the economics of the reinsurance arrangement in a more transparent way, there would be some additional operational complexities associated with splitting and presenting the ceding commission in this manner – particularly for non-proportional reinsurance agreements that include a reimbursement for acquisition costs implicit in premiums charged.

What did the FASB discuss?

Although some FASB members agreed that the FASB staff recommendation had the best conceptual merit and would be consistent with the presentation decisions on the single margin, the majority of FASB members preferred Alternative 1 for its simplicity. In addition, FASB members expressed a desire to stay converged with the IASB on this topic.

What did the FASB decide?

The FASB decided that the cedant would treat ceding commissions that are not contingent on claims or benefits experience that it receives from the reinsurer as a reduction of the premium ceded to the reinsurer.

BUSINESS COMBINATIONS AND PORTFOLIO TRANSFERS (FASB ONLY)

At the acquisition date, an insurer would measure insurance liabilities assumed and assets acquired at fair value, and present the components separately.

An insurer would measure a portfolio of insurance contracts acquired in a portfolio transfer in accordance with the insurance standard.

Accounting for business combinations and portfolio transfers involving insurance contracts

What's the issue?

Under current US GAAP, an insurer acquiring another entity in a business combination measures identifiable liabilities assumed, assets acquired and equity instruments issued at their fair value at the acquisition date. The fair value of the acquired contracts is presented in two components:

- a liability measured in accordance with the insurer's existing accounting policies, based on the current assumptions as of the acquisition date (this would frequently be larger than the fair value of the acquired contracts); and
- an intangible asset or liability, representing the difference between the fair value of the acquired insurance contracts and the reported amount under the first component.

The proposals in the IASB's 2010 ED included specific guidance on the accounting for business combinations and portfolio transfers. Under those proposals, an insurer would measure a portfolio of insurance contracts acquired in a business combination at the higher of the fair value or the present value of the fulfilment cash flows. If the present value of the fulfilment cash flows is higher than the fair value, then the difference would result in an increase in the initial carrying amount of goodwill. If the fair value is higher than the present value of fulfilment cash flows, then the difference would be treated as the residual margin at initial recognition. As a result of measuring the contracts acquired in a business combination at the higher of fair value or the present value of fulfilment cash flows, no intangible assets would be recognised. The IASB has not yet redeliberated the topic of business combinations and portfolio transfers, and may not do so before releasing the next exposure draft.

The FASB's DP did not include proposals on accounting for business combinations and portfolio transfers. As a result, the FASB discussed the following related topics:

- accounting for business combinations involving insurance contracts;
- accounting for portfolio transfers involving insurance contracts;
- accounting for insurance contracts acquired through a combination of entities or businesses under common control; and
- transition guidance for acquisitions before the effective date.

What did the FASB staff recommend?

Topic	FASB staff recommendations
Accounting for business combinations	At the acquisition date, an insurer would measure insurance liabilities assumed and insurance assets acquired in a business combination at fair value as follows. a) **Expected net cash flows** would be measured in accordance with the insurer's accounting policies for insurance contracts that it issues using current assumptions. The discount rate determined at the acquisition date would be 'locked in', and the interest expense would be accreted and presented in the statement of comprehensive income. b) **The single margin** would be determined as the difference between the allocation of the purchase price to the insurance contract liability – i.e. the hypothetical premium – and the expected net cash flows determined in (a) above. c) **An implied acquisition cost** would be measured as the difference between the fair value and the sum of (a) and (b) above.

Topic	FASB staff recommendations
Accounting for portfolio transfers	An insurer would measure a portfolio of insurance contracts acquired in a portfolio transfer that does not meet the definition of a business combination following the guidance for reinsurance – i.e. in accordance with the insurance contract standard.
Accounting for insurance contracts acquired through a combination of entities or businesses under common control	An insurer would account for insurance contracts acquired through a business combination of entities or businesses under common control following the guidance in Subtopic 805-10 *Business Combinations*, which specifically addresses the accounting for such transactions.
Transition guidance for acquisitions before the effective date	To apply the proposals retrospectively to business combinations that took place before the effective date, an insurer would need to reallocate the components of the purchase price as of the acquisition date.

What did the FASB discuss?

The majority of the FASB discussion focused on the FASB staff recommendation on the accounting for business combinations. Several of the FASB members commented that the staff recommendation was over-engineered and should be simplified. The FASB staff responded that their proposal was aimed at isolating the components of the margin on the contracts acquired – including the implicit intangible asset for the value of the business acquired. The staff viewed the intangible asset as being more akin to an acquisition cost of the business combination, and thought that the separate presentation of this component would be consistent with other decisions made with respect to the presentation of the single margin.

Although some of the FASB members agreed that the staff recommendation may achieve consistency with decisions made on the presentation of the single margin, they did not think that this could justify the added complexity. They also noted that their decision on the presentation of ceding commissions was inconsistent with the proposals for the presentation of the single margin. The majority of the FASB members preferred a simplified approach that did not attempt to isolate any 'implicit acquisition costs' or an 'intangible asset'.

In addition, the FASB discussed transition guidance for acquisitions before the effective date. They agreed that insurers would need to reallocate the purchase price attributed to the insurance contracts liability using fair value. However, they were concerned about the operational complexity of the transition proposals, particularly with respect to determining fair values for assets and liabilities for past acquisitions.

What did the FASB decide?

Topic	FASB decision
Accounting for business combinations	At the acquisition date, an insurer would measure insurance liabilities assumed and assets acquired in a business combination at fair value as follows. a) **Expected net cash flows** would be measured in accordance with the insurer's accounting policies for insurance contracts that it issues using current assumptions. The discount rate determined at the acquisition date would be 'locked in', and the interest expense would be accreted and presented in the statement of comprehensive income. b) **Single margin** would be measured as the difference between the fair value of the insurance contract liability – i.e. the hypothetical premium – and the expected net cash flows determined in (a) above.
Accounting for portfolio transfers	Agreed with staff recommendation.
Accounting for insurance contracts acquired through a combination of entities or businesses under common control	Agreed with staff recommendation.
Transition guidance for acquisitions before the effective date	For business combinations before the effective date of the insurance contracts standard, applying the transition guidance will require insurers to reallocate the purchase price attributed to the insurance contracts liability to the components in accordance with the above decisions as of the acquisition date, using the fair value guidance in effect at that date.

PARTICIPATION FEATURES OF MUTUAL INSURANCE COMPANIES (FASB ONLY)

Measurements of discretionary contractual participation features would reflect expectations of payments on a going concern basis, resulting in equity (deficits) for mutual insurers.

Participation features of mutual insurance companies

What's the issue?

Mutual insurance companies are owned entirely by their policyholders, and their profits are paid to those policyholders in the form of dividend distributions or reduced future premiums. Insurance contracts issued by mutual insurers provide policyholders with the right to receive benefits that are guaranteed under the policy, and often the right to share in the experience of the insurer. These benefits are either:

- guaranteed by contractual, legal or regulatory requirements; or
- at the discretion of the insurer.

Under a mutual insurance structure, policyholders are eligible to receive an equitable portion of the company's divisible surplus as a dividend. When determining the dividend payout for an individual policy, many life insurers allocate divisible surplus to eligible participating policyholders; this is to reflect the portion that each policy is considered to have contributed to that surplus (the 'contribution principle'). The amount and/or timing of distributions relating to the performance of the insurer may be discretionary; and these distributions can be made only to those who were policyholders during the performance period or, based on the timing of distributions, may benefit future policyholders as well.

The FASB staff noted that respondents had requested further clarification as to how mutual insurers would apply the mirroring approach in the Boards' tentative proposals – in particular, relating to the treatment of dividend distributions. Under the tentative decisions to date, the measurement of cash flows arising under an insurance contract that depend wholly or partly on:

- the performance of specific assets or liabilities; or
- the performance of the insurer,

would reflect that dependence. If this concept is applied to insurance contracts issued by mutual insurers, then the dividends expected to be paid to both current and future policyholders could be interpreted as being included in the contract's cash flows (because the owners of a mutual insurance company are the policyholders), and hence included in the insurer's liability. Therefore, under this interpretation all of the accumulated profits would be considered to be expected contract cash flows, as part of the insurance liability; this would result in zero equity for the insurer.

The FASB discussed how the insurance liabilities of mutual insurance companies should be measured, and whether there is a remaining contractual or discretionary surplus after accounting for expected dividends and payments to policyholders.

What did the FASB staff recommend?

The staff paper discusses two views on how to treat the present value of expected future dividends.

View 1	The present value of expected future dividends will equal any apparent surplus earned in the year. As a result, a mutual insurer would have no equity.
View 2	The present value of expected future dividends will equal the amount that the mutual insurer expects to pay to policyholders after considering the amount of surplus it expects to retain. This would result in the mutual insurer retaining some portion of its performance; it would, therefore, have equity.

The FASB staff supported View 2, because they did not believe that recording the net performance of the insurer as part of the insurance contracts liability would provide useful information to users – in particular, with respect to underwriting results, capital, or financial strength.

The FASB staff recommended that, in measuring the insurance contracts liability, discretionary payments to current and future policyholders as a result of a contractual participation feature would be based on the insurer's expectation – which considers that the entity is a going concern. This would result in an amount of the net performance or notional surplus not being included in the measurement of the insurance contract liability – regardless of whether the insurer is structured as a mutual entity.

The FASB staff believed that the net performance or notional surplus not included in the measurement of the insurance contract liability of a mutual insurance company would be presented as equity.

What did the FASB discuss?

One FASB member asked whether the IASB supported View 1 or View 2. The IASB staff member in attendance commented that, based on the IASB's tentative decisions to date, they would support View 1. The FASB members were generally supportive of View 2, but were concerned with the wording of the staff recommendation. Some FASB members commented that the staff recommendation was proposing a unit of account at the entity level rather than the portfolio level. Others were concerned about making a specific exception to the definition of 'expected cash flows' for these specific entities. However, many FASB members agreed with the staff recommendation, and commented that further guidance would be added into the basis for conclusions regarding their considerations on expected cash flows.

What did the FASB decide?

The FASB tentatively decided to clarify that, on measuring the insurance contracts liability, discretionary payments as a result of a contractual participation feature would be based on the insurers' expectation of payments to policyholders (considering the entity as a going concern); this would result in equity (deficits) for mutual insurers.

FIELDWORK (IASB ONLY)

Fieldwork – Planning

What did the IASB staff propose?

Objective

In September 2012, the IASB announced its plans to issue a targeted re-exposure draft in the first half of 2013. This will include the full standard, but will only seek feedback on key changes from the proposals in the 2010 ED. The IASB staff proposed to undertake fieldwork as part of the re-exposure of the insurance contracts proposals. The objectives of the planned fieldwork are to:

- understand how the targeted proposals would be applied in practice;
- evaluate the costs and benefits of the targeted proposals; and
- assess how the proposed approach will help insurers to communicate with users of their financial statements.

Fieldwork participants would be asked to apply the proposed measurement model to a selected portfolio of insurance contracts over two annual periods.

Population of fieldwork participants

Fifteen entities agreed to participate in the previous round of the IASB's fieldwork. These entities will be invited to participate in this round of fieldwork. The IASB staff plans to work collaboratively with national standard setters and regional bodies, in identifying participants and conducting the fieldwork to avoid undue costs to preparers. Some regional bodies – e.g. the European Financial Reporting Advisory Group (EFRAG) – and interested national standard setters are also planning to conduct similar fieldwork during the comment period.

Fieldwork with users of financial statements

The IASB staff intends to hold workshops with users of financial statements to discuss the usefulness of the information produced by applying the targeted proposals. The content of the workshops will be tailored to users' particular interests by developing appropriate material and focusing the discussion on the usefulness of:

- the information produced by the treatment of participating contracts and unearned profit;
- the presentation, and related disclosures, of volume information in profit or loss and of the effects of changes of discount rates in OCI; and
- the disclosures proposed on transition.

Timing

The IASB staff plans to develop the fieldwork questionnaires when the forthcoming re-exposure draft is finalised. Fieldwork would take place during the comment period and the IASB staff would present a preliminary analysis of the results at the time of the comment letter analysis.

What did the IASB discuss?

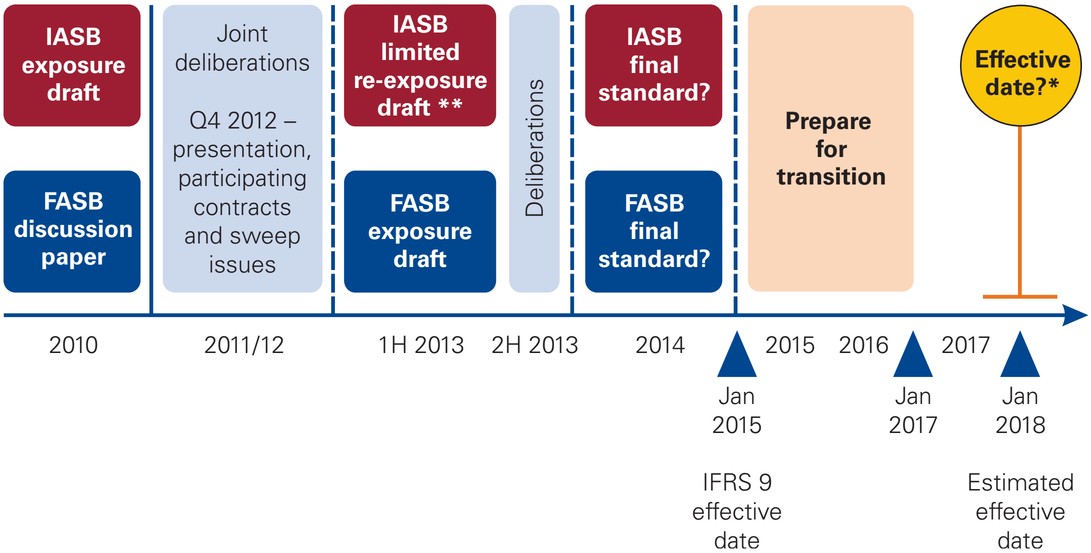
In general, the IASB agreed with the fieldwork approach proposed by the IASB staff, but had the following comments.

- One IASB member wanted to ensure that the population of fieldwork participants would be expanded compared to the last round of fieldwork.
- One IASB member highlighted the importance of requesting feedback on the disclosure requirements and transition. The IASB staff confirmed that both areas would be covered by the fieldwork.

- One IASB member proposed including a real case as an example to illustrate the effects of the proposed requirements. The preference was to do this before balloting the proposals (which is not expected for at least four months).

TIMELINE FOR COMPLETION

Based on the IASB's published workplan, a limited re-exposure document from the IASB is expected in the first half of 2013. We anticipate similar timing for the FASB's ED. A final standard is not anticipated before 2014.



* The effective date of the final IFRS is expected to be approximately three years after the standard is issued. The IASB staff currently estimates that the issue date will be mid to late 2014 – which, on this basis, would result in an expected effective date of annual reporting periods beginning on or after 1 January 2018.

** The limited re-exposure by the IASB is expected to include questions on the proposals relating to the following issues.

