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INSURANCE

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cutting through complexity

"The time to get organised is now! The Boards' exposure drafts are expected by June of this year. The complexities of the new models and their interaction with the proposed financial instruments models will have significant and wide-reaching reporting and operational impacts for insurers."

Joachim Kölschbach,
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Moving towards global insurance accounting

This edition of *IFRS Newsletter: Insurance* highlights the results of the IASB and the FASB (the Boards) discussions during 6–19 February 2013 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 decided on a 120-day comment period for their respective upcoming exposure drafts.
- The IASB decided to begin the balloting process for its targeted re-exposure draft.
- The IASB decided on transition requirements for contracts acquired through a business combination.
- The FASB decided not to include a minimum time period between the issuance of the proposed insurance standard and the effective date in its ED, but rather to ask a question about the key drivers affecting the timing of implementation.
- Additionally, the FASB made decisions on:
  - a practical expedient for determining the single margin at transition;
  - early adoption and comparative periods;
  - the scope of guarantees;
  - contract modifications;
  - the measurement of investment components and aggregate insurance contract revenue; and
  - foreign currency transactions.

KEY DECISIONS MADE THIS PERIOD

IASB-only decisions

Permission to ballot the targeted re-exposure draft and comment period

- The IASB will begin the balloting process for the targeted re-exposure draft.
- The targeted re-exposure draft will be open for comment for 120 days.

Transition

- In applying the transition requirements for insurance contracts, an insurer would account for the in-force contracts that were previously acquired through a business combination using:
  - the date of the business combination as the date of inception of those contracts; and
  - the fair value of those contracts at the date of the business combination as the premium received.
- When an insurer first applies the proposed insurance standard to insurance contracts previously acquired through a business combination, any gains or losses would adjust retained earnings (rather than goodwill).

FASB-only decisions

Transition

- The FASB decided on the following practical expedient.
  1. When determining the margin at contract inception, insurers would be able to measure the insurance contract liability and the margin using the insurer's determination of the portfolio immediately before transition.
  2. Contracts written or substantially modified after the date of transition would be grouped into portfolios in accordance with the proposed guidance, which, if they are different from those determined under point 1, may require separate portfolios.

Effective date, comparative periods, early adoption and comment period

- The upcoming exposure draft (ED), *Insurance Contracts Update*, will not include a minimum time period between the issuance of the proposed insurance contracts standard and the effective date, but rather will ask a question about the key drivers affecting the timing of implementation.
- The effective date for non-public entities would be a minimum of one year after the effective date for public entities.
- Insurers would be required to restate all comparative periods presented.
- Insurers would not be allowed to early adopt the proposed insurance standard.
- The comment period for its upcoming ED will be 120 days.

Scope for guarantees

- The Board decided on the types of guarantees to be scoped out of the proposed insurance standard.

Contract modifications

- The FASB included additional criteria from Subtopic 944-30 *Financial Services—Insurance—Acquisition Costs*, under which an insurer would derecognise an existing contract and recognise a new contract.

Reconsideration of the measurement of investment components and aggregate insurance contract revenue

- The amount of consideration allocated to investment components and excluded from the premium presented in the statement of comprehensive income would be equal to the cash flows that the insurer estimates it will be obligated to pay to policyholders or their beneficiaries regardless of whether an insured event occurs.
- At the end of each reporting period, these cash flows would be re-estimated based on current assumptions used in the measurement of the insurance contract liability, with any effect on insurance contract revenue allocated prospectively to periods in proportion to the value of coverage and any other services that the insurer estimates will be provided in those periods.

Foreign currency transactions

- When remeasuring foreign currency transactions, all financial statement components related to an insurance contract would be classified as monetary.

FEBRUARY ACTIVITIES

What happened during 6–19 February?[1]

At this month's meetings (6–19 February), the IASB discussed the comment period for the targeted re-exposure draft and the transition requirements related to business combinations, and decided to begin the process of balloting the targeted re-exposure draft. The FASB discussed a number of housekeeping issues, including the scope of guarantees, accounting for contract modifications and foreign currency transactions, the treatment of investment components, transition issues and the length of the comment period for its upcoming ED.

This month, the IASB completed the technical decisions needed to finalise its targeted re-exposure draft on insurance contracts. The IASB granted the staff permission to begin the balloting process for the targeted re-exposure draft and agreed on a comment period of 120 days. In addition, the IASB staff noted that they would like to complete the IASB's due process – e.g. the receipt and summarisation of comment letters and the completion of roundtable discussions – for that document by the end of 2013. This would imply publication of its targeted re-exposure draft in May or June 2013. The FASB staff said that they expected to issue their ED in June 2013, with a timeline for their due process similar to that of the IASB, and also including a 120-day comment period.

The IASB staff also confirmed that the targeted re-exposure draft will focus on the five key topics previously agreed: the requirement to present the effect of changes in discount rates in other comprehensive income (OCI); the presentation proposals, including those on the presentation of insurance contract revenue; the measurement proposals for participating contracts; unlocking the residual margin; and the revised transition proposals. However, the questions will be drafted at a high level. The IASB staff also plans to include additional questions on the expected operational and reporting complexities of the proposals.

The IASB also decided that, in applying the transition requirements for insurance contracts, an insurer would account for the in-force insurance contracts acquired through business combinations using:

- the date of the business combination as the date of inception of those contracts; and
- the fair value of those contracts at the date of the business combination as the premium received.

In addition, when the proposed insurance standard is first applied to insurance contracts acquired through business combinations, any gains or losses would adjust retained earnings rather than goodwill.

At the FASB-only meetings on 6 and 13 February, the Board made decisions on the following topics:

- scope for guarantees;
- contract modifications;
- reconsideration of the measurement of investment components and aggregate insurance contract revenue;
- a practical expedient for determining the single margin at transition;
- foreign currency transactions; and
- effective date, comparative periods and early adoption.

In late February, the FASB is expected to continue its discussions on the insurance project, covering topics such as unit-linked accounts, the fair value option, presentation and disclosures.

1 This issue of *IFRS Newsletter: Insurance* covers IASB and FASB meetings taking place up to 19 February 2013. The FASB is expected to have further discussions on the insurance project on 20 and 27 February, which will be included in the next *IFRS Newsletter: Insurance*.

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PERMISSION TO BALLOT A TARGETED RE-EXPOSURE DRAFT AND COMMENT PERIOD (IASB ONLY)

The IASB granted the staff permission to begin the balloting process for the targeted re-exposure draft.

The targeted re-exposure draft will be open for comment for 120 days.

What's the issue?

At this month's meetings, the IASB completed the technical decisions needed to finalise its targeted re-exposure draft on insurance contracts. The staff asked the IASB:

- to grant the staff permission to begin the balloting process for the targeted re-exposure draft;
- to state whether any IASB members intend to dissent from the proposals; and
- to agree on the comment period for its targeted re-exposure draft.

What did the IASB staff recommend?

The staff noted that the minimum comment period for a revised ED is 90 days. However, the staff recommended a comment period of 120 days for its targeted re-exposure draft on insurance contracts, because:

- some areas of the proposals are expected to have wide-ranging implications that may need to be assessed by interested parties; and
- additional time is needed for the IASB's intended outreach to stakeholders, including fieldwork.

What did the IASB discuss?

One IASB member asked the staff to outline again the questions that would be asked in their targeted re-exposure draft. The staff responded that the questions would focus on the five areas, as previously agreed[2]. The staff explained that these questions would be at a reasonably high level, but they may include additional questions addressing the details of these topics – e.g. whether the use of OCI should be mandatory or optional.

The staff said that they also planned to include questions to solicit feedback on the operational and reporting complexities of the proposals, and on the clarity of the proposals as drafted. They also mentioned that they planned to perform comprehensive field testing in the exposure period to gather further input on key concerns. One Board member thought that the IASB should co-ordinate with the FASB on field testing and outreach, because the Boards were issuing separate EDs but many aspects of the proposed models were the same.

What did the IASB decide?

The IASB decided:

- to grant the staff permission to begin the balloting process for the targeted re-exposure draft; and
- that the targeted re-exposure draft would be open for comment for 120 days.

In addition, one IASB member said that he would dissent from the proposals, because he does not support the Board's decision to present the effects of discount rate changes in OCI.

2 The five areas are: the requirement to present the effect of changes in discount rates in OCI; the presentation requirements, including the presentation of insurance contract revenue; the measurement proposals for participating contracts; unlocking the residual margin; and the revised transition proposals.

TRANSITION – CONTRACTS ACQUIRED THROUGH A BUSINESS COMBINATION (IASB ONLY)

At transition, the date of the business combination would be used as the date of inception of the contracts acquired in that business combination.

At transition, the fair value at the date of the business combination would be used as the premium received.

Any gains or losses on initial application would adjust retained earnings rather than goodwill.

What's the issue?

The IASB discussed the treatment of in-force contracts at transition that were previously acquired through a business combination. In particular, the IASB considered:

- how to measure in-force contracts at transition that were previously acquired through a business combination; and
- whether retained earnings or goodwill would be adjusted to reflect gains or losses resulting from the initial application of the proposed insurance standard.

What did the IASB staff recommend?

The staff noted that the principle in the 2010 exposure draft (2010 ED) is to measure insurance contracts acquired through business combinations in a similar way to insurance contracts originated by the insurer. As a result, the same transition principles would be applied to measure all contracts at transition. However, an insurer needs to acknowledge the specifics of a business combination and use the information available for business combinations when applying the transition requirements to those contracts. The staff believed that the specifics of insurance contracts acquired through business combinations are accounted for as follows.

Accounting for the specifics of insurance contracts acquired through business combinations	Consistency of accounting for insurance contracts originated by the insurer
The date of inception of those contracts is deemed to be the acquisition date – i.e. the date of the business combination.	The staff believed that using the acquisition date as the date of inception for contracts acquired through business combinations is consistent with the recognition point for contracts originated by the insurer – i.e. the beginning of the coverage period.
The cash inflow of those contracts – i.e. premiums received – is deemed to be the fair value at the acquisition date.	The staff noted that the basis for conclusions for the 2010 ED confirms that the fair value of a portfolio of contracts acquired through a business combination may be viewed as corresponding to the fair value of the consideration received.