- The requirement that the cash flows used to measure participating contracts be based on the cash flows used to account for the underlying items – i.e. the mirroring approach.
- The requirement to present premiums in the statement of comprehensive income, including the requirements that:
  - the part of the premium that relates to investment components be excluded from the premium presented in the statement of comprehensive income; and
  - the premiums be allocated in the statement of comprehensive income on an earned basis.
- The requirement to use the residual margin to offset changes in estimates of future cash flows – i.e. unlocking of the residual margin.
- The requirement to present in OCI the effect of changes in the discount rate used to measure the insurance contract liability.
- The revised transition proposals.

Significant differences between the IASB and FASB models that are likely to be carried forward into the published proposals include:

- three vs four building blocks in measurement (the IASB's model includes a risk adjustment);
- unlocking vs locked-in margins;
- the consideration of successful vs unsuccessful sales efforts in acquisition costs; and
- the scope of investment contracts with a discretionary participation feature.

THE INSURANCE PROJECT TODAY

The current status of the insurance contracts project and key decisions made to date are outlined in the tables on the following pages. These decisions are compared with the proposals in the IASB's 2010 ED *Insurance Contracts* and the FASB's DP *Preliminary View on Insurance Contracts*.

The proposals indicated with **[!]** have had a significant change made. Key proposals with significant changes include:

- the scope of financial guarantees
- recognition
- contract boundaries
- acquisition costs
- the premium-allocation approach
- participating contracts
- reinsurance
- use of other comprehensive income
- presentation of the statement of comprehensive income
- transition.

The proposals indicated with **[X]** have had either a significant clarification made or an addition of implementation guidance. Key proposals affected include:

- future cash flows
- discount rate
- risk adjustment
- residual margin/single margin
- unbundling
- financial instruments with a DPF
- presentation of the statement of financial position.

Based on the deliberations to date, the areas of divergence between the Boards appear to be changing from the proposals in the ED and the DP. New areas of divergence include: the consideration of successful and unsuccessful sales efforts for acquisition costs; unlocking the residual margin compared with the locked-in single margin (other than for onerous contracts); whether to permit or require the premium-allocation approach; the definition of a portfolio; and the unit of account for releasing margins. The Boards converged on the treatment of non-discretionary performance-linked participation features and may have achieved a pragmatic solution to get consistency in eligibility for the premium-allocation approach.

Tentative decisions compared with key proposals in the 2010 ED

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Scope	**Definition of an insurance contract** The proposals would apply to all insurance contracts (including reinsurance contracts) that an entity issues and reinsurance contracts that an entity holds. An insurance contract is 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. This definition is consistent with the current definition of an insurance contract in IFRS 4 *Insurance Contracts*. The proposals include a requirement to consider the time value of money in assessing risk transfer and a test that insurance risk is not considered transferred unless there is a scenario that has commercial substance in which the present value of the net cash outflows of the insurer can exceed the present value of the premiums.	Proposals in ED have been tentatively confirmed. In addition, the Boards tentatively decided: • If a reinsurance contract does not transfer significant insurance risk because the assuming entity is not exposed to a loss, then the reinsurance contract is nevertheless deemed to transfer significant insurance risk if substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts is assumed by the reinsurer. • An insurer should assess the significance of insurance risk at the individual contract level. Contracts entered into simultaneously with a single counterparty for the same risk, or contracts that are otherwise interdependent that are entered into with the same or a related party, should be considered a single contract for the purpose of determining risk transfer.	• Some reinsurance contracts reinsure groups of direct contracts in the aggregate where the reinsurer assumes a stated percentage of premiums and claims on a defined group of contracts from the insurer – e.g. quota share contracts. In these cases, the individual direct contracts could each qualify as insurance contracts but, when they are combined as a group of contracts, it is often difficult to demonstrate a significant possibility of a loss on the group of contracts in aggregate. The revised wording would address this issue. • The guidance for interdependent contracts clarifies when an operating entity within a consolidated group transfers risk to an independent insurer and this insurer passes the risk back to the consolidated group. The arrangement is to be treated as one contract when determining significant risk transfer.
	Financial guarantees [!] The ED proposed to delete the separate definition of a financial guarantee contract contained in IFRS 4 and IAS 39 and the related measurement guidance in IAS 39. Financial guarantee contracts issued by an entity that meet the definition of an insurance contract would be within the scope of the IASB's final standard and FASB's ED on insurance contracts. The proposals indicated that credit-related contracts that pay out regardless of whether the counterparty holds the underlying debt instrument or that pay out on a change in credit rating or change in credit index would continue to be accounted for as derivatives under IAS 39.	**IASB** The IASB tentatively agreed with the staff's recommendation to *exclude* many financial guarantee contracts from the scope of the insurance contracts project subject to the existing option in IFRS 4 that: • permits an issuer of a financial guarantee contract to account for the contract as an insurance contract if it previously had asserted that it regards such contracts as insurance contracts and had accounted for them on that basis; and • requires an issuer to account for a financial guarantee contract in accordance with the financial instruments standards in all other cases.	• The Boards have commented that the treatment of economically similar instruments should be consistent and have recognised the existing inconsistency in the treatment of financial guarantees in both IFRS and US GAAP. Despite this view, they considered banking constituent feedback that the proposed insurance model would place more demand on systems and resources than accounting for such contracts as financial instruments.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Scope		**FASB** The FASB indicated a preference not to amend the current US GAAP guidance in Codification Topic 460 *Guarantees* that provides an exception to the recognition provisions for intragroup guarantees. The FASB tentatively decided that the proposed insurance contracts standard would apply to guarantee contracts within the scope of *FASB Accounting Standards Codification* Topic 944, Financial Services–Insurance, and would not apply to guarantee contracts within the scope of Topic 815, Derivatives and Hedging.	• The IASB tentatively agreed not to provide an exception for intragroup guarantees from the accounting for financial guarantee contracts consistent with the current provisions of IAS 39 and IFRS 4. • In November 2012, the FASB discussed the nature of financial guarantee contracts they wished to have subjected to the insurance contracts standard. Under current US GAAP, the nature of the guarantee, and type of entity issuing the guarantee, drives the accounting guidance applied. As a result, the accounting guidance for guarantees under US GAAP varies, with different measurement models being applied. The FASB decided to scope those contracts that are currently treated as insurance contracts under US GAAP into the insurance contracts proposals. However, they did not decide whether the wide range of guarantees currently in scope of Topic FASB ASC 460 that meet the definition of an insurance contract would be subject to the insurance contracts proposals. This is expected to be discussed in future meetings.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Scope	**In Scope – Financial instruments with a DPF (IASB) [X]** Financial instruments that contain a DPF would be within the scope of the final standard on insurance contracts. A 'DPF' is a contractual right to receive, as a supplement to guaranteed benefits, additional benefits: • that are likely to be a significant portion of the total contractual benefits; • whose amount or timing is contractually at the discretion of the issuer; and • that are contractually based on the following, provided that there also exist insurance contracts that provide similar contractual rights to participate in the performance of the same contracts, the same pool of assets or the profit or loss of the same company, fund or other entity: – the performance of a specified pool of insurance contracts or a specified type of insurance contract; – realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or – the profit or loss of the company, fund or other entity that issues the contract. The condition on the existence of insurance contracts with similar participating rights is an addition to the definition in IFRS 4. In measurement, the boundaries of financial instruments with a DPF are defined as the point at which the contract holder no longer has a contractual right to receive benefits arising from a DPF.	**IASB** The IASB tentatively decided that the forthcoming insurance contracts standard should apply to financial instruments with DPFs that are issued by insurers. It should not apply to any financial instruments issued by entities other than insurers. **FASB** The FASB tentatively decided that investment contracts with discretionary participation features should not be included within the scope of the insurance contracts standard unless the contract meets the definition of insurance. These excluded contracts would be scoped into the financial instruments standards. The IASB tentatively decided that the contract boundary for a financial instrument with a DPF is the point at which the contract no longer confers substantive rights on the contract holder. A contract no longer confers substantive rights on the contract holder when: • the contract holder no longer has a contractual right to receive benefits arising from the DPF in that contract; or • the premiums charged confer on the contract holder substantially the same benefits as those that are available, on the same terms, to those that are not yet contract holders. The IASB tentatively decided that an entity would recognise a financial instrument with a DPF only when the entity becomes a party to the contractual provisions of the instrument – e.g. when the entity is contractually obliged to deliver cash.	• The Boards elected to discuss this topic separately, in part because they have separate projects on financial instruments and the IASB will need to address these instruments specifically when it withdraws IFRS 4. • The ED scoped financial instruments with a DPF into the standard on insurance contracts. The ED included in the definition of a DPF a condition that required the existence of insurance contracts with similar participating rights in the same pool of assets. This resulted in a more restrictive scoping than what currently exists in IFRS 4. • The IASB members had mixed views on this topic. The majority of IASB members supported the proposal to include these financial instruments within the insurance standard because they are typically issued by insurers and managed with participating insurance contracts and would not be specifically addressed in the current and future financial instrument standards. • However, to avoid scope creep and opportunities that may arise to structure contracts artificially in order to qualify for insurance contract accounting, the Boards limited the scope to those financial instruments with a DPF issued by insurers. • Due to the limitation of scope to those financial instruments with a DPF issued by insurers, further consideration may be needed for application to reporting entities that include both banks and insurers.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Scope	**Out of scope – Financial instruments with DPF (FASB)** The FASB's approach would scope any financial instrument with a DPF into its proposed financial instruments standard.		
	Scope exceptions The proposals would apply to all insurance contracts except: • product warranties issued directly by a manufacturer, dealer or retailer; • residual value guarantees provided by a manufacturer, dealer or retailer, as well as a lessee's residual value guarantee embedded in a finance lease; • employers' assets and liabilities under employee benefit plans and retirement benefit obligations reported by defined benefit retirement plans; • contractual rights or contractual obligations that are contingent on future use of, or right to use, a non-financial item; • contingent consideration payable or receivable in a business combination; • fixed-fee service contracts that have as their primary purpose the provision of services, but that expose the service provider to risk because the level of service depends on an uncertain event; and • direct insurance contracts that an entity holds as a policyholder. This exemption does not apply to a reinsurance contract that an insurer holds.	Proposals in ED have been tentatively confirmed, with revisions to the exclusion criteria for fixed-fee contracts. If fixed-fee contracts meet all of the following criteria, then they would be excluded from the future insurance standard: • contracts are not priced based on an assessment of the risk associated with the individual customer; • contracts typically compensate customers by providing a service rather than cash payment; and • the type of risk transferred is primarily related to the use (or frequency) of services relative to the overall risk transferred. Contracts that did not meet all three criteria would be considered to be insurance contracts. **FASB only** The FASB decided that title insurance contracts should be in the scope of the insurance contracts standard, because they meet the tentative definition of an insurance contract. The FASB decided to exclude from the scope of the proposed insurance contracts standard charitable gift annuities, that possess a donation element and are issued by not-for-profit entities within the scope of FASB Accounting Standards Codification® Topic 958, *Not-for-Profit Entities*.	• The proposed scope exclusions are similar to those in IFRS 4 except that there are additional exclusions for some types of fixed-fee contracts. • Respondent feedback highlighted general confusion on how a service provider would determine whether the primary purpose of the fixed-fee contract was insurance or the provision of services, particularly as some would consider the provision of insurance to be a service. • Under the revised criteria for the scope exclusion for fixed-fee contracts, many roadside assistance programmes are expected to be out of scope.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Recognition	**Recognition [!]** Under the proposals, an insurer would recognise an insurance contract liability or an insurance contract asset when the insurer becomes a party to the insurance contract, which is the earlier of: • the date when the insurer is bound by the terms of the insurance contract; and • the date when the insurer is first exposed to risk under the contract. This is when the insurer can no longer withdraw from its obligation to provide insurance coverage to the policyholder for insured events and no longer has the right to re-assess the risk of the particular policyholder and, as a result, can no longer change the price to fully reflect that risk.	The Boards tentatively decided that insurance contract assets and liabilities should initially be recognised when the 'coverage' period begins. An onerous contract liability would be recognised in the pre-coverage period if the insurer becomes aware of onerous contracts during that period. The IASB tentatively decided that risk adjustment should be considered when identifying onerous contracts and that the measurement of an onerous contract liability should include a risk adjustment. The measurement of an identified onerous contract liability should be updated at the end of each reporting period.	• Changing the timing of recognition to the date on which coverage begins addresses the concerns regarding the accounting for contracts such as group medical plans in which the binding of the group contract may precede the determination of individual certificates of insurance under the group contract by a significant amount of time and quota share reinsurance contracts in which an insurer may be bound before the underlying direct contracts are underwritten. • There is an expectation that management would be aware when contracts become onerous in the pre-coverage period. • Further consideration may need to be given to contracts in which significant insurance-related services are provided long before coverage starts – e.g. in cases of some deferred annuities with guaranteed terms.
The measurement model	**Measurement model** The proposals contain one comprehensive measurement model for all types of insurance contracts issued by insurers, with a premium-allocation approach for some short-duration contracts. The measurement model is based on a 'fulfilment' objective that reflects the fact that an insurer generally expects to fulfill its liabilities over time by paying benefits and claims to policyholders as they become due, rather than transferring the liabilities to a third party. The model uses certain 'building blocks' in measuring that package of cash flows.	Proposals in ED have been tentatively confirmed.	• The measurement objective largely expresses a value rather than a cost notion. • There are significant differences between the measurement model in the ED and a measurement model based on fair value, including: exclusion of own credit risk; use of the entity's own inputs for non-financial market variables; elimination of day one gains and use of a residual margin; and the treatment of service margins.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
The measurement model	**Four building blocks (preference in IASB's ED)** At initial recognition, an insurer would measure a contract as the sum of: • the present value of the fulfilment cash flows, which would be made up of: – an explicit, unbiased and probability-weighted estimate – i.e. expected value, of the future cash outflows less the future cash inflows that will arise as the insurer fulfils the insurance contract; – a discount rate that adjusts those cash flows for the time value of money; and – a risk adjustment, being an explicit estimate of the effects of uncertainty about the amount and timing of those future cash flows; and • a residual margin that eliminates any gain at inception of the contract. If the initial measurement of an insurance contract results in a day one loss, then the insurer would recognise that day one loss in profit or loss. The present value of the fulfilment cash flows would be remeasured each reporting period.	Proposals in ED have been tentatively confirmed.	• The Boards will continue to explore whether the two approaches could be made more comparable through disclosure.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
The measurement model	**Three building blocks (preference in FASB's DP)** At initial recognition, an insurer would measure a contract as the sum of: • the present value of the fulfilment cash flows, which is made up of: – an explicit, unbiased and probability-weighted estimate – i.e. expected value – of the future cash outflows less the future cash inflows that will arise as the insurer fulfils the insurance contract; and – a discount rate that adjusts those cash flows for the time value of money; and • a single margin (previously referred to as a 'single margin') that eliminates any gain at inception of the contract. The FASB decided that the margin at inception (single margin) should be measured by reference to the premium so as to eliminate day one gains. If the initial measurement of an insurance contract results in a day one loss, then the insurer would recognise that day one loss in profit or loss. No separate risk adjustment would be included in determining whether there is a day one loss under a single margin approach. The present value of the fulfilment cash flows would be remeasured each reporting period.	Proposals in ED have been tentatively confirmed.	• In the FASB model, risk and uncertainty would be reflected implicitly through a single margin rather than in a risk adjustment. This alternative approach would not generally give rise to differences at inception in most cases because both the residual and the single margin would be calibrated to the consideration received for the insurance contract (premium received/receivable). However, differences would arise in subsequent measurement of the insurance contract. • The FASB chair indicated that the FASB may re-assess its decision on including a single margin in measurement in the context of a close-to-final model.