The staff also considered whether an insurer would adjust retained earnings or goodwill when the proposed insurance standard is first applied to insurance contracts acquired through business combinations. The staff made the following observations.

- When a new IFRS is applied retrospectively, adjustments are recorded against retained earnings. Adjusting goodwill as a result of the transition to the proposed insurance standard would create an exception to the transition requirements in other IFRSs.
- Any significant retrospective adjustments to goodwill would require the revaluation of all assets and liabilities acquired during the business combination.

As a result, the staff recommended that, in applying the transition requirements for insurance contracts, an insurer would account for the in-force insurance contracts acquired through business combinations using:

- the date of the business combination as the date of inception of those contracts; and
- the fair value of those contracts at the date of the business combination as the premium received.

In addition, the staff recommended that, when the proposed insurance standard is first applied to insurance contracts acquired through business combinations, any gains or losses would be adjusted in retained earnings rather than goodwill.

The staff considered treating all contracts as having been originated by the insurer because this may be simpler. However, the staff believed that this would not provide relevant information for contracts acquired through business combinations.

What did the IASB discuss?

One IASB member asked the staff whether the staff recommendation would conflict with the current guidance in IFRS 3 *Business Combinations* when an insurer enters into a business combination within 12 months of transitioning to the insurance proposals. Specifically, he was referring to the IFRS 3 guidance that allows an entity to adjust goodwill recognised in a business combination within 12 months to reflect new information about facts and circumstances that existed as at the acquisition date.

The staff noted that they had considered this guidance in IFRS 3, and did not believe that there was any conflict; this was because adjustments arising from the application of the insurance proposals would generally not result in "new information about facts and circumstances that existed at the acquisition date" as considered in IFRS 3. The staff said that they would reword the guidance to make this clear.

What did the IASB decide?

The IASB agreed with the staff recommendations.

TRANSITION – PRACTICAL EXPEDIENT FOR DETERMINING THE SINGLE MARGIN (FASB ONLY)

When determining the margin at contract inception, insurers would be able to use their determination of the portfolio immediately before transition.

Contracts written or substantially modified after the date of transition would be grouped into portfolios in accordance with the proposed guidance, which may require separate portfolios.

What's the issue?

The FASB previously decided that, at transition, if retrospective application of the proposed insurance standard is impracticable, then an insurer would estimate what the margin would have been at contract inception had they been able to apply the proposed standard retrospectively. These amounts are rolled forward to the earliest period presented. All objective information that is reasonably available would need to be considered when estimating the margin. The objective information available to many insurers may be limited to the existing definition of a portfolio under US GAAP. The staff noted that in current reporting, there is diversity in the way insurers apply this definition of a portfolio.

In their previous meetings, the FASB had asked the staff to explore a practical expedient that might allow insurers to:

- determine the margin at transition based on the previous 'definitions of portfolios' used in their existing accounting model during the retrospective period; and
- as part of transition, allocate that margin to the 'new portfolios' based on the proposals' definition of a portfolio.

The FASB thought that this type of practical expedient might avoid data collection issues by allowing insurers to determine the margin using exiting accumulations of data.

What did the FASB staff recommend?

The staff noted that, although the FASB intended to eliminate diversity in the interpretation of the current portfolio definition by proposing a new portfolio definition for the forthcoming insurance standard, it would probably be complex, and perhaps overly burdensome, for users to re-group the objective information used in estimating the single margin at transition based on the new portfolio definition.

As a result, the staff recommended the following practical expedient for determining the single margin at transition.

1. When determining the margin at contract inception, insurers would measure the insurance contract liability and the margin using the insurers' determination of the portfolio before transition.
2. Contracts written or substantially modified after the date of transition would be grouped into portfolios in accordance with the proposed guidance, which may require separate portfolios if they are different from point 1 above.

What did the FASB discuss?

One FASB member asked the staff whether the practical expedient would also be applied by insurers performing a full retrospective application of the proposed insurance standard. The staff confirmed that insurers applying the new insurance retrospectively would also be able to use the practical expedient.

Another FASB member commented that the current wording of the staff recommendation might restrict insurers from determining the margin at transition in a full retrospective approach using the 'new definition of a portfolio' when this was available. Some FASB members also expressed concern about the unintended consequences of applying the practical expedient. The impact on the size and comparability of margins for insurers that write similar business would depend on the aggregation level of portfolios applied by insurers today, and may be significant if the insurer classifies its portfolios at a higher level of aggregation – e.g. life and non-life as opposed to product line.

However, the staff thought that most insurers would have the data available, and that in practice most of them report portfolios at a level of aggregation lower than the reporting entity level – i.e. life and non-life portfolios.

What did the FASB decide?

The FASB agreed with the staff recommendation, but modified the recommendations to allow rather than require an insurer to measure the insurance contract liability and the margin at transition using the insurer's determination of the portfolio immediately before transition.

COMMENT PERIOD AND OTHER TRANSITION ISSUES (FASB ONLY)

The ED will not specify an effective date, but rather ask a question about the key drivers affecting the timing of implementation.

The effective date for non-public entities would be a minimum of one year after the effective date for public entities.

Insurers would be required to restate all comparative periods presented.

Effective date and comparative periods

What's the issue?

The FASB's 2010 discussion paper (2010 DP) did not specify an effective date for the proposed insurance standard. However, comment letters and other feedback from constituents indicated that the usual two-year timeframe for transition to a new standard would not be sufficient to implement the proposed insurance standard. This was because:

- the transition to the proposed insurance standard would be operationally challenging due to the pervasive effect on data accumulation, systems, controls and reporting, as well as product design and capital management; and
- such complex requirements would require insurers to provide education both within the organisation and to stakeholders.

What did the FASB staff recommend?

The staff believed that the FASB's upcoming ED should provide an effective date for the proposed insurance standard. Feedback from the comment letters and other outreach indicated that insurers would need a relatively long period of time (estimates ranged from three to six years) to adapt their systems and processes to the requirements of the proposed insurance standard. Therefore, more time would be granted to insurers between the issuance of the proposed insurance standard and the effective date than would typically be given for implementing a new standard.

In addition, the staff considered whether the effective date of the proposed insurance standard should be delayed for non-public entities. The staff believed that non-public entities would need even more time to implement the proposed insurance standard, because of resource and cost constraints.

The staff also considered whether insurers should be required to restate comparative financial information. They supported the restatement of comparative financial information, because:

- the proposed insurance standard needs to be applied retrospectively, and therefore insurers would already be required to measure insurance contracts for past periods; and
- user feedback indicated that it was important for trending future results to recognise and measure all insurance contracts consistently, both in the current period and in all comparative periods presented.

As a result, the staff recommended that:

- the requirements would be effective no earlier than for reporting periods following the third fiscal year end after the proposed insurance standard has been issued;
- the effective date for non-public entities would be a minimum of one year after the effective date for public entities; and
- insurers would be required to restate all comparative periods presented.

What did the FASB discuss?

FASB members had different views on whether its ED should indicate an effective date for the proposed insurance standard. There was no firm consensus on the minimum timeframe – e.g. two or three years – that should be allowed for implementation from the issuance of the proposed insurance standard. As a result, most FASB members agreed not to specify or indicate an effective date.

However, they agreed that the ED should ask constituents to provide feedback on:

- the estimated time needed to implement the changes considering retrospective application; and
- the key drivers of that expected implementation time, particularly with respect to transition issues.

One specific issue raised was whether entities – both insurers and non-insurers – that rely heavily on service providers for data or claims processing, or actuarial services, would need additional time to implement the proposals; this is because many service providers will need to adapt their systems and processes to accommodate any additional data requirements for reporting under the proposed requirements.

The FASB also discussed whether to grant non-public entities an additional year to implement the proposed insurance standard. Most FASB members agreed that a one-year deferral for non-public entities was reasonable. However, a few FASB members thought that the effective date should also be delayed for public non-insurance companies (currently not within the scope of the insurance standards under US GAAP), because they may not have adequate systems in place to implement the proposed insurance standard. Most FASB members did not want to delay the effective date for non-insurance companies. However, they supported asking constituents for their view on this in their upcoming ED.

What did the FASB decide?

The FASB made the following decisions.

- Its ED will not include a minimum time period between the issuance of the proposed insurance standard and the effective date, but a question would be asked about the key drivers impacting timing of implementation.
- The effective date for non-public entities would be a minimum of one year after the effective date for public entities.
- Insurers would be required to restate all comparative periods presented.

Insurers would not be allowed to early adopt the proposed insurance standard.

Early adoption

What's the issue?

Early adoption of a new accounting standard may reduce comparability of the financial statements of entities adopting the new guidance at different times. As a result, the FASB usually does not allow early adoption of a new standard.

The comment letter respondents had differing views on early adoption. However, many respondents to the 2010 DP did emphasise the importance of aligning the effective dates for insurance contracts and financial instruments guidance on implementation.

The FASB's financial instruments guidance is expected to come into effect before the insurance proposals, although the effective date has not been finalised. However, the FASB had previously decided to permit an insurer, upon adopting the insurance contracts standard, to designate and classify financial assets designated to its insurance business as if it had also adopted the relevant, effective classification and measurement guidance for financial instruments on that date. This would result in a 'fresh start' classification of financial instruments if insurers transition to the insurance proposals after the financial instruments proposals, eliminating some of the related transition concerns.

What did the FASB staff recommend?

The staff believed that:

- aligning the effective date of the proposed insurance standard with the effective date of the financial instruments guidance would be ideal; and
- delaying the implementation of the financial instruments guidance for insurers would not be reasonable.

In addition, the proposed financial instruments standard does not require a restatement of comparative financial information, but rather a cumulative effect adjustment in the year in which it is adopted. Therefore, if the proposed insurance standard was early adopted in conjunction with the adoption of the financial instruments guidance, then this would result in a restatement of prior periods presented only for insurance contracts; and it would therefore result in inconsistent reporting.