The measurement model	Key proposals in the 2010 ED	Update to proposals	KPMG observations
	Level of measurement Under the proposals, an insurer would measure the present value of the fulfilment cash flows and the risk adjustment at a portfolio level of aggregation for insurance contracts. A *portfolio of contracts* contains contracts that are subject to broadly similar risks and managed together as a single pool. This definition is consistent with IFRS 4.	The Boards tentatively confirmed that, in general, the final standard and ED will measure insurance contracts at the portfolio level. The IASB tentatively decided that: • A portfolio of insurance contracts should be defined as contracts that are: – subject to similar risks and priced similarly relative to the risk taken on; and – managed together as a single pool. • The unit of account used to *determine* the residual margin and perform the onerous test should be the portfolio.	• The IASB and FASB agreed on different definitions of a portfolio for measurement and a different unit of account for releasing the residual/single margin. • Both the IASB and FASB definitions are aimed at a similar objective and both of their decisions would limit the combining of loss- and profit-making contracts for the purpose of recognising the residual margin and onerous contracts. • The FASB definition does not include the criterion that risks are 'managed together' in the same pool because it was thought that the other criteria on similar risks covered this notion. In addition, the FASB's definition includes the criterion that contracts have a similar duration and similar expected patterns of release of the single margin. The FASB added these criteria because it thought that they were needed to ensure that the entire margin is run off by the end of the contract period.
	The residual margin would be determined by grouping insurance contracts by portfolio and, within the same portfolio, by date of inception of the contract and by the coverage period of the contract.	The unit of account used to *release* the residual margin should not be prescribed. However, the release of the residual margin should be performed in a manner consistent with the objective of releasing the residual margin over the coverage period to the period(s) in which the service is provided.	• Both the IASB and FASB would allow releasing the margin on a contract basis.
		The IASB tentatively decided that it would not specify further guidance on the unit of account for the risk adjustment.	

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
The measurement model		The FASB tentatively decided that: • a portfolio of insurance contracts should be defined as contracts that: – are subject to similar risks and priced similarly relative to the risk taken on; and – have a similar duration and similar expected patterns of release of the single margin. • the unit of account used to *determine* and *release* the single margin, and perform the onerous contract test, should be the portfolio.	
	Non-performance risk The present value of the fulfilment cash flows does not reflect the risk of non-performance by the insurer, either at initial recognition or subsequently.	Proposal in ED has been tentatively confirmed.	
Building blocks – Cash flows	**Contract boundaries [!]** For the purposes of measurement, the boundary of an insurance contract would be the point at which the insurer either: • would no longer be required to provide coverage; or • would have the right or ability to re-assess the risk of the particular policyholder and, as a result, could set a price that fully reflects that risk. Options, forwards and guarantees that do not relate to the existing coverage under the insurance contract would not be included within the boundary of that contract. Instead those features would be recognised and measured as new insurance contracts or other stand-alone instruments according to their nature.	The Boards tentatively decided that a contract renewal should be treated as a new contract when the insurer is no longer required to provide coverage; or the existing contract does not *confer any substantive rights* on the policyholder. All renewal rights should be considered in determining the contract boundary, whether they arise from a contract, from law or from regulation. A contract does not confer any substantive rights on the policyholder when the insurer has the right or the practical ability to re-assess the risk of the particular policyholder and, as a result, can set a price that fully reflects that risk.	• Many health insurers are not able to reprice on an individual contract basis, which may prevent them from meeting the second criterion in the ED proposals, extending the duration of contracts for which pricing is assessed only at a portfolio level or when regulation requires the insurer to renew and/or restricts the ability to reprice or both. Some health insurers currently account for such contracts using an unearned premium approach and they manage their pricing and account for these contracts as annual contracts. • Some health insurers were concerned that the contract boundary principle in the ED would limit their use of the premium-allocation approach for short-duration contracts and would require them to estimate cash flows that would extend to periods covered by renewal rights rather than the original contract term. The subsequent revisions made to the contract boundary principle were meant to address these concerns.

Building blocks – Cash flows

Key proposals in the 2010 ED	Update to proposals	KPMG observations
	An additional point affects contracts whose pricing of the premiums does not include risks related to future periods. The contract would not confer any substantive rights on the policyholder when the insurer has the right or the practical ability to re-assess the risk of the portfolio that the contract belongs to and, as a result, can set a price that fully reflects the risk of that portfolio.	• Some of the Board members were concerned about unintended consequences of applying the revised principle to term life insurance contracts that have traditionally been treated as long-duration contracts. • There was also a view expressed by some Board members that the modification should include a provision that if the contracts became onerous at a portfolio level, then an additional liability should be provided.
Future cash flows [X] The estimates of cash flows for a portfolio of contracts would include all *incremental* cash inflows (premium receipts) and outflows such as claims and benefits paid, claim handling expenses, persistency and surrender benefits, participation benefits, incremental acquisition costs and other costs of servicing the contract arising from the portfolio. These cash flows should: • be explicit – i.e. separate from estimates of discount rates that adjust those cash flows for the time value of money and the risk adjustment that adjusts these cash flows for uncertainty about timing and amount of future cash flows; • reflect the perspective of the insurer; • reflect all available information that relates to the cash flows of the contract including, but not limited to, industry data, historical data of the insurer's costs, and market inputs when those inputs are relevant to the cash flows of the contract;	The Boards tentatively decided that: • the measurement of insurance contracts should use the expected value of future cash flows rather than a single, most likely outcome; • the measurement model should be based on current estimates; and • the measurement of an insurance contract should include all cash flows that arise as the insurer fulfils the insurance contract. The Boards also tentatively decided to clarify that: • the measurement objective for expected value refers to the *mean* value, considering all relevant information; and • the implementation guidance would not require *all possible* scenarios to be identified and quantified provided the measure is consistent with the objective of determining expected value.	• Many respondents were concerned about the implications of the cash flow guidance on the measurement of property and casualty liabilities. They suggested that the cash flow guidance as drafted in the proposals may limit the use of traditional actuarial approaches for property and casualty liabilities and was worded in a manner that presumes stochastic modelling. The Boards have revised the guidance to make reference to the *mean value* or *estimate of the mean* as opposed to *all possible outcomes* to address these concerns. • To the extent that the costs included in measurement are expanded, this would have an impact on the amount of the residual or single margin recognised at inception and, if it is unlocked, its capacity to absorb the effects of changes in certain assumptions.

Building blocks – Cash flows	Key proposals in the 2010 ED	Update to proposals	KPMG observations
	• be current and consistent with market prices – i.e. use estimates of financial market variables such as interest rates; and • include only cash flows arising from existing contracts within the contracts' boundaries. For subsequent reporting periods, the measurement of cash flows would reflect updated estimates of the remaining future cash flows at the end of that reporting period.	The Boards tentatively decided to clarify that the *costs* included in the cash flows used in measuring a portfolio of insurance contracts should be all the *costs* that the insurer would incur in fulfilling contracts and that: • relate *directly* to the fulfilment of the contracts in the portfolio; • are attributable *directly* to contract activities and can be allocated to that portfolio; or • are chargeable separately to the policyholder under the terms of the contract. Costs that do not relate directly to the insurance contracts or contract activities should be excluded. These costs should be recognised as expenses in the period in which they are incurred. The Boards confirmed that insurers should measure the insurance contract liability taking into account estimates of expected cash flows at the end of the reporting period. The Boards tentatively decided to provide application guidance to clarify that an insured event (e.g. an infrequent, high-severity event such as a hurricane) that was impending at the end of the reporting period does not constitute evidence of a condition that existed at the end of the reporting period when it happens or does not happen after that date. Consequently, such an event is a non-adjusting event, to which IAS 10 *Events after the Reporting Period* applies, and a non-recognised event to which ASC section 855-10-25 applies. Insurers should account for contract riders that are part of the insurance contract at inception as part of the contractual terms of the contract. The general decisions on unbundling and disaggregation should apply to contract riders.	

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Building blocks – Cash flows	**Acquisition costs [!]** Under the proposals, incremental acquisition costs – i.e. costs of selling, underwriting and initiating an insurance contract that would not have been incurred if the insurer had not issued that particular contract – would be included in the present value of the fulfilment cash flows of a contract. All other acquisition costs would be expensed when incurred in profit or loss. Unlike other cash flows, the determination as to whether acquisition costs are incremental and therefore included in fulfilment cash flows would be considered on an individual contract basis rather than at a portfolio level.	The Boards tentatively decided that the acquisition costs to be included in the initial measurement of a portfolio of insurance contracts should be all the direct costs that the insurer will incur in acquiring the contracts in the portfolio, and should exclude indirect costs such as: • software dedicated to contract acquisition • equipment maintenance and depreciation • agent and sales staff recruitment and training • administration • rent and occupancy • utilities • other general overheads • advertising. In addition: • the IASB tentatively decided that no distinction should be made between successful acquisition efforts and unsuccessful efforts; and • the FASB tentatively decided that the acquisition costs included in the cash flows of insurance contracts will be limited to those costs related to successful acquisition efforts. • The FASB decided that direct-response advertising should be expensed as incurred consistent with other forms of advertising. • The Boards tentatively decided that acquisition costs incurred before a contract's coverage period begins should be recognised as part of the insurance contracts liability for the portfolio of contracts, where the contract will be recognised once the coverage period begins.	• Application guidance is expected, illustrating further the types of acquisition costs that would be included in the initial measurement of the cash flows of insurance contracts. • The Boards are at opposite ends of the spectrum regarding the inclusion of unsuccessful efforts in the definition of acquisition costs. • The FASB agreed unanimously that only acquisition costs associated with successful contract acquisition efforts should be included in the cash flows used to determine the initial measurement of a portfolio of insurance contracts. This decision is consistent with FASB Accounting Standards Update No. 2010 26 *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*. • The IASB staff believes that measurement should include the costs of both successful and unsuccessful efforts to ensure that the same liability would be recognised regardless of whether insurers perform contract acquisition services in-house, source externally through external agents or use direct response advertising.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Building blocks – Discount rate	**Discount rate [X]** Under the proposals, an insurer would adjust the future cash flows for the time value of money using a discount rate that is consistent with cash flows whose characteristics reflect those of the insurance contract liability – e.g. timing, currency, liquidity. The discount rate would also exclude any factors that influence the observed rates but would not be relevant to the insurance contract liability – i.e. risks present in the instrument for which market prices are observed that are not relevant to the insurance contract liability. If the cash flows of a contract do not depend on the performance of specific assets, then the discount rate would reflect the yield curve for instruments with no or negligible credit risk, adjusted for differences in liquidity between those instruments and the contract.	Proposals in ED have been tentatively confirmed. The Boards tentatively decided to clarify that the same objective applies to the discount rate used to measure both participating and non-participating contracts. They plan to provide guidance that, to the extent that the amount, timing or uncertainty of the cash flows arising from an insurance contract depends wholly or partly on the performance of assets – i.e. participating contracts, the insurer should measure that portion of the cash flows using a discount rate that reflects that dependence. In some circumstances it may be appropriate to use a replicating portfolio approach, although this technique would not be *required* in those circumstances. The Boards tentatively decided that all insurance contracts are measured using a discount rate that is updated each reporting period. The Boards tentatively agreed: • not to discount short-tail post-claim liabilities when the effect is immaterial; and • to require discounting for all non-life long-tail post-claim liabilities. The Boards tentatively decided to provide a practical expedient from discounting incurred claims that are *expected* to be paid within 12 months of the insured event, *unless facts and circumstances* indicate that the payment will no longer occur within 12 months.	• The use of various methods for developing discount rates may result in diversity in discount rates used by insurers for similar products. Further details of the disclosure requirements, such as yield curves used in measuring cash flows for each major currency, are expected to be discussed when the Boards deliberate disclosures.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Building blocks – Discount rate	**N/A** The ED and DP did not provide additional guidance on the approaches used for the discount rate.	**Discount rate guidance** The Boards tentatively decided to provide guidance regarding matters to be considered in determining the discount rate and clarified that the discount rate should reflect only the effect of risks and uncertainties that are not reflected in other building blocks in the measurement of the liability. The Boards tentatively decided that in applying the top-down approach to determining the discount rate: • an appropriate yield curve should be determined by an insurer based on current market information and reflecting current market returns either for the actual portfolio of assets the insurer holds or for a reference portfolio of assets with similar characteristics to those of the insurance contract liability; • the insurer should use an estimate that is consistent with the IASB's guidance on fair value measurement, such as Level 3 fair values, if there are no observable market prices for some points on that yield curve; • cash flows of the instruments should be adjusted in two ways so that they mirror the characteristics of the cash flows of the insurance contract liability: – Type I, which adjust for differences between the timing of the cash flows to ensure that the assets in the portfolio (actual or reference) selected as a starting point are matched to the duration of the liability cash flows; and – Type II, which adjust for risks inherent in the assets that are not inherent in the liability. If there is no observable market risk premium, then the entity uses an appropriate technique to determine that the market risk premium is consistent with the estimate; and	• Use of a top-down approach may be equally and in some cases more difficult than using a bottom-up approach due to the complexities in estimating a market risk premium and determining the split between a market risk premium and an adjustment for liquidity in a given asset rate. In subsequent measurement, there may also be challenges in isolating the changes in spread as a result of market risk vs liquidity premiums. • Many respondents were concerned about the practical difficulties of developing a discount rate using a bottom-up approach of determining the risk-free rate plus an adjustment for illiquidity. The Boards clarified that other approaches may be utilised, such as top-down approaches that calculate a discount rate by starting with an asset rate adjusted for various items that would not be reflective of the characteristics of the liability, such as risk premiums for expected and unexpected credit losses. This clarification enables insurers to use a variety of methods in determining the discount rate as long as these methods meet the overall objective.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Building blocks – Discount rate		• an insurer using a top-down approach need not make adjustments for remaining differences between the liquidity inherent in the liability cash flows and the liquidity inherent in the asset cash flows.	
Building blocks – Risk adjustment	**Risk adjustment [X]** **Incorporating a risk adjustment (preference in the IASB's ED)** The risk adjustment, determined at the level of a portfolio of insurance contracts, would reflect the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected. Notwithstanding the general requirement for separate estimates of future cash flows, discount rates and a risk adjustment, the ED indicated that a replicating asset approach based on the fair value of the replicating asset may be appropriate. The risk adjustment would be remeasured each reporting period. Changes in measurement of the risk adjustment would be recognised in profit or loss. The ED included application guidance that discusses the techniques for estimating the risk adjustment. These techniques would be limited to three approaches: confidence level, conditional tail expectation (CTE) and cost of capital.	The IASB tentatively decided that the measurement of an insurance contract should contain an explicit risk adjustment. The IASB tentatively decided that the risk adjustment should be the compensation the insurer requires for bearing the uncertainty inherent in the cash flows that arise as the insurer fulfils the insurance contract. In addition, the IASB tentatively agreed that the application guidance should clarify the following. • 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 and (2) fulfilling a fixed liability that has the same expected present value of cash flows as the insurance contract. • In estimating the risk adjustment, the insurer should consider both favourable and unfavourable outcomes in a way that reflects its degree of risk aversion. The Boards noted that a risk-averse insurer would place more weight on unfavourable outcomes than on favourable ones. The IASB tentatively agreed not to limit the range of available techniques and related inputs to the risk adjustment. It also decided to retain as examples the three techniques proposed in the ED (confidence level, CTE and cost of capital), together with the related application guidance.	• Several IASB members focused on the need to have a clear objective if the techniques for estimating a risk adjustment will not be limited. • Some Board members commented that if a clear objective is defined, then insurers will use the most appropriate techniques to calculate the risk adjustment. There will be subjectivity in implementing the risk adjustment, but these differences can be shown through disclosures. • The Boards held a number of educational sessions on the risk adjustment during March. Speakers included representatives from Swiss Re, Munich Re and Lonergan Edward & Associates. Their presentations focused on the methods for determining risk adjustments and practical implementation issues associated with an insurance measurement model that includes a risk adjustment. • Although the IASB decided not to limit permitted techniques, it retained the confidence level disclosure, which requires the insurer to translate its risk adjustments into a confidence level disclosure, even if it has used another measurement technique. This additional disclosure requirement is intended to enhance comparability among insurers. Requiring this disclosure may also motivate insurers to use confidence level techniques for the measurement of the risk adjustment.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Building blocks – Risk adjustment			• The proposals require risk adjustments to be determined at the portfolio level. This restricts the measurement of the risk adjustment to reflect only risk diversification within a portfolio. Many respondents to the ED/DP commented that diversification benefits should not be restricted to the portfolio because it would not economically represent how an insurer often prices risks that it considers to be a diversification of risks between portfolios. These respondents were concerned that the proposals would potentially result in overstated risk adjustments as well as losses at inception for some portfolios that are expected to be profitable. The IASB tentatively decided not to prescribe the unit of account for measurement of the risk adjustment thereby removing this previous restriction.
	No risk adjustment (preference in the FASB's DP) The FASB tentatively decided to eliminate an explicit risk adjustment from the measurement approach.	The FASB tentatively confirmed that a risk adjustment would not be included in measurement.	
Building blocks – Margins	**Residual margin (preference in the IASB's ED) [X]** A residual margin would arise at inception when the present value of the fulfilment cash flows is less than zero. If the present value of the fulfilment cash flows at inception is positive – i.e. the expected present value of cash outflows plus the risk adjustment is greater than the expected present value of cash inflows – then this amount would be recognised immediately as a loss in profit or loss. The residual margin would be determined on initial recognition at a portfolio level for contracts with a similar inception date and coverage period. This residual margin amount would be locked in at inception.	The IASB confirmed the proposal in the ED that a residual margin would arise at inception when the present value of the fulfilment cash flows is less than zero. The IASB tentatively decided that the residual margin should not be locked in at inception. The IASB tentatively decided that an insurer should: • adjust the residual margin for favourable and unfavourable changes in the estimates of future cash flows used to measure the insurance liability, with experience adjustments recognised in profit or loss;	• The residual margin would be adjusted for changes in estimates of future cash flows prospectively rather than retrospectively due to concerns about the operational practicality in applying a full retrospective approach. • In adjusting the residual margin, an insurer would need to track changes in estimates of future cash flows at a sufficiently granular level of detail, as well as aggregating on a portfolio level. Part of the rationale for not unlocking changes in financial variables is to avoid creating an accounting mismatch with financial assets classified and measured at fair value.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Building blocks – Margins	The residual margin would be recognised in profit or loss over the coverage period in a systematic way that best reflects the exposure from providing insurance coverage, either on the basis of the passage of time or on the basis of the expected timing of incurred claims and benefits if that pattern differs significantly from the passage of time.	• not limit increases in the residual margin; • recognise changes in the risk adjustment in profit or loss in the period of the change; and • make any adjustments to the residual margin prospectively. In addition, the IASB tentatively decided that: • the residual margin should not be negative; and • insurers should allocate the residual margin over the coverage period on a systematic basis that is consistent with the pattern of transfer of services provided under the contract. The IASB confirmed that: • an insurer should accrete interest on the residual margin; and • the rate used for the accretion of interest should be the discount rate of the liability determined at initial recognition – i.e. a locked-in rate. The IASB also tentatively decided it would not provide additional guidance on estimating the discount rate that related to the accretion of interest on the residual margin.	• The allocation of the residual margin is based on the pattern of transfer of the services provided (e.g. insurance coverage and auxiliary services such as asset management services). A profit driver would be selected at inception based on the type of service provided including expected claims, expected premiums for yearly renewable insurance in which premiums increase each year with age, expected annuity payments, or assets under management. The residual margin would then be translated into a percentage of the chosen profit driver. The residual margin released each period would be that percentage times the actual cash flows for that period. The staff indicated that this proposed approach is closely aligned with the Australian margin on services approach. • Many Board members thought that if the residual margin were to be adjusted for future changes in estimates, then these changes should be explicitly disclosed on the face of the statement of comprehensive income (rather than netted in the change in the residual margin) to show the inherent uncertainty/volatility in insurance results. • An insurer determines the residual margin upon entering into the contract by taking into account the time value of money. By not unlocking the residual margin for changes in discount rate, the residual margin implicitly reflects time value as estimated on day one and hence requires accretion. Using a locked-in discount rate avoids some of the problems associated with using a current rate, such as recognising amounts in OCI that do not reverse to zero. • Accreting interest on the residual margin using the rate at the inception of the contract is consistent with the treatment of prepayments in ED/2011/6 *Revenue from Contracts with Customers*.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Building blocks – Margins	**Single margin (preference in the FASB's DP) [X]** A single margin would arise at inception when the expected present value of the future cash outflows less future cash inflows is less than zero. If the expected present value of cash outflows is greater than the future cash inflows, then this amount would be recognised immediately as a loss in profit or loss. The single margin would not be remeasured to reflect increases in risk, uncertainty or changes in the price for bearing risk. The single margin would be released over both the coverage period (during which the insurer provides insurance coverage) and the benefit paying period (during which the insurer is exposed to uncertainty of ultimate cash outflows). The single margin would be amortised using two factors: • the insurer's exposure from the provision of insurance coverage; and • the insurer's exposure from uncertainties related to future cash flows. The specific method to determine current period amortisation could be characterised as a percentage of completion method (reflecting the pattern of the decline of risk) calculated as follows. $\frac{\text{(Premium allocated to current period + current period claims and benefits)}}{\text{(Total contract premium + total claims and benefits)}}$	The FASB tentatively decided the following. • An insurance contract measurement model should use a single margin approach that recognises 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 previously recognised margin. The FASB tentatively decided that an insurer is released from risk for the purpose of recognising the single margin in profit as follows. • If the variability of the cash flows of a specified uncertain future event is primarily due to the timing of that event, then an insurer is released from risk on the basis of reduced uncertainty in the timing of the specified event. • If the variability of the cash flows of a specified uncertain future event is primarily due to the frequency and severity of that event, then an insurer is released from risk as variability in the cash flows is reduced as information about expected cash flows becomes more known throughout the life cycle of the contract. The FASB tentatively decided to include the following implementation guidance.	• The formulaic approach to amortisation in the proposals was removed in favour of an approach based on reduction in variability of cash flows. • A significant difference between the IASB and FASB measurement approaches is the remeasurement of the risk adjustment and residual margin under the IASB's model compared with the FASB's model, which runs off a locked-in single margin at inception. • Some Board members have commented that although there is a significant amount of subjectivity in developing a risk adjustment, the run-off of a single margin based on the release from risk may be equally subjective. • Many of the Board members did not agree with adjusting the residual margin for changes in the discount rate because this was perceived to create accounting mismatches – e.g. when assets are carried at fair value through profit or loss. Some Board members commented that using remeasurement of the residual margin as an approach to reducing volatility due to discount rate movements may not be effective because changes in financial assumptions could eliminate the entire residual margin. • The FASB's decision did not address the specific methods for how an insurer would determine when it is released from its exposure to risk. Judgement will be needed to determine the release from risk based on the specific facts and circumstances. This guidance may be further revised in drafting. The FASB also agreed to consider the inclusion of an onerous contract test as part of the model.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Building blocks – Margins		The FASB made the following decisions: • The single margin should not be unlocked for changes in actual or expected cash flows and, instead, such changes should be reported in profit and loss immediately. • If an insurer determines that a portfolio of contracts is onerous, then an additional liability should be recognised with a corresponding offset to eliminate any remaining margin. This liability is measured as: – the present value of future payments for benefits and related settlement and maintenance costs; less – the present value of future gross premiums; less – the insurance contract liability. • If the additional liability exceeds the remaining margin, then an insurer would recognise an expense for the excess amount. The write-off of the single margin on contracts deemed onerous may not be reversed in future periods.	