As a result, the staff recommended that:

- insurers would be permitted to early adopt the guidance on insurance contracts if they also adopt the guidance in the proposed update on financial instruments; and
- if the proposed insurance standard is early adopted, then comparative financial information would not be required in the first year of adoption (or the second year of adoption for the statement of comprehensive income if the entity presents two years of comparatives and the proposed insurance standard is not yet effective).

What did the FASB discuss?

One FASB member expressed his concern with limiting the presentation of comparative financial information, because this would be at odds with a retrospective application of the proposed insurance standard. Although the FASB members were sympathetic to the insurers' plea for aligned effective dates, most preferred not to allow early adoption. However, they thought that the issue should be reconsidered when more reliable information about the effective date of the financial instruments standard is available. Overall, most FASB members supported not allowing early adoption of the proposed insurance standard, and seeking feedback from constituents on early adoption.

What did the FASB decide?

The FASB decided that insurers would not be allowed to early adopt the proposed insurance standard.

Comment period

The comment period for the FASB's upcoming ED will be 120 days.

What's the issue?

The typical comment period from the issuance of a major FASB ED is 90 days. In the case of a joint project, the FASB typically provides a comment period of 120 days.

What did the FASB staff recommend?

The staff believed that a 120-day comment period was needed because:

- some of the proposals in its upcoming ED on insurance contracts would represent a fundamental change to current US GAAP; and
- field testing would be needed to understand the impacts of the proposed changes.

As a result, the staff recommended a 120-day comment period.

What did the FASB decide?

The FASB agreed with the staff recommendation and decided to provide a 120-day comment period for its upcoming ED.

SCOPE FOR GUARANTEES (FASB ONLY)

The FASB decided on the types of guarantees to be scoped out of the proposed insurance standard.

What's the issue?

Under current US GAAP, the accounting guidance to be applied is driven by the nature of the guarantee and the type of entity issuing the guarantee.

- Guarantees issued by insurers are accounted for as insurance under FASB ASC Topic 944 *Financial Services—Insurance*.
- Guarantees meeting the definition of a derivative follow the accounting guidance in FASB ASC Topic 815 *Derivatives and Hedging*.
- Other guarantees – including those issued by non-insurance entities that do not meet the definition of a derivative – follow the accounting guidance in FASB ASC Topic 460 *Guarantees*.

The accounting guidance under these three topics varies, with different measurement models being applied.

At previous meetings, the FASB decided to scope those contracts that are currently treated as insurance contracts under US GAAP – i.e. apply the accounting guidance in FASB ASC Topic 944 – into the insurance contracts proposals. Similarly, it confirmed that guarantees that currently apply the guidance in FASB ASC Topic 815 would remain out of scope. However, the FASB did not decide whether the wide range of guarantees currently in scope of FASB ASC Topic 460 that meet the definition of an insurance contract would be subject to the insurance contracts proposals.

What did the FASB staff recommend?

The FASB asked the staff to perform an analysis to:

- identify guarantees that meet the definition of insurance contracts; and
- determine whether the guarantees have differentiating characteristics that support different accounting.

The staff reviewed existing guidance in FASB ASC Topic 460, and were unable to develop an overall principle to identify guarantees that should be scoped out of the proposed insurance standard based on an over-riding characteristic. Consequently, the staff believed that the proposed insurance standard should be applied to all guarantees that meet the definition of an insurance contract – including those guarantees currently in the scope of FASB ASC Topic 460. However, they also proposed retaining the current scope exclusions in FASB ASC Topic 460, to prevent a major scope change from existing practice.

As a result, the staff recommended that the proposed insurance standard would apply to all guarantee contracts that meet the definition of an insurance contract (unless the guarantee meets any other scope exceptions included in the proposals), except for those having any of the following characteristics.

Characteristics that would exclude guarantee contracts from the scope of the proposed standard
• The insurer is not exposed to risk throughout the term of the guarantee – i.e. from inception of the contract and throughout its term – either through direct legal ownership of the guaranteed obligation or through a back-to-back arrangement with another party that is required by the back-to-back arrangement to maintain direct ownership of the guaranteed obligation.
• A guarantee or an indemnification is of an entity's own future performance.

Characteristics that would exclude guarantee contracts from the scope of the proposed standard (continued)

- The guarantee is addressed in the following areas of the Codification:
  - guarantees addressed in FASB ASC Topic 840 *Leases*:

    (i) a lessee’s guarantee of the residual value of the leased property at the expiration of the lease term;

    (ii) a contract that is accounted for as contingent rent;

    (iii) a seller-lessee's residual value guarantee if that guarantee results in the seller-lessee deferring profit from the sale greater than or equal to the gross amount of the guarantee; and