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Building blocks – Margins		An insurer should consider specific facts and circumstances to qualitatively determine whether a reduction in the variability of cash flows has occurred to the extent that the insurer is released from risk. Those facts and circumstances should include the following: • the entity's relative experience with the types of contracts; • the entity's past experience in estimating expected cash flows; • inherent difficulties in estimating expected cash flows; • the relative homogeneity of the portfolio and within the portfolio; and • past experience not being representative of future results. A reduction in the variability of the cash flows such that an insurer is released from risk is a matter of judgement and should be based on facts and circumstances unique to the entity and the nature of the insurance contracts. Different insurers may define a reduction in variability of cash flows in different ways, as further information is obtained about the expected cash flows during the life cycle of an insurance portfolio. An insurer should disclose the methodology used to calculate the profit realisation of the single margin.	• As part of the FASB's implementation guidance, there will be additional guidance on the points in the life cycle that should be considered for examination and assessment of a 'reduction in the variability of cash flows'. This includes: – when an insurer incurs a claim but that claim has not yet been reported; – when a claim has been reported; – as additional information becomes known; – the point at which the parties to the contract have agreed on a settlement amount; and – the point at which the claim has been paid.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Premium-allocation approach	**Premium-allocation approach (previously referred to as the 'modified measurement approach') [!]** The proposals contain a premium-allocation approach for pre-claim liabilities of short-duration contracts. This model is intended to be a proxy for the building-block measurement model in the pre-claims period. Under the proposals, 'short-duration' contracts are insurance contracts with a coverage period of approximately 12 months or less that do not contain any embedded options or derivatives that significantly affect the variability of cash flows.	**IASB** Contracts should be eligible if the premium-allocation approach would produce measurements that are a reasonable approximation of those that would be produced by the building-block approach. Application guidance would be added consistent with FASB eligibility criteria. Insurers would be permitted rather than required to apply the premium-allocation approach. **FASB** The building-block approach should be applied rather than the premium-allocation approach if, at the contract inception date, either of the following conditions is met: • it is likely that, during the period before a claim is incurred, there will be a significant change in the expectations of net cash flows required to fulfil the contract; or • significant judgement is required to allocate the premium to the insurer's obligation to each reporting period. This may be the case if, for example, significant uncertainty exists about the premium that would reflect the exposure and risk that the insurer has for each reporting period, or the length of the coverage period. Insurers would be *required* to apply the premium-allocation approach.	• The Boards disagree about whether the premium-allocation approach is a proxy for the building-block approach or is a separate accounting model. – Under the FASB approach, the incurred claims liability would not include a single margin. Under the IASB approach, the measurement of the claims liability would include a risk adjustment. In addition, based on the proposals in the ED, under the building-block approach, the cash inflows and outflows are presented net and under the premium-allocation approach there is a separate presentation of the premiums written and not yet collected and the liability for remaining coverage, which is also shown gross from the liability for incurred claims. – For these reasons, FASB members felt that the premium-allocation approach constituted a separate model and should be required rather than permitted. • Both Boards would allow contracts with a coverage period of one year or less to qualify automatically for the premium-allocation approach. • It is expected that both approaches will capture substantially all, if not all, of the same contracts. As a result, significant differences in eligibility under the approaches are not expected. • There was some concern raised on how certain catastrophe coverages would be scoped – i.e. under the building-block or the premium-allocation approach – applying either the IASB or FASB eligibility requirements. Some members of the Boards suggested further guidance was needed in this area.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Premium-allocation approach	Under this measurement approach, an insurer would measure its pre-claims obligation at inception as premiums received at initial recognition plus the expected present value of future premiums within the boundary of the contract less incremental acquisition costs.	The Boards tentatively decided that discounting and interest accretion to reflect the time value of money should be required in measuring the liability for remaining coverage for contracts (including the pre-claims obligation) that have a significant financing component, as defined according to the characteristics of a significant financing component under the revenue recognition proposals. However, as a practical expedient, insurers need not apply discounting or interest accretion in measuring the liability for remaining coverage if the insurer expects at contract inception that the period of time between payment by the policyholder of all or substantially all of the premium and the satisfaction of the insurer's corresponding obligation to provide insurance coverage will be one year or less. The Boards tentatively decided that the discount rate at inception of the contract would be used to measure the liability for remaining coverage, when it is accreted or discounted. The Boards also tentatively decided that: • the measurement of acquisition costs should include directly attributable costs (for the FASB limited to successful acquisition efforts only) – this is consistent with the decision made for the building-block approach; and • insurers should be permitted to recognise all acquisition costs as an expense if the contract coverage period is one year or less. The Boards agreed to explore an approach in which acquisition costs would be netted against the single/residual margin when applying the building-block approach, and netted against the liability for remaining coverage. That amount could be presented separately from the present value of expected cash flows (plus a risk margin for the IASB).	• The Boards have expressed a desire to keep the premium-allocation approach as consistent as possible with the revenue recognition proposals. As such, the discounting proposals have been revised, with practical expedients added to align them closer with the revenue recognition project.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Premium-allocation approach	This pre-claims obligation would be reduced over the coverage period in a systematic way that best reflects the exposure from providing insurance coverage, either on the basis of the passage of time or on the basis of the expected timing of incurred claims and benefits if this pattern differs significantly from the passage of time.	Proposal in ED has been confirmed.	
	The pre-claims liability is the pre-claims obligation less the present value of future premiums within the boundary of the contract. The insurer would also accrete interest on the carrying amount of the pre-claims liabilities. If a contract is onerous based on a comparison of the expected present value of the fulfilment cash flows for future claims and the pre-claim obligations for contracts in a portfolio with similar inception dates, then the excess of the present value of the fulfilment cash flows over the carrying amount of the pre-claims obligation would be recognised as an additional liability and expense.	The Boards tentatively decided that an onerous contract test should be performed if facts and circumstances have changed, indicating that a contract has become onerous in the pre-claims period. The Boards tentatively decided that: • an insurance contract is onerous if the expected present value of the future cash outflows from that contract (plus the risk adjustment for the IASB) exceeds: – the expected present value of the future cash inflows from that contract (for the pre-coverage period); and – the carrying amount of the liability for the remaining coverage (for the premium-allocation approach); and • insurers should perform an onerous contract test when facts and circumstances indicate that the contract might be onerous. The Boards also tentatively decided that they would provide application guidance about when a contract is onerous. The Boards tentatively decided that if an insurer elects not to discount the liability for incurred claims that are expected to be paid within 12 months, then the insurer should use an undiscounted basis in identifying whether contracts are onerous and in measuring the liability for onerous contracts. The measurement of an identified onerous contract liability should be updated at the end of each reporting period.	• The revenue recognition model defines acquisition costs as incremental costs that the entity would not have incurred if the contract had not been obtained. This would be a different approach from an insurance contract model in which direct costs associated with successful contract acquisition would be included in the measurement.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Premium-allocation approach		The Boards confirmed that insurers should measure the onerous contract liability taking into account estimates of expected cash flows at the end of the reporting period. The Boards tentatively decided to provide application guidance to clarify that an insured event (e.g. an infrequent, high-severity event such as a hurricane) that was impending at the end of the reporting period does not constitute evidence of a condition that existed at the end of the reporting period when it happens or does not happen after that date. Consequently, such an event is a non-adjusting event, to which IAS 10 *Events after the Reporting Period* applies, and a non-recognised event to which ASC section 855-10-25 applies.	
	Liabilities for claims incurred would be measured at the present value of fulfilment cash flows in line with the general measurement model.	The IASB tentatively decided the liability for incurred claims is measured using the risk-adjusted expected present value of fulfilment cash flows. The FASB tentatively decided that the liability for incurred claims would be measured as the present value of unbiased expected cash flows (statistical mean) without a single margin. The discount rate would reflect the characteristics of the liability when the effect of discounting is material. The Boards tentatively agreed: • not to discount short-tail post-claim liabilities when the effect is immaterial; and • to require discounting for all non-life long-tail post-claim liabilities. The Boards tentatively decided to provide a practical expedient from discounting incurred claims that are expected to be paid within 12 months of the insured event, unless facts and circumstances indicate that the payment will no longer happen within 12 months. The Boards tentatively decided that, when the liability for incurred claims is discounted, an insurer would use the rate at the inception of the contract to determine the amount of the claims and interest expense in profit or loss. The rate would subsequently be locked in.	• Under the IASB approach, a risk adjustment would be included in the measurement of the claims obligation for incurred claims, which would be remeasured each reporting period. Under the FASB's decision, there is no margin included in this measurement. This difference will lead to higher liabilities under the IASB's approach, particularly in the earlier stages of the claims settlement period. • The treatment of incurred claims under the FASB's proposed approach varies significantly from current US GAAP. Under US GAAP, claim liabilities may or may not be recorded at the statistical mean of the cash outflows. Other qualitative factors that affect the range or variability of outcomes may be considered in developing an insurer's best estimate of loss reserves. In addition, claim liabilities under US GAAP are frequently not discounted.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Participating contracts	**Participating contracts [!]** Payments to policyholders arising from participating features in insurance contracts are cash flows from the contract like any other and would be included in the expected present value of fulfilment cash flows in measuring an insurance contract.	**IASB** The IASB tentatively decided the following for participating insurance contracts. • The measurement of the fulfilment cash flows related to the policyholder's participation should be based on the measurement in the IFRS financial statements of the underlying items in which the policyholder participates. Such items could be assets and liabilities, the performance of an underlying pool of insurance contracts or the performance of the entity. • An insurer should reflect, using a current measurement basis, any asymmetric risk-sharing between the insurer and policyholders in the contractually linked items arising from a minimum guarantee. • An insurer should present changes in the insurance contract liability in the statement of comprehensive income consistently with the presentation of changes in the linked items – i.e. in profit or loss, or in other comprehensive income. • The same measurement approach should apply to both unit-linked and participating contracts. • It will retain an *option* to measure the share of interest in owner-occupied property and an insurer's own shares underlying unit-linked contracts that relate to the contract holders at fair value through profit or loss.	• The revised proposals would mean that insurers with participating contracts backed by fixed interest securities may be able to measure the assets at amortised cost or at fair value through other comprehensive income under the proposals for financial instruments and measure the liabilities on the same basis. This approach would allow insurers with participating contracts to avoid volatility in the statement of comprehensive income that would arise from measuring the assets at fair value through profit or loss. • The asymmetric risk-sharing between the insurer and the policyholder could impact the measurement of the cash flows and the risk adjustment. • The FASB believed that insurers should focus on liability, not equity – i.e. insurers should not begin by valuing the surplus. It commented that the liability should be valued on the basis of the fulfilment cash flows that result from the contractual agreement with the policyholder. Then after the liability is properly valued, the liability would be adjusted for an accounting mismatch. • Many of the Board members supported additional disclosures, including the fair value of assets measured at amortised cost and clarification of the extent to which the difference belongs to policyholders.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Participating contracts		**FASB** The FASB tentatively decided the following, as it relates to the measurement of insurance contract fulfilment cash flows and to the measurement of the obligation from any nondiscretionary performance-linked participating features that both contractually depend wholly or partly on the performance of other assets or liabilities recognised on the insurer's statement of financial position, or the performance of the insurer itself, and are a component of an insurance contract's obligations. • The obligation due to the performance-linked participating features should be measured based on an insurer's current liability (that is, the contractual obligation incurred to date) adjusted to eliminate accounting mismatches that reflect timing differences between the current liability and the measurement of the underlying items in the US GAAP statement of financial position that are expected to reverse within the boundary of the insurance contract. An underlying item is defined as the asset or liability (or group of assets or liabilities) on which the cash flows resulting from the participation feature depend. • Any changes in the liability for the performance-linked participating features should be presented in the same way within the statement of comprehensive income (that is, consistently in net income and/or other comprehensive income) as the changes in the underlying item. • No further adjustments to the measurement of the liability for the performance-linked participating features are deemed necessary for the purpose of reflecting expected cash flows. The FASB tentatively decided that for contracts to which the mirroring decisions do not apply and for which the contractual obligation to the policyholder is directly linked to the fair value of the underlying items, changes in the insurance liability would be presented in profit or loss.	Although the wording in the IASB and FASB decisions differ, both Boards would measure the obligation for the performance-linked participation feature in a way that reflects how those underlying items are measured in the US GAAP/IFRS financial statements. That could be achieved by two methods, which both lead to the same measurement: • eliminating from the building-block approach changes in value not reflected in the measurement of the underlying items, or • adjusting the insurer's current liability (that is, the contractual obligation incurred to date) to eliminate accounting mismatches that reflect timing differences (between the current liability and the measurement of the underlying items in the US GAAP/IFRS statement of financial position) that are expected to reverse within the boundary of the insurance contract. Any changes in the liability for the performance-linked participating feature should be presented in the statement of comprehensive income consistently with the changes in the underlying item (i.e. in profit or loss, or in other comprehensive income). As a result, if gains/losses on underlying assets are presented in other comprehensive income, the changes in the insurance contract liability would also be presented in other comprehensive income.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Participating contracts		The FASB tentatively decided to clarify that, on measuring the insurance contracts liability, discretionary payments as a result of a contractual participation feature should be based on the insurers' expectation of payments to policyholders (considering the entity as a going concern), thus resulting in equity (deficits) for mutual insurers.	
		The Boards tentatively confirmed that options and guarantees embedded in insurance contracts that are not separately accounted for as a derivative under the financial instrument requirements should be measured within the overall insurance contract obligation using a current, market-consistent, expected value approach. The Boards agreed that when an insurer measures an obligation, created by an insurance contract liability, that requires payment depending wholly or partly on the performance of specified assets and liabilities of the insurer that measurement should include all such payments that result from that contract, whether paid to current or future policyholders. The Boards considered previous tentative decisions that apply to contracts with participating features for which the mirroring approach would apply. In particular, they noted that the mirroring decision would take precedence over the tentative decision that insurers should present in OCI changes in the insurance contract liability arising from the effect of changes in the discount rate. As a result, for contracts with participating features to which the mirroring decision applies, insurers would present changes in the insurance contract liability in the statement of comprehensive income consistently with the presentation of changes in the directly linked underlying items.	

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Participating contracts		**Contracts that are affected by expected asset returns, but to which mirroring does not apply:** The Boards tentatively decided to clarify that, for cash flows in an insurance contract that are not subject to mirroring and that are affected by asset returns, the discount rate that reflects the characteristics of the cash flows should reflect the extent to which the estimated cash flows are affected by the return from those assets. This would be the case regardless of whether: • the transfer of the expected returns of those assets are the result of the exercise of insurer's discretion; or • the specified assets are not held by the insurer. The Boards tentatively decided that for *cash flows in the insurance contract* that are not subject to mirroring and are affected by asset returns, when there is any change in expectations of the cash flows used to measure the insurance contracts liability (i.e. any expected change in the crediting rate), an insurer should reset the locked-in discount rate that is used to present interest expenses for those cash flows.	• The approach is consistent with the principles of the measurement model and previous Board decisions. Board members supported a clarification since insurers could apply different methodologies to determine the discount rate for these types of contracts. • Several Board members commented that parts of the contracts' cash flows may be asset-return related and other parts of the contracts' cash flows are not affected by asset returns. As a result, it would be appropriate to split the cash flows into two components: – cash flows that are affected by asset returns, for which changes in the discount rate would be reflected in profit or loss (i.e. in interest expense); and – cash flows that are not affected by asset returns, for which changes in the discount rate are reflected in OCI.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Unbundling and embedded derivatives	**Unbundling** Under the proposals, if a component – e.g. an investment (financial) component, a service component – is not closely related to the insurance coverage specified in a contract, then an insurer would unbundle and account separately for that component within the scope of another standard.		• See separate discussions below related to investment components, services, and embedded derivatives.
	The proposals included the following examples of components that would not be closely related to the insurance coverage and that would result in unbundling: • an investment component reflecting an account balance that is credited with an explicit return at a rate based on the investment performance of a pool of underlying investments. The rate should pass on all investment performance but may be subject to a minimum guarantee;	The IASB tentatively decided that insurers should exclude the present value of the amounts that the insurer is obliged to pay to policyholders or their beneficiaries regardless of whether an insured event occurs, determined consistently with measurement of the overall insurance contract liability, from the aggregate premiums presented in the statement of comprehensive income. The FASB did not vote on this issue.	

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Unbundling and embedded derivatives	• an embedded derivative that is separated from its host contract under IAS 39; and • contractual terms related to services that are not closely related to the insurance coverage but have been combined in a contract with that coverage for reasons that have no commercial substance.	The Boards tentatively decided that: • an investment component in an insurance contract is an amount that the insurer is obliged to pay the policyholder or a beneficiary regardless of whether an insured event occurs; and • in the statement of financial position, insurers should not be required to present investment components separately from the insurance contract unless the investment component is distinct. However, insurers should disclose both: – the portion of the insurance contract liability that represents the aggregated premiums received (and claims/benefits paid) that were excluded from the statement of comprehensive income; and – the amounts payable on demand. The Boards tentatively decided that if an investment component is distinct, an insurer should unbundle the investment component and apply the applicable IFRS(s) or US GAAP in accounting for the investment component. An investment component is distinct if the investment component and the insurance component are not highly interrelated. Indicators that an investment component is highly interrelated with an insurance component are: • a lack of possibility for one of the components to lapse or mature without the other component also lapsing or maturing, • the products are not sold separately in the same market or jurisdiction, or • the value of the insurance component depends on the value of the investment component or the value of the investment component depends on the value of the insurance component.	• The staff recommended that an insurer separate investment components that oblige the insurer to pay the policyholder regardless of whether an insured event occurs from insurance contracts. These cash flows would not be included in revenue amounts or volume metrics used for the statement of comprehensive income. • Under the staff recommendation and the IASB's decision, a number of investment components would be disaggregated from the premium in the statement of comprehensive income, including: – some explicit account balances; – cash surrender values of whole life contracts; and – other amounts under endowment contracts and annuity contracts. • The Boards' decision to unbundle distinct investment components is intended to address those limited circumstances in which an entity could add minimal insurance risk to a non-insurance product in order to avoid being in the scope of other standards. • The proposed unbundling criteria are expected to result in limited unbundling because of the 'highly interrelated' notion and it is rare that insurance and investment products would be sold separately in the insurer's market or jurisdiction. These criteria do not make any distinction between explicit and implicit account balances and the staff's recommendation was interpreted not to require explicit and implicit account balances to be unbundled in most circumstances.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Unbundling and embedded derivatives		An insurer should account for investment components that are not distinct from the insurance contract together with the insurance component under the insurance contracts standard. In applying the general decisions on unbundling and disaggregation, policy loans should be considered in the determining the component to which they relate. The Boards confirmed that an embedded derivative would be separated from its host contract under IAS 39. The Boards tentatively decided that insurers should be prohibited from applying revenue recognition or financial instrument standards to components of an insurance contract when unbundling is not required.	
		The Boards tentatively decided the following for unbundling services. • An insurer identifies whether any promises to provide services in an insurance contract would be performance obligations as defined in ED/2011/6 *Revenue from Contracts with Customers*. If a performance obligation to provide services is distinct, then an insurer applies the applicable IFRS or US GAAP in accounting for that performance obligation. **FASB only** The FASB decided that a title insurance carrier would unbundle a title insurance contract into a service component (a title search service component accounted for using the revenue recognition standard) and an insurance component (an indemnification component that covers title defects that would be accounted for using the insurance contracts standard). The FASB also decided to include a title insurance example in the application guidance to illustrate the requirement to unbundle a title contract into a service component and an insurance component.	

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Unbundling and embedded derivatives		• A 'performance obligation' is a promise in a contract with a policyholder to transfer a service to the policyholder. Performance obligations include promises that are implied by an insurer's customary business practices, published policies or specific statements if those promises create a valid expectation by the policyholder that the insurer will transfer a service. Performance obligations do not include activities that an insurer is required to undertake to fulfil a contract unless the insurer transfers a service to a policyholder as those activities occur. For example, an insurer may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the policyholder as the services are performed. Therefore, those promised set-up activities are not a performance obligation. • Except as specified in the following paragraph, a service is distinct if either of the following criteria is met: – the insurer regularly sells the service separately; or – the policyholder can benefit from the service either on its own or together with other resources that are readily available to the policyholder. 'Readily available' resources are services that are sold separately (by the insurer or another entity), or resources that the policyholder has already obtained (from the insurer or from other transactions or events).	

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Unbundling and embedded derivatives		• Notwithstanding the requirements in the previous paragraph, a service in an insurance contract is not distinct and the insurer therefore accounts for the service together with the insurance component under the insurance contracts standard if both of the following criteria are met: – the service is highly interrelated with the insurance component and transferring them to the policyholder requires the insurer also to provide a significant service of integrating the service into the combined insurance contract that the insurer has entered into with the policyholder; and – the service is significantly modified or customised in order to fulfil the contract. The Boards tentatively decided the following. • An insurer should attribute cash flows to an investment component and to an embedded derivative on a stand-alone basis. This means that an insurer would measure an investment component or embedded derivative as if it had issued that item as a separate contract. The insurer would therefore not include the effect of any cross-subsidies or discounts/supplements in the investment component. • After excluding the cash flows related to unbundled investment components and embedded derivatives the amount of consideration and discounts/ supplements should be attributed to the insurance component and/or service component in accordance with proposals in paragraphs 70-80 of ED/2011/6 *Revenue from Contracts with Customers*.	

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Unbundling and embedded derivatives		• In addition, after excluding the cash flows related to unbundled investment components and embedded derivatives, cash outflows (including expenses and acquisition costs) that relate directly to one component should be attributed to that component. Cash outflows related to more than one component should be allocated to those components on a rational and consistent basis, reflecting the costs that the insurer would expect to incur if it issued that component as a separate contract. Once cash outflows are attributed to components, the insurer would account for those costs in accordance with the recognition and measurement requirements that apply to that component.	
	Embedded derivatives Under the proposals, IAS 39 would apply to an embedded derivative in an insurance contract unless the embedded derivative itself is an insurance contract or is a surrender option with fixed terms. If the economic characteristics and risks of the embedded derivative are not closely related to those of the host insurance contract, then the insurer would be required to separate the embedded derivative and measure it at fair value with recognition of changes in fair value in profit or loss.	Proposals in the ED have been tentatively confirmed	• It is not clear whether the IASB plans also to carry forward the implementation guidance currently in IFRS 4 on embedded derivatives to the final standard. • Under the current guidance in IFRS 4, surrender options with fixed terms are excluded from the general requirements in IAS 39. This exception will be carried forward to the final standard.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Reinsurance	**Reinsurance [!]** A reinsurer would account for reinsurance contracts that it issues using the recognition and measurement approach for insurance contracts. At initial recognition, a cedant would measure a reinsurance contract as the sum of: • the present value of the fulfilment cash flows, which would be made up of the expected present value of the cedant's future cash inflows plus a risk adjustment less the expected present value of the cedant's future cash outflows; and • a residual margin that would eliminate any loss at inception of the contract. The cedant would estimate the present value of fulfilment cash flows in the same manner as the corresponding part of the present value of fulfilment cash flows for the underlying insurance contract, after remeasuring the underlying insurance contract on initial recognition of the reinsurance contract.	The Boards tentatively decided that a cedant should not recognise a reinsurance asset until the underlying contract is recognised, unless the amount paid under the reinsurance contract reflects aggregate losses of the portfolio of underlying contracts covered by the reinsurance contract. If the reinsurance coverage is based on aggregate losses, then the cedant should recognise a reinsurance asset when the reinsurance contract coverage period begins. An onerous contract liability should be recognised if management becomes aware in the pre-coverage period that the reinsurance contract has become onerous. The Boards tentatively decided the following. • At initial recognition, if the present value of the fulfilment cash flows (including the risk adjustment under the IASB's tentative decisions) for the reinsurance contract is:	• Since IFRS are principles-based standards, the Boards did not believe that it was appropriate to specify the method in which the cedant determines the amount of risk adjustment ceded. The guidance added clarification by stating that the ceded portion of the risk adjustment should represent the risk being removed by the use of reinsurance. • The Boards did not make any decisions on the treatment of ceding commissions for the purposes of measurement or presentation. Further discussion on this topic is expected. • Since the IASB has not finalised the impairment guidance in IFRS 9, IASB members indicated that insurers will rely on the impairment guidance in IAS 39 until the IFRS 9 impairment guidance is finalised. The IASB is aiming to finalise the IFRS 9 impairment guidance before or at the same time as the insurance contract standard. It was noted that the staff should take this timing into consideration when drafting the final insurance guidance.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Reinsurance	The cedant would consider the risk of non-performance by the reinsurer on an expected value basis when estimating the present value of fulfilment cash flows and would update for any change in the risk of non-performance by the reinsurer in subsequent measurement. The residual margin determined at inception cannot be negative. If the present value of the fulfilment cash flows is: • less than zero – i.e. the expected present value of future cash inflows plus the risk adjustment is less than the expected present value of future cash outflows – then the cedant would recognise this amount as the residual margin at initial recognition of the contract; or • greater than zero – i.e. the expected present value of future cash inflows plus the risk adjustment exceeds the expected present value of future cash outflows – then the cedant would recognise that amount as a gain in profit or loss at initial recognition of the contract. Any ceding commissions a cedant receives would be recognised as a reduction of the premium ceded to the reinsurer.	– less than zero and the coverage provided by the reinsurance contract is for future events, then the cedant should establish that amount as part of the reinsurance recoverable, representing a prepaid reinsurance premium, and should recognise the cost over the coverage period of the underlying insurance contracts; – less than zero and the coverage provided by the reinsurance contract is for past events, then the cedant should recognise the loss immediately; or – greater than zero, then the cedant should recognise a reinsurance residual or single margin. The cedant should estimate the present value of the fulfilment cash flow for the reinsurance contract, including the ceded premium. This should be without reference to the residual/single margin on the underlying contracts, in the same manner as the corresponding part of the present value of the fulfilment cash flows for the underlying insurance contract or contracts, after remeasuring the underlying insurance contracts on initial recognition of the reinsurance contract. The ceded portion of the risk adjustment should represent the risk being removed through the use of reinsurance.	

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Reinsurance		**FASB** The FASB made the following tentative decisions. • The cedant should account for a reinsurance contract using the same approach – i.e. building-block or premium allocation approach – that the cedant uses to account for the underlying direct insurance contracts. • Reinsurance contracts that reinsure insurance contracts measured using both the building-block and premium allocation approaches, should be separated based on the underlying contract measurement model and each component accounted for using the same approach used to account for the underlying direct insurance contracts. • The reinsurer should evaluate whether the reinsurance contract should be accounted for under the building-block approach or premium allocation approach in the same manner in which an insurer should evaluate a direct insurance contract. In other words, insurers should apply the building-block approach rather than the premium allocation approach if, at the contract inception date, either of the following conditions is met: – it is likely that, during the period before a claim is incurred, there will be a significant change in the expectations of the net cash flows required to fulfil the contract; or – significant judgement is required to allocate the premium to the insurer's obligation to each reporting period.	
		• The cedant should treat ceding commissions that are not contingent on claims or benefits experience that it receives from the reinsurer as a reduction of the premium ceded to the reinsurer.	• As a result of the FASB's decisions for the presentation of ceding commissions and residual margin, ceding commissions will not offset direct acquisition costs in the statement of comprehensive income.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Reinsurance		**IASB** The IASB tentatively decided that the cedant and reinsurer should evaluate whether to account for the reinsurance contract using the building-block approach or the premium allocation approach in the same manner in which an insurer should evaluate a direct insurance contract. In other words, the premium allocation approach would be permitted if it would produce measurements that are a reasonable proxy to those that are produced by the building-block approach. When considering non-performance by the reinsurer: • the cedant would apply the impairment model for financial instruments when determining the recoverability of the reinsurance asset; • the assessment of risk of non-performance by the reinsurer should consider all facts and circumstances, including collateral; and • losses from disputes should be reflected in the measurement of the recoverable when there is an indication that, on the basis of current information and events, the cedant may be unable to collect amounts due according to the contractual terms of the reinsurance contract.	
		The Boards tentatively decided that for retroactive reinsurance contracts, the residual or single margin included in the cedant's reinsurance recoverable and the reinsurer's insurance contract liability should be amortised over the remaining settlement period in the same manner as the release of the single/residual margin, based on: i) release from risk (FASB only); and ii) the pattern of services under the contracts (IASB only).	Retroactive reinsurance contracts cover events taking place in the past. Consequently, the insurer (cedant) may have recognised the margin on the underlying contracts. If recognition of the margin was based on coverage under the underlying contracts, then any gain or loss on the retroactive reinsurance would be recognised upfront. Although recognition of the margin over the settlement period would be inconsistent with the margin release for other insurance contracts, the Boards wanted to avoid the recognition of day one gains consistent with other aspects of the model.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Reinsurance		The Board made the following tentative decisions. • Cash flows resulting from loss-sensitive features that are not accounted for as investment components should be treated as part of the claims and benefits cash flows (rather than part of the premiums). • Insurers should treat the effects of loss-sensitive features in the same way as other changes in estimates of claims and benefits cash flows arising from the contract. Accordingly, under the premium allocation approach, cedants and reinsurers should recognise an asset or liability to the extent that any cash (or consideration) would be receivable or payable under the contract based on experience to date (based on incurred losses). • Insurers should treat the effects of non-loss-sensitive premium adjustments in the same way as other changes in estimates of premiums arising from the contract. Any premium adjustments pursuant to contractual features providing cedants a unilateral right (but not an obligation) to reinstate a reinsurance contract should not be considered to be a loss-sensitive feature for purposes of applying this guidance.	
		Reinsurers and cedants present any gains or losses on commutation as an adjustment to the claims or benefits and should not gross up the premiums, claims or benefits in recognising the transaction on the statement of comprehensive income.	The staff paper discusses the applicability of this recommendation to direct insurance contracts. Although not explicitly referenced in the staff recommendation or the Boards' decision, the staff paper on this topic (Paper 2G *Amendments, modifications, and commutations of insurance contracts*), comments that because commutations are more common with reinsurance contracts, their analysis discusses commutations in that context. However, they note their recommendation is equally applicable to direct insurance commutations – e.g. policy buy-backs.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Contract modifications		The Boards tentatively decided that an insurer should derecognise an existing contract and recognise a new contract (under the applicable guidance for the new contract), if it amends the contract in a way that would have resulted in a different assessment of either of the following items had the amended terms been in place at the inception of the contract: i) whether the contract is within the scope of the insurance contract standard; or ii) whether to use the premium allocation approach or the building-block approach to account for the insurance contract. In addition, the IASB tentatively decided that an insurer derecognises an existing contract and recognise a new contract if it amends the contract in a way that would have resulted in the contract being included in a different portfolio than the one in which it was included at initial recognition. The FASB plans to consider which additional circumstances will result in derecognition and whether there needs to be application guidance.	Some Board members commented that criteria for what was as a 'substantial' modification were too broad, in particular the proposed third criterion as to the inclusion in a different portfolio (not included in the final decision), and they thought it would capture too many modifications or would not capture all substantial modifications. Some Board members suggested adding additional application guidance that would discuss the factors an insurer should consider in their determination including: • the insured event, risk, or period of the contract; • the nature of the investment return rights; • deposits, premiums, or charges relating to the original benefit; • the investment component of the contract; or • the participation or dividend features.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Contract modifications		**Substantial modifications** The Boards tentatively decided that when an insurer makes a substantial modification to an insurance contract, the gain or loss on extinguishment of the existing contract should be determined by measuring the existing contract using the current entity-specific price that the insurer would hypothetically charge the policyholder for a contract equivalent to the newly recognised contract. **Non-substantial modifications** The Boards tentatively decided for non-substantial modifications: i) If the modification eliminates the insurer's obligation to provide some of the benefits that the contract would previously have required it to provide, then the insurer derecognises that portion of its obligation (including any related portion of the residual/single margin). ii) If the modification entitles the policyholder to further benefits, then the insurer treats the modification as a new stand-alone contract (i.e. the margin is determined in the same way as for a new stand-alone contract with no effect on the measurement of the original contract).	