    (iv) a sales incentive program in which a manufacturer contractually guarantees that the buyer will receive a minimum resale amount at the time the equipment is disposed of, if that guarantee prevents the manufacturer from being able to account for a transaction as a sale of an asset, as described in paragraphs 840-10-55-12 to 55-25;
  - a contract that provides for payments that constitute a vendor rebate (by the guarantor) based on either:
    - the sales revenues of, or the number of units sold by, the guaranteed party; or
    - the volume of purchases by the buyer that are discussed in FASB ASC Topic 605 *Revenue Recognition*;
  - a guarantee or an indemnification whose existence prevents the guarantor from being able to either account for a transaction as the sale of an asset that is related to the guarantee’s underlying, or recognise in earnings the profit from that sale transaction; this would include, among other items, a transaction that involves the sale of a marketable security to a third party buyer with the buyer's having an option to put the security back to the seller for a fixed price, if the existence of the put option prevents the transferor from accounting for the transaction as a sale, as described in paragraphs 860-20-55-20 to 55-23;
  - guarantees addressed in FASB ASC Topic 360 *Property, Plant, and Equipment*:

    (i) a seller's guarantee of the return of a buyer's investment or return on investment of a real estate property; and

    (ii) a seller's guarantee of a specified level of operations of a real estate property; and
  - a guarantee for which the guarantor’s obligation would be reported as an equity item rather than a liability under FASB ASC Topic 480 *Distinguishing Liabilities from Equity* and FASB ASC Topic 505 *Equity*.

In addition, the staff asked the Board to consider whether the following guarantees should be excluded from the scope of the proposed insurance standard:

- guarantees issued by an entity that meet the definition of an insurance contract and are both:
  - unusual or non-recurring; and
  - unrelated to the type of risk that is the subject of other guarantees issued by the entity; and
- guarantees issued by related parties under common control.

What did the FASB discuss?

The FASB discussed whether all guarantees listed as scope exclusions in the staff recommendation would need to be explicitly scoped out of the proposed insurance standard. A few FASB members believed that some guarantees listed as scope exclusions in the recommendation may not meet the definition of an insurance contract, but instead meet the definition of a derivative; this is because they are related to financial risk and not to insurance risk. However, the staff referred to the current guidance in FASB ASC Topic 460 that explicitly states that these guarantees are not derivatives.

They also discussed whether guarantees issued by an entity that are both:

- unusual or non-recurring; and
- unrelated to the type of risk that is the subject of other guarantees issued by the entity

would also need to be excluded from the scope of the proposed insurance standard. Most FASB members supported such a scope exclusion. They believed that it would be useful to limit the scope for occasional transactions entered into by entities that:

- are not in the business of issuing guarantees; and
- would be unlikely to have adequate data and processes to apply the measurement model under the proposed insurance contract.

Some FASB members also suggested limiting the scope exception for these guarantees to non-insurance entities, instead of generally scoping them out of the proposed insurance standard.

The FASB also considered a scope exclusion for guarantees on behalf of or between related parties or entities under common control. FASB members generally supported a scope exclusion for those types of transactions. However, they believed that the important criterion was whether the entity issued similar guarantees to third parties.

What did the FASB decide?

The FASB agreed with the staff recommendation as outlined above.

In addition, the FASB decided that the proposed insurance contracts standard would not apply to:

- guarantees issued by an entity that are both:
  - unusual or non-recurring; and
  - unrelated to the type of risk that is the subject of other guarantees issued by the entity;
- a guarantee between related parties or entities under common control when the issuer of the guarantee is not also issuing similar guarantees to third parties; and
- a guarantee of debt owed to a third party by a related party or entity under common control when the issuer of the guarantee is not also issuing similar guarantees of debt owed by third parties.

CONTRACT MODIFICATIONS (FASB ONLY)

The FASB included additional criteria from Subtopic 944-30, under which an insurer would derecognise an existing contract and recognise a new contract.

What's the issue?

According to a previous joint decision, an insurer would derecognise an existing contract and recognise a new contract if it amends the contract in a way that, had the amended terms been in place at the inception of the contract, would have resulted in a different assessment of either of the following items:

- whether the contract is within the scope of the insurance contracts standard; or
- whether to use the premium-allocation approach or the building-block approach to account for the insurance contract.

The FASB asked the staff to perform additional analysis of modifications to insurance contracts that would result in contract extinguishment. In particular, the FASB asked them to consider conditions indicating substantial change as outlined in Subtopic 944-30 *Financial Services—Insurance—Acquisition Costs*, originally issued as AICPA Statement of Position 05-1 *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modification or Exchanges of Insurance Contracts*.

What did the FASB staff recommend?

The staff reviewed Subtopic 944-30 and noted that it includes six criteria to identify a substantial contract modification. One of the criteria in Subtopic 944-30 for avoiding contract extinguishment is that there is no change to the amortisation method or revenue classification of the contract. The staff believed that this condition did not need to be considered, because it had previously been addressed by decisions on the treatment of the margin and acquisition costs. However, the staff noted that all of the five other criteria mentioned in Subtopic 944-30 would need to be addressed in identifying a substantial modification to an insurance contract.

As a result, the staff recommended that, in addition to the conditions addressed by previous Boards decisions, an insurer would derecognise an existing contract and recognise a new contract if any of the following conditions exist.

- The insured event, risk, or period of coverage of the contract has changed, as noted by significant changes in the kind and degree of mortality risk, morbidity risk, or other insurance risk, if any.
- There has been a change in the nature of the investment return rights – e.g. whether amounts are determined by formulas specified by the contract, by a pass through of the actual performance of referenced investments, or at the discretion of the insurer – accounted for as part of the insurance contract, if any, between the insurance enterprise and the contract holder.
- Any additional deposit, premium or charge relating to the original benefit or coverage, in excess of the amounts specified or allowed in the original contract, is required to effect the transaction.
- If there is a reduction in the original benefit or coverage; or if any reduction in the deposit, premiums, or charges is less than the corresponding reduction in benefits or coverage.
- There is a net reduction in the contract holder's account value or the cash surrender value, if any exists – except for reductions resulting from:
  - distributions to the contract holder or contract designee; or
  - charges related to newly purchased or elected benefits or coverages.
- There is a change in the participation or dividend features of the contract, if any such features exist.

What did the FASB discuss?

One FASB member asked the staff whether contract modifications are common for insurance contracts. The staff noted that modifications to insurance contracts are not unusual, and often accompany the design of new products. In addition, part of the reason for issuing Statement of Position 05-1 was due to modifications to insurance contracts in practice.

What did the FASB decide?

The FASB agreed with the staff recommendation.

MEASUREMENT AND ALLOCATION OF INVESTMENT COMPONENTS (FASB ONLY)

The FASB decided on the measurement and allocation of investment components excluded from insurance contract revenue in the statement of comprehensive income.

What's the issue?

In a FASB meeting in October 2012, the Board decided on a method to allocate the consideration for an insurance contract between investment and insurance components. As a result of this previous decision, the amount of consideration allocated to the investment component for any given period would be determined as the sum of:

- the increase/decrease of the amount of the cash surrender value or the account balance to which the policyholder is entitled;
- *plus* the amount of surrenders;
- *plus* the cash surrender value included in any death benefits paid;
- *less* any interest credited.

At the time of the decision, the FASB had not yet decided on the presentation of insurance contract revenue in the statement of comprehensive income, but noted that the Board decision may be more difficult to apply in an earned-premium presentation. In particular, it may be difficult to determine the amount of consideration to be allocated to the investment component for the purpose of allocating revenue to each period.

As a result, the FASB reconsidered how to measure the consideration to be allocated to the investment component at this month's meeting, taking into account its previous decision to apply an earned-premium approach to the statement of comprehensive income.

What did the FASB staff recommend?

The staff believed that there was an inconsistency between its decision on the measurement of the investment component and the earned-premium presentation, because:

- the earned-premium approach requires insurance contract revenue to be allocated to periods in proportion to the value of coverage provided; and
- for the purpose of measuring the investment component, the insurance contract revenue to be recognised each period was the actual amount of fees charged to the account balance for the period.

However, the timing of those fees does not correlate directly with the value of coverage provided by the insurer.

The staff considered a few alternative approaches for allocating consideration to investment components, seeking to retain the benefits of the decision in an earned-premium presentation. However, the staff believed that none of the alternatives that they analysed would be compatible with the decision on the earned-premium presentation, and that they may lead to misleading revenue amounts.

The staff thought that the amount of consideration allocated to the investment component should be based on the estimated future payout to the policyholders attributable to the investment component. The expected cash flows to be paid to the policyholders would be re-estimated at the end of each reporting period, and allocated prospectively in proportion to the coverage provided.

As a result, the staff recommended the following.

- The amount of consideration allocated to investment components and excluded from the premium presented in the statement of comprehensive income would be equal to the cash flows that the insurer estimates it will be obligated to pay to policyholders or their beneficiaries regardless of whether an insured event occurs.
- At the end of each reporting period, these cash flows would be re-estimated based on the current assumptions used in the measurement of the insurance contract liability, with any effect

on insurance contract revenue allocated prospectively to periods in proportion to the value of coverage and any other services that the insurer estimates will be provided in those periods.

What did the FASB discuss?

The FASB supported the staff recommendation. They believed that the prospective re-allocation of the consideration to the investment component at each reporting date:

- would be consistent with the January decisions on the prospective re-allocation of the remaining insurance contract revenue when there is a change in the expected pattern of coverage provided; and
- would mitigate the volatility of insurance contract revenue that may otherwise exist.

What did the FASB decide?

The FASB agreed with the staff recommendation.

FOREIGN CURRENCY TRANSACTIONS (FASB ONLY)

When remeasuring foreign currency transactions, all financial statement components related to an insurance contract would be classified as monetary.

What's the issue?

Under current US GAAP guidance, the exchange rate to be used for remeasuring foreign currency transactions into the entity's functional currency depends on the classification of the item as monetary or non-monetary.

Classification of item	Exchange rate used for remeasurement
Monetary item	Current rate
Non-monetary item	Historical rate

What did the FASB staff recommend?

The staff presumed that the following items would be classified as monetary, consistent with current US GAAP guidance:

- liabilities for incurred claims for contracts accounted for under the premium-allocation approach, because this would be consistent with the treatment of the loss reserves on short-duration contracts under current accounting; and
- insurance contract liabilities for contracts accounted for under the building-block approach, because this would be consistent with the treatment of long-duration life insurance contracts under current accounting.