Business combinations and portfolio transfers	Key proposals in the 2010 ED	Update to proposals	KPMG observations
	Business combinations An insurer would measure a portfolio of insurance contracts initially at the higher of the fair value or the present value of the fulfilment cash flows of the assumed contracts. This treatment would be an exception from the general requirements in IFRS 3 *Business Combinations* and ASC Topic 805 *Business Combinations*, which require an entity to measure assets acquired and liabilities assumed in a business combination at fair value. If the present value of the fulfilment cash flows is higher than the fair value, then the difference would result in an increase in the initial carrying amount of goodwill. If the fair value is higher than the present value of fulfilment cash flows, then the difference would be treated as the residual margin at initial recognition.	**FASB** The FASB tentatively decided that, at the acquisition date, an insurer should measure insurance liabilities assumed and insurance assets acquired in a business combination at fair value. The components should be measured as follows. **a) Expected net cash flows** measured in accordance with the insurer's accounting policies for insurance contracts that it issues using current assumptions. The discount rate determined at the acquisition date should be deemed the locked-in rate at which interest expense is accreted and presented in the statement of comprehensive income. **b) Single margin** measured as the difference between the fair value of the insurance contract liability (that is, the hypothetical premium) and the expected net cash flows determined in (a) above.	
		The FASB tentatively decided that insurance contracts acquired through a combination of entities or businesses under common control should apply the guidance in Subtopic 805-10. The FASB tentatively decided that for business combinations prior to the effective date of the insurance contracts standard, applying the transition guidance would require insurers to reallocate the purchase price attributed to the insurance contracts liability to the components in accordance with decisions reached herein as of the acquisition date, using the fair value guidance in effect at that date. **The IASB has not yet redeliberated the proposals for business combinations.**	• The guidance in Subtopic 805-10 exempts a combination of entities or businesses under common control from applying the business combinations guidance and specifically addresses the accounting for such transactions. • Several FASB members commented that they were concerned with the operational complexities in applying the transition proposals particularly with respect to business combinations. The FASB mentioned that they were planning to review of the feasibility of the transition proposals.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Business combinations and portfolio transfers	**Portfolio transfers** For each portfolio of insurance contracts acquired in a portfolio transfer, an insurer would determine the expected present value of the fulfilment cash flows and compare that amount with the consideration received for those contracts, after adjusting the consideration for any other assets and liabilities acquired in the same transaction, such as financial assets and customer relationships, treating the difference as follows: • if the consideration is the higher amount, then the difference would be established as the residual margin at that date; and • if the consideration is the lower amount, then the difference would be recognised immediately as an expense.	**FASB** The FASB tentatively decided that an insurer should measure a portfolio of insurance contracts acquired in a portfolio transfer that does not meet the definition of a business combination in accordance with the insurance contracts standard. **The IASB has not yet redeliberated the proposals for portfolio transfers.**	
Presentation and disclosure	**Statement of financial position [X]** Under the proposals, an insurer would present each portfolio of insurance contracts as a single amount within the captions of insurance contract assets or insurance contract liabilities. An insurer would also present a pool of assets underlying unit-linked contracts as a single line item separate from the insurer's other assets and the portion of the liabilities linked to the pool would be presented as a single line item separate from the insurer's other liabilities. Reinsurance assets would not be offset against insurance contract liabilities.	The IASB tentatively decided that an entity should: • present all rights and obligations for all insurance contracts on a net basis in the statement of financial position; • be required to present separate line items for insurance contracts and for reinsurance contracts in the statement of financial position.	• The IASB's decisions on the presentation of rights and obligations and reinsurance balances are consistent with the presentation approach proposed in the 2010 ED. • The specified line items to be presented in the statement of financial position in accordance with IAS 1 do not include insurance contracts or reinsurance contracts. Consequently, the IASB added presentation requirements in the insurance proposals. • The IASB's staff proposals did not include a separate presentation of unit-linked contracts in the statements of financial position and comprehensive income. The IASB staff commented that the general presentation requirements in IAS 1 and unbundling proposals in the insurance standard should address the presentation of unit-linked contracts and other insurance contracts with investment components.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Presentation and disclosure		The Boards tentatively decided the following. • An insurer should disaggregate the following components, either in the statement of financial position or in the notes, in a way that reconciles to the amounts in the statement of financial position: – expected future cash flows – risk adjustment (IASB only) – residual margin (IASB only) – single margin (FASB only) – effects of discounting. • For contracts measured using a premium-allocation approach, the liability for remaining coverage should be presented separately from the liability for incurred claims in the statement of financial position. • For contracts measured using the building-block approach, any unconditional right to any premiums or other consideration should be presented in the statement of financial position as a receivable separately from the insurance contract asset or liability and accounted for in accordance with the existing guidance for receivables. The remaining rights and obligations should be presented on a net basis in the statement of financial position. • For contracts measured using the premium-allocation approach, all insurance contract rights and obligations should be presented on a gross basis – i.e. presented separately, in the statement of financial position. • Liabilities (or assets) for insurance contracts should be presented separately for those measured using the building-block approach and those measured using the premium-allocation approach.	• The IASB staff paper and IASB discussions relating to the separate presentation of reinsurance and insurance contracts in the statement of financial position did not distinguish between reinsurance contracts assumed and reinsurance contracts ceded. • The November 2012 Staff Paper 3A *Presentation and disclosures: Proposed drafting* (pages 21-23) illustrates how the IASB's tentative decisions and recommendations with respect to presentation might be applied. • The revised proposals would result in a statement of financial position that would disaggregate contracts measured under the building-block and premium-allocation approaches. • Many respondents to the ED and DP thought that a gross presentation of rights and obligations would for non-life contracts provide more relevant information because a net presentation would make it more difficult to understand how much unearned premium has been written.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Presentation and disclosure		• Portfolios that are in an asset position should not be aggregated with portfolios that are in a liability position in the statement of financial position. • The FASB tentatively decided that acquisition costs would be reported as part of the margin – i.e. the margin includes the acquisition costs expected to be paid and is reduced when those acquisition costs are paid. • The FASB decided tentatively that an insurer would disaggregate in the statement of financial position the insurance contracts liability into the expected cash flows to fulfil the insurance obligation and the margin.	
	Statement of comprehensive income [!] Under the ED, all income and expense from insurance contracts would be presented in profit or loss. The proposals contained a new presentation for the statement of comprehensive income, which would follow the proposed measurement model. The underwriting margin would be subject to disaggregation requirements (in the notes or on the face of the statement of comprehensive income), disclosing the change in risk adjustment and release of the residual margin. Other items to be presented in the statement of comprehensive income would include: • gains and losses at initial recognition, further disaggregated on the face of the statement of comprehensive income or in the notes into losses at initial recognition of an insurance contract, losses on insurance contracts acquired in a portfolio transfer and gains on reinsurance contracts bought by a cedant; • acquisition costs that are not incremental at the level of an individual contract;	The Boards tentatively decided that premiums and claims presented in the statement of comprehensive income would be determined by applying an earned-premium presentation, whereby premiums are allocated to periods in proportion to the value of coverage (and any other services) that the insurer has provided in the period, and that claims should be presented as they are incurred. The papers for the October 2012 meetings included a mechanical approach based on the pattern of expected claims and benefits at inception by period to determine the earned premium for each period. The FASB asked the FASB staff when drafting to consider the inclusion of application guidance about other approaches that may meet the earned-premium principle, noting that the description of the approach within the staff paper was too prescriptive. The IASB tentatively decided that the general requirements of IAS 1 *Presentation of Financial Statements* are sufficient to specify the presentation requirements for the statement of comprehensive income for insurance contracts.	• A significant number of respondents had concerns about the loss of volume information for key metrics – i.e. premiums, claim expenses – in the new presentation format. There were also concerns regarding the inconsistencies between the presentation of short and long-duration contracts. • The Boards had considerable debate on the best way to present and characterise premiums on the face of the statement of comprehensive income. The Boards' concern is that any premium number disclosed, especially as it relates to life contracts, may be characterised as revenue, which they do not believe is appropriate in all circumstances.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Presentation and disclosure	• experience adjustments and changes in estimates, further disaggregated on the face or in the notes into experience adjustments, changes in estimates of cash flows and discount rates, and impairment losses on reinsurance assets; and • interest on insurance contract liabilities.	The IASB tentatively decided that cash flows relating to acquisition costs would be recognised in the statement of comprehensive income over the coverage period. The Boards tentatively decided that acquisition costs would be recognised in the statement of comprehensive income consistent with the proposed allocation of the residual/single margin. In other words: • For the IASB, in a way consistent with the pattern of transfer of services provided under the contract. • For the FASB, as the insurer satisfies its performance obligations to stand ready to compensate the policyholder if a specified uncertain future event adversely affects the policyholder, which is when the insurer is released from exposure to risk as evidenced by a reduction in the variability of cash outflows. Consequently, the margin recognised would be grossed up for the amount of acquisition costs recognised. The Boards tentatively decided that in an earned-premium presentation a portion of premium would be allocated to cover non-claims fulfilment costs. The portion would be equal to the originally expected non-claims fulfilment costs included in the measure of the building-block liability. The Boards tentatively decided that the premium allocated to cover non-claims fulfilment costs would be included in earned premium in the periods in which the costs are expected to be released from the liability for remaining coverage – i.e. when it is expected that they will be either incurred or added to the liability for incurred claims. The amounts presented as expenses would be the actual costs incurred or added to the liability for incurred claims in the period.	• The objective of this approach is to provide a volume measure that is similar to a measure of revenue that results from applying the revenue recognition proposals. Under the revenue recognition proposals, an entity recognises revenue when they have satisfied a performance obligation by transferring a promised good or service to a customer. Applying this notion to the insurance proposals, an insurer would measure earned premiums as the consideration they are entitled to for the performance obligation satisfied in the period – i.e. the insurance coverage that it has provided to the policyholder. An insurance contract would be viewed as creating a performance obligation that requires the insurer to stand ready to pay valid claims. An insurer would recognise earned premiums over time by measuring premiums by reference to the initial estimates of the pattern of services provided for each period – e.g. by reference to the expected claims and expense in each period. Due to the tracking of assumptions required over the life of the contract under the earned-premium approach, it is expected to be operationally complex. This new form of premium reporting for insurance may allow comparison with other industries that report gross revenues but would also require significant education for both insurers and users. The majority of the Boards' members agreed that the earned-premium approach was a better representation of revenues in the statement of comprehensive income and was consistent with the revenue recognition principles. In addition, under the earned-premium presentation the amounts presented for the building-block approach are broadly consistent with the amounts presented for the premium-allocation approach.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Presentation and disclosure			Some members expressed concerns about the earned-premium approach, including: • premiums presented would not address the requests for volume information from respondents to the ED because the premiums presented are similar to an allocation of revenue across periods rather than a metric that provides volume information for business sold during the period; • revenue amounts presented under the earned-premium presentation, which are based on the initial expected pattern of claims and benefits, do not reflect revisions to estimates; and • using initial expectations of claims in determining and allocating revenue may be particularly difficult when applying the transition requirement Some members supported retaining the summarised margin approach as originally proposed in the IASB's 2010 ED accompanied by supplemental disclosures on volume information in the notes to the financial statements. The FASB wanted to avoid a prescribed method of calculation (such as that shown in the staff paper) and allow for alternative ways of calculating premiums and claims as long as they reflected the value of coverage that the insurer had provided in the period.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Presentation and disclosure	Income and expense from unit-linked contracts would be presented as a separate single line item. Premiums and claims would not generally be presented in the statement of comprehensive income, on the basis that they represent settlements of insurance contract assets or liabilities rather than revenues or expenses. However, related information is required to be provided in the notes. For short-duration contracts subject to the premium-allocation approach for pre-claims liabilities, the underwriting margin would be disaggregated into line items reflecting each of premium revenues, claims and other expenses, amortisation of incremental acquisition costs and changes in additional liabilities for onerous contracts.		
	Use of other comprehensive income (OCI) [!]	The Boards made the following tentative decisions. • Interest expense is recognised in profit or loss by discounting current estimates of future cash flows at a locked-in discount rate determined at inception. • Changes in the insurance liability arising from changes in discount rates (other than the unwind of the locked-in discount rate presented in profit or loss) would be presented in OCI. • All other changes in the insurance liability, unless they are recognised as an adjustment to the residual margin, are recognised in profit or loss.	• Many constituents have stated that their concerns with volatility could be addressed if changes in the insurance contract liabilities arising from changes in the discount rate were presented in other comprehensive income and the financial assets that support these liabilities were also measured at fair value through other comprehensive income. • The Boards have been seeking to reduce differences in their respective classification and measurement models for financial instruments. Considering also the potential interaction with the insurance project and that both fair value and amortised cost information is useful for some portfolios of financial assets, the IASB tentatively decided to introduce a FVOCI measurement category for eligible debt investments to IFRS 9.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Presentation and disclosure		The Boards tentatively decided to *require* changes in the insurance liability (excluding those liabilities that are contractually linked to underlying assets) arising from changes in discount rates to be recognised in OCI regardless of the classification and measurement applied to the insurer's underlying assets. The Boards agreed to discuss further how their tentative decisions would apply to contract liabilities that are contractually linked to assets – e.g. participating and unit-linked contracts. The Boards also tentatively decided that a loss recognition test for the purposes of recycling amounts related to the insurance liability from OCI to profit or loss would not be needed.	• The IASB agreed that debt instruments consisting solely of payments of principal and interest would be subject to FVOCI classification if they are held within a business model whose objective is both to hold financial assets to collect contractual cash flows and to sell financial assets. • Several Board members were concerned that accounting mismatches would result in using OCI for liability remeasurement when assets classified and measured at FVOCI were sold and a gain or loss recognised in profit or loss on the assets without any reciprocal recycling to profit or loss from OCI relating to the insurance liability. Although this accounting mismatch was acknowledged, several members thought these mismatches may not be pervasive since insurers offering long-term insurance products generally buy and hold their assets to maturity and actively manage durations through investment of new cash flows. • Although many Board members were concerned duration mismatches would not be transparent in profit or loss, they thought this could be partly addressed by including robust disclosures on interest-related movements in both profit or loss and OCI and the effectiveness of the insurers' asset-liability management strategies. • Some Board members were concerned that requiring the use of OCI for all liabilities would create accounting mismatches when insurers held assets required to be measured at fair value through profit or loss under the proposed financial instruments standards.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Presentation and disclosure			• They were particularly concerned with contracts that were contractually-linked to assets such as unit-linked contracts and participating products which are often supported by equity investments. They thought when contracts were contractually linked to assets, their measurement attribute should match that of the assets. The Boards plan to discuss further how the OCI approach would apply to insurance liabilities contractually-linked to assets.
	Disclosures Under the proposals, an insurer would disclose quantitative and qualitative information in respect of: • the amounts arising from insurance contracts recognised in the financial statements; and • the nature and extent of risks arising from insurance contracts. An insurer would consider the level of detail necessary to satisfy the disclosure requirements, including how information is aggregated or disaggregated. Aggregation levels for disclosures that may be appropriate would be type of contract and geography, but information may not be aggregated across different reportable segments as defined in IFRS 8 *Operating Segments*. Sufficient information would be provided to allow reconciliation to the line items in the statement of financial position.	The Boards confirmed the disclosures proposed in paragraphs 79–84 and 90–97 of the ED, with the following changes. • Deletion of the requirement that an insurer does not aggregate information relating to different reportable segments (i.e. paragraph 83) to avoid a conflict with the principle for the aggregation level of disclosures. • A requirement that an insurer disclose separately the effect of each change in inputs and methods, together with an explanation of the reason for the change, including the types of contract affected. • For contracts in which the cash flows do not depend on the performance of specified assets (i.e. non-participating contracts), a requirement to disclose the yield curve (or range of yield curves) used.	• Under the revised aggregation principle for disclosures, the level of aggregation could vary for different types of qualitative and quantitative disclosures. However, the standard would add to the examples listed in paragraph 84 of the ED by stating that one appropriate aggregation level might be reportable segments. • One of the key new disclosures introduced in the ED was the confidence level disclosure equivalent for the risk adjustment. Some constituents raised concerns that this disclosure may result in excessive cost for little benefit when an insurer uses a different measurement technique for the risk adjustment. The staff recommended removing this requirement. However, this recommendation was rejected by the IASB due to concerns about comparability.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Presentation and disclosure		• A requirement that the maturity analysis of net cash outflows resulting from recognised insurance liabilities proposed in paragraph 95(a) be based on expected maturities; and removal of the option to base the maturity analysis on remaining contractual maturities. Furthermore, within the context of time bands, the requirement that the insurer disclose, at a minimum, the expected maturities on an annual basis for the first five years and in aggregate for maturities beyond five years would also be removed. In place of this disclosure, the FASB would rely on its tentative decisions related to risk disclosures for financial institutions, as reached in its project on financial instruments. Those disclosures would apply to insurance entities. In addition, the IASB tentatively decided to delete the proposed requirement in paragraph 90(d) to disclose a measurement uncertainty analysis. The FASB decided to retain this disclosure. The IASB tentatively decided to retain the confidence level disclosure in paragraph 90(b)(i) of the ED.	• The additional disclosures for insurance contracts being considered by the FASB under the financial instruments project are heavily based on the existing disclosure requirements under IFRS 7. Insurers reporting under IFRS 4 include many of these disclosures in their current reporting. Several of those disclosure requirements will be new for US insurers, which typically report this information on risks associated with financial instruments in their management discussion and analysis. • The Boards agreed to align the wording of the disclosure objectives of active projects (revenue recognition, leases and insurance). In a meeting on cross-cutting issues, the Boards tentatively decided that an entity would be required to present in tabular format any roll forward retained by or added to disclosure requirements. • The IASB decided that it would not explore further disclosures about the effect of regulation on reported equity in the Insurance Contracts project.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Presentation and disclosure		The IASB tentatively agreed with the disclosure package as set out by the staff in September 2012 Agenda Paper 16F *Disclosures: Overview and proposed drafting*, including requirements that insurers should: • disclose gains or losses arising on contract modifications, commutation or derecognition; • provide reconciliations between the opening and closing carrying amounts of insurance contract liabilities and insurance contract assets, including information about: the carrying amounts of onerous contract liabilities recognised in the pre-coverage period; the expected present value of fulfilment cash flows, the risk adjustment; and the residual margin; and • disclose amounts payable on demand in a way that highlights the relationship between such amounts and the carrying amounts of the related contracts. The IASB tentatively decided not to add more guidance on the level of disaggregation of the reconciliation of carrying amounts beyond the requirements to: consider the level of detail necessary to satisfy the disclosure objective; and aggregate or disaggregate data so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics. The IASB tentatively decided to delete the specific disclosure proposed in paragraph 89 of the ED about contracts for which uncertainty about the amount and timing of claims payments is not typically fully resolved within one year.	

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Presentation and disclosure		The IASB made the following tentative decisions for contracts with cash flows contractually linked to underlying items. • An insurer should disclose the carrying amounts of those insurance contracts. • If an insurer measures those contracts on a basis other than fair value, and discloses the fair value of the underlying items, then the insurer should disclose the extent to which the difference between the fair value and carrying value of underlying assets would be passed to policyholders. The IASB tentatively decided that, for all insurance contracts, an insurer should disclose a reconciliation from the opening to the closing balance of the aggregate carrying amount of insurance contract liabilities and insurance contract assets, showing separately: • the remaining balance of liabilities for remaining coverage but excluding any amounts that are attributable to losses on initial recognition (for the premium allocation approach, this will be the unearned premium); • liabilities for remaining coverage that are attributable to losses on initial recognition and subsequent changes in estimates that are immediately recognised in profit or loss (for the premium allocation approach, this will be the additional liabilities for onerous contracts); and • the liabilities for incurred claims.	

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Presentation and disclosure		The IASB tentatively decided that, for contracts accounted for using the building-block approach, an insurer should disaggregate the insurance contract revenue into the inputs to the measure of insurance contract revenue in the period – for example: • the probability-weighted claims, benefits and expenses expected to be incurred in the period; • an allocation of expected acquisition costs; • the risk margin relating to that period's coverage; and • the margin allocated to that period. The IASB tentatively decided that for contracts accounted for using the building-block approach, insurers should disclose the effect of contracts written in the period on the insurance contract liability, showing separately the effect on: • the expected present value of future cash outflows, showing separately the amount of acquisition cost; • the expected present value of future cash inflows; • the risk adjustment; and • the residual margin. The IASB tentatively decided that in the period in which the new insurance contracts standard is initially applied, disclosure of the current period and prior period line item amounts that would have been reported in accordance with previous accounting policies in IFRS 4 should not be required. The IASB tentatively decided to require a disclosure of a reconciliation from premium receipts to revenue.	• November 2012 Staff Paper 3A *Presentation and disclosures: Proposed drafting* (pages 24-28) illustrates how the IASB's tentative decisions and recommendations with respect to reconciliation disclosures might be applied.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Transition	With respect to transition, the ED proposed that at the beginning of the earliest period presented, an insurer would, with a corresponding adjustment to retained earnings: • measure its existing portfolios of insurance contracts at the present value of the fulfilment cash flows. Measurement both at transition and subsequently would not include a residual margin for those contracts because the Boards believed that requiring insurers to estimate a transitional balance may be costly and subject to bias through the use of hindsight; • derecognise any existing deferred acquisition costs; and • derecognise any intangible assets arising from insurance contracts assumed in previously recognised business combinations, excluding intangible assets such as customer relationships and customer lists that relate to possible future contracts. An insurer would be permitted, but not required, to redesignate a financial asset as measured at fair value through profit or loss at the start of the earliest period presented when it adopts the proposals if doing so would reduce a measurement or recognition inconsistency. The reclassification is a change in accounting policy in accordance with IAS 8. The insurer would recognise the cumulative effect of that redesignation as an adjustment to opening retained earnings of the earliest period presented and remove any balances from accumulated other comprehensive income.	**Measurement** The Boards tentatively decided that when an insurer first applies the new insurance contracts standard, the insurer should do the following. • At the beginning of the earliest period presented: – measure the present value of the fulfilment cash flows using current estimates at the date of transition (i.e. as of the earliest period presented); and – account for the acquisition costs in accordance with their existing tentative decisions for acquisition costs and derecognise any existing balances of deferred acquisition costs. • Determine the single or residual margin at the beginning of the earliest period presented, as follows. • Determine the margin through retrospective application of the new accounting principle to all prior periods, unless it is impracticable to do so. • If it is impracticable to determine the cumulative effect of applying that change in accounting principle retrospectively to all prior periods, then apply the new policy to all contracts issued after the start of the earliest period for which retrospective application is practicable (i.e. apply retrospectively as far back as is practicable). • The IASB tentatively decided that an insurer would determine the residual margin on transition assuming that all changes in estimates of cash flows between initial recognition and the beginning of the earliest period presented were already known at initial recognition.	• The majority of respondents to the IASB's ED had not supported the transition proposals, which required the measurement of the present value of fulfilment cash flows with no residual margin. The transition proposals are expected to have significant impacts on insurers' future reported profitability, especially for those insurers writing long-term contracts. • A margin determination would only need to be determined for contracts accounted for under the building block approach (i.e. it would not be needed for those applying the premium-allocation approach, because the margin is implicit in measurement). • The staff paper discussed a couple of possible methods for determining the margin at inception (e.g. using historical assumptions and using an average margin percentage), and also suggested that it may be practical to amortise the margin on a straight-line basis up to the point in time that it is possible to apply the new requirements prospectively. However, the Boards agreed not to prescribe specific guidance on how an insurer would estimate the margin. • Some Board members commented that further restraints were needed when 'estimating' expected profit, to avoid an overstated liability and margin. Specifically, they were concerned that, if margins were overstated, that future profitability would also be overstated. The Boards asked the staff to consider developing a constraint, or set of constraints, on the estimated amount of the single or residual margin.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Transition			• The IASB noted that fully retrospective application in relation to changes in cash flows would be a difficult exercise involving a high risk of using hindsight in the calculation. It would require insurers to know whether changes from original estimates made at inception had been changes in estimates of future cash flows or experience adjustments, and in which period those changes in estimates occurred. Depending on what the insurer estimated, the effect of those changes in estimates would be either recognised as an adjustment to retained earnings or recognised as part of the remaining residual margin to be allocated to profit and loss. As a result, they decided that an insurer determines the residual margin on transition assuming that all changes in estimates of cash flows between initial recognition and the beginning of the earliest period presented were already known at initial recognition.
	Additionally, an insurer would be exempt from disclosing previously unpublished information about claims development that occurred earlier than five years before the end of the first financial year in which it would apply the proposals. An insurer would disclose if it is impracticable to prepare information about claims development that occurred before the beginning of the earliest period presented.	• For contracts issued in earlier periods for which retrospective application would normally be considered impracticable because it would require significant estimates that are not based solely on objective information, an insurer should be required to estimate what the margin would have been if it had been able to apply the new standard retrospectively. In such cases, an insurer need not undertake exhaustive efforts to obtain objective information, but should take into account all objective information that is reasonably available. • If it is impracticable to apply the new accounting policies retrospectively for other reasons, then an insurer should apply the general requirements of ASC Topic 250-10/IAS 8 that are relevant to situations in which there are limitations on retrospective application (i.e. measure the margin by reference to the carrying value before transition).	• Some constituents suggested that the Boards specify the retrospective period of time for which the guidance should be applied (e.g. 10 years) to provide additional comparability among insurers at transition. However, the staff and Boards rejected this, because it may limit the consistency in measurement of margins and hence profitability of business. • A key issue discussed at the IASB Insurance Working Group meeting in June was whether it would be necessary to include all contracts written in the retrospective analysis, or only those in force at the time of the 'earliest period practical'. The cause of concern is the unit of account. Since the unit of account is at the portfolio level, a retrospective approach in theory would include all contracts written (unless a practical expedient is provided).

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Transition		**Determining the discount rate** The Boards tentatively decided that, for those periods for which it would be impracticable to determine the discount rate that would reflect the characteristics of the liability, insurers should be required to, determine the discount rate as follows. a) Calculate the discount rate in accordance with the standard for a minimum of three years prior to the transition date and, if possible, determine an observable rate that approximates the calculated rates for those years. If there is not an observable rate that approximates the calculated rate for those three years, then determine the spread between the calculated rate for those years and an observable rate. b) Use the same observable reference point in prior periods to determine the rate (plus or minus the spread determined in (a) if applicable) to be applied at the contract inception for contracts that were issued in the retrospective period. c) Apply the yield curve corresponding to that rate to the expected cash flows for contracts recognised in the retrospective period, to determine the single or residual margin at contract inception. d) Use the rate from the reference yield curve reflecting the duration of the liability to recognise interest expense on the liability. e) Recognise in OCI the cumulative effect of the difference between that rate and the discount rate determined at the transition date.	• In addition, the FASB asked the staff to explore a practical expedient that might allow insurers to determine the margin based on the previous "definition of portfolios" used in an insurers' existing accounting model during the retrospective period and then allocate that margin to the 'new portfolios' as part of transition. The FASB thought that this practical expedient might avoid data collection issues by allowing insurers to determine the margin using existing accumulations of data and allocate that margin to new portfolios at transition. • Some FASB members raised a concern on the practicality of the full retrospective approach for those contracts that may have not been considered insurance contracts under previous accounting standards, but would qualify under the new insurance standards. Some members and staff mentioned that a practical expedient may be considered for these contracts. • The Boards also considered what discount rate should be used in the retrospective period when determining the discount rate would otherwise be impracticable. This would be particularly relevant when determining the 'locked-in' rate to be used to recognise interest in profit or loss under the OCI proposals. • A few Board members asked the staff to further contemplate the practical implications of the proposal and consider whether further restrictions were needed to avoid scenarios where the calculated or 'proxy' liability rate is lower than the risk-free rate.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Transition		**Transition disclosures** The Boards decided tentatively that insurers should be required to make the disclosures required by ASC Topic 250-10/IAS 8. In addition, insurers should make the following, more specific, disclosures. a) If full retrospective application is impracticable, then the earliest practicable date to which the insurer applied the guidance retrospectively. b) The method used to estimate the expected remaining residual or single margin for insurance contracts issued before that earliest practicable date, including the extent to which the insurer has used information that is objective; and separately, the extent to which the insurer has used information that is not objective, in determining the margin. c) The method and assumptions used in determining the initial discount rate during the retrospective period. Also, the FASB asked the FASB staff to consider whether all the disclosures in ASC Topic 250-10 should be required. The Boards also tentatively decided that an insurer need not disclose previously unpublished information about claims development that occurred earlier than five years before the end of the first financial year in which it first applies the new guidance. Furthermore, if it is impracticable, when an insurer first applies the guidance, to prepare information about claims development that occurred before the beginning of the earliest period for which the insurer presents full comparable information, then it should disclose that fact. (This decision confirms the proposal in the IASB's ED.) All IASB members and all FASB members supported this decision.	

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Transition		The IASB tentatively decided that, in the period in which the new insurance contracts standard is initially applied, disclosure of the current period and prior period line item amounts that would have been reported in accordance with previous accounting policies in IFRS 4 should not be required.	
		Restatement of comparative financial information The IASB tentatively decided that entities would be required to restate comparative information on first application.	• In its deliberations on IFRS 9, the IASB concluded that restatement of comparative financial statements would not result in useful information with respect to classification and measurement of an entity's financial instruments. As a result, IFRS 9 will not require entities to restate comparative financial statements. The IASB considered why restatement of comparative financial information would not provide useful information (interaction between classification and measurement, impairment and hedging requirements, as well as differences between the classification and measurement requirements in IAS 39 and those in IFRS 9) and concluded that these reasons would not exist in the case of restatement of comparative financial information for insurance liabilities. • Considering that comparative financial statements may not be useful if insurers are required to restate comparative information for their insurance liabilities but not for their financial assets, the IASB noted that the proposed mandatory effective date of the final insurance standard is likely to be a number of years after the mandatory effective date of IFRS 9 and the insurer would already have implemented the requirements of IFRS 9 for three annual reporting periods.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Transition		The FASB tentatively decided that for business combinations prior to the effective date of the insurance contracts standard, applying the transition guidance will require insurers to reallocate the purchase price attributed to the insurance contracts liability to the components in accordance with the above decisions as of the acquisition date, using the fair value guidance in effect at that date.	
	First-time adopters Transition requirements would apply both to insurers that have already adopted IFRS when they first apply the final standard and to insurers that adopt IFRS for the first time.	Proposal in ED has been tentatively confirmed.	
		Redesignation of assets in the scope of IAS 16 and IAS 40 The IASB decided not to include explicit guidance on redesignating property, plant and equipment on transition.	• The ED proposed permitting an insurer to redesignate a financial asset if significant inconsistency in measurement or recognition would be reduced. The ED did not address redesignation of other types of assets (e.g. assets in the scope of IAS 16 and IAS 40). • An insurer is already permitted to switch from the cost model to the revaluation model to account for property, plant and equipment according to IAS 16 and IAS 8. Likewise, an insurer is already permitted to switch between the cost model and the fair value option to account for investment property according to IAS 40 and IAS 8 provided that the change enhances the reliability and relevance of the financial statements.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Transition	**Redesignation of financial assets** At the beginning of the earliest period presented, when an insurer first applies the insurance standard, it is permitted, but not required, to redesignate a financial asset as measured at fair value through profit or loss if doing so would eliminate or significantly reduce an inconsistency in measurement or recognition. The reclassification is a change in accounting policy and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* applies. The insurer would recognise the cumulative effect of that redesignation as an adjustment to opening retained earnings of the earliest period presented and remove any related balances from accumulated OCI.	The IASB tentatively decided that an insurer would follow the reclassification guidance in IFRS 9 except that an insurer should be: • permitted to designate eligible financial assets under the fair value option where new accounting mismatches are created by the application of the proposed insurance contracts standard; • required to revoke previous designations under the fair value option where an accounting mismatch no longer exists because of the application of the proposed insurance contracts standard; and • following earlier application of IFRS 9, permitted to use OCI for the presentation of changes in the fair value of some or all equity instruments that are not held for trading, or revoke a previous election. The FASB tentatively decided that on initial adoption of the insurance contracts standard, an insurer would be permitted to designate and classify its financial assets that are designated to an entity's insurance business by either: • legal entity; or • internal designation (including designations relating to funding of insurance contracts that are newly determined to be insurance) as if it had adopted on that date the relevant classification and measurement guidance for financial instruments in effect (Topic 320 *Investments – Debt and Equity Securities*, and related fair value options or the proposed FASB financial instruments standard). The effect would be reported as a change in accounting principle.	The IASB staff considered two alternative solutions to mitigate accounting mismatches: • Permit insurers to classify financial assets at amortized cost, fair value through profit and loss, or fair value through OCI, as if IFRS 9 had been initially applied at the same time that the insurance standard is applied. • Limited reconsideration of the fair value option and also permit an insurer to newly designate / revoke previous designation of equity investments that are not held for trading to fair value through OCI.

	Key proposals in the 2010 ED	Update to proposals	KPMG observations
Effective date	**Effective date** The ED did not include an effective date for the proposals or state whether they may be adopted early. The IASB has issued an additional consultation, in conjunction with the FASB, on the effective dates of these proposals and other proposed standards to be issued in 2011. The IASB has delayed the effective date of IFRS 9 (formerly effective for annual periods beginning on or after 1 January 2013) to annual periods beginning on or after 1 January 2015.	The IASB stated its intention to allow approximately three years between the date of publication and the mandatory effective date. In the September 2012 meeting, the IASB announced plans to issue a targeted re-exposure document in the first half of 2013. The IASB staff at that time expected that the *earliest date* for a final insurance standard would be May 2014. If there is a period of three years between the issuance of the final standard and the mandatory effective date, then the final insurance standard would not be effective until annual periods beginning on or after 1 January 2018. In addition, the current effective date of IFRS 9 is from annual periods beginning on or after 1 January 2015. Accordingly, there would be no alignment of effective dates of the insurance standard and IFRS 9.	• The IASB considered the responses to the 2010 ED and the results of recent outreach to users and insurers. Feedback received from this outreach supported a time period of at least three years between the publication of the final insurance standard and the mandatory effective date. Although the IASB generally allows a period of at least 18 months between the publication of a new standard and its mandatory effective date, the IASB supported a longer period because the proposed insurance standard will be a fundamental change to current practices of insurers and implementing the new requirements will be an extensive task. • The IASB also considered an alternative to requiring a shorter period between the issuance of the final standard and the mandatory effective date but allowing relief from the restatement of comparative information on transition. However, this possibility was rejected because the IASB has previously decided to require retrospective application of the new insurance standard where possible. Insurers would thus already be required to determine the measurement of insurance contracts under the new model for past periods, in particular to determine the residual margin at inception and subsequent allocation.
		Early application The IASB tentatively decided to permit entities to apply the final standard before the mandatory effective date.	

Key proposals still to be discussed

	Key proposals in the 2010 ED and DP	KPMG observations
Derecognition	**Derecognition** An insurance contract liability (or a part thereof) would be derecognised from the statement of financial position when, and only when, it is extinguished – i.e. when the obligation specified in the insurance contract is discharged or cancelled or expires.	• The Boards may or may not redeliberate this topic before the release of the IASB's ED or staff draft and the FASB's ED.

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FIND OUT MORE

For more information on the project, including our publications on the 2010 ED, *New on the Horizon: Insurance, The New World for Insurance: Business perspectives on Phase II* and *The New World for Insurance: Progress report on Phase II*, see our website.

The IASB's website and the FASB's website contain summaries of the Boards' meetings, meeting materials, project summaries and status updates.

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