In addition, the staff performed further analysis of the following items:

- liabilities for remaining coverage for contracts accounted for under the premium-allocation approach;
- single margins for contracts accounted for under the building-block approach; and
- policy acquisition costs for contracts accounted for under the building-block approach.

The staff had mixed views on the approach to be recommended.

FASB staff view 1	Assess each component of insurance contracts individually, to determine whether it should be classified as monetary or non-monetary
FASB staff view 2	Classify all components as monetary

Most of the staff recommended that all components would be classified as monetary items, because of the following advantages:

- consistent accounting for various components of insurance contracts;
- consistent accounting for all types of insurance contracts, regardless of the Board's tentative decisions on presentation in the financial statements;
- simpler application;
- elimination of an accounting mismatch if cash is held in the foreign currency and is measured at the current rate; and
- convergence with the proposals in the IASB's 2010 ED.

What did the FASB discuss?

The FASB noted that, under a previous FASB decision, expected acquisition costs are reported in the insurance liability 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. However, acquisition costs that are already paid are not recognised in the statement of financial position. FASB members discussed whether these two components of acquisition costs need to be assessed separately and classified differently as monetary and non-monetary.

The FASB members agreed that assessing each component of the insurance contract items separately would be complex and costly, and would not be warranted under cost-benefit considerations.

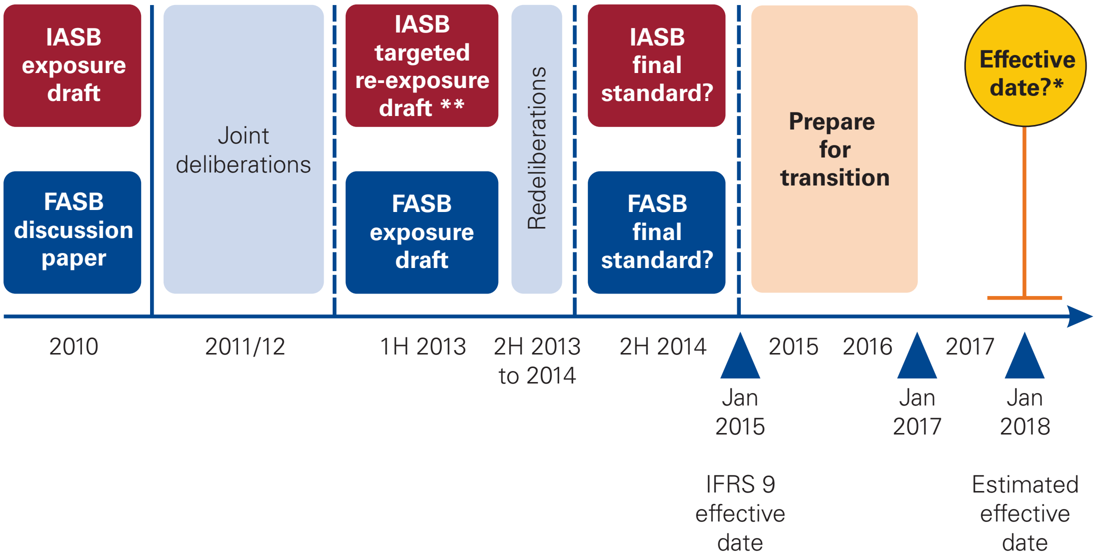
In addition, one FASB member noted the industry's appeal to consider both the asset and liability side of the statement of financial position. Insurance liabilities are funded to a large extent by financial assets that are monetary items and remeasured at current rates. If insurance liabilities were classified as non-monetary, then an inconsistency with the treatment of funding financial assets would arise.

What did the FASB decide?

The FASB decided that when remeasuring foreign currency transactions, all financial statement components related to an insurance contract would be classified as monetary.

TIMELINE FOR COMPLETION

Based on the IASB's published workplan, a targeted re-exposure draft from the IASB is expected to be released in the second quarter of 2013. We anticipate a similar timing for the FASB's ED. A final standard is not anticipated before the second half of 2014.



* The effective date of the final IFRS standard 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 targeted 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 would 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 requirement 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 discount rates used to measure insurance contract liabilities.
- The revised transition proposals.

In addition, the IASB staff also plans to include questions on the expected operational and reporting complexities of the proposals, and on the clarity of the proposals as drafted.

Significant differences between the IASB and the 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);
- unlocked 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 (up until 19 February 2013) 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 discretionary participation feature (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.

In the February 2013 meetings, the Boards agreed on 120-day comment periods for their respective upcoming exposure drafts.

TENTATIVE DECISIONS COMPARED WITH KEY PROPOSALS IN THE 2010 ED

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	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 included a requirement to consider the time value of money in assessing risk transfer and a test that insurance risk would not be 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.	**Joint** The proposals in the ED have been confirmed. In addition, the Boards decided the following. • 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 would 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, would be considered a single contract for the purpose of determining risk transfer. **IASB** The implementation guidance that currently accompanies IFRS 4 will not be carried forward to the new standard. However, the proposals will include an explicit explanation that not carrying forward the implementation guidance on IFRS 4 does not mean that the IASB rejected that guidance.	• 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.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Scope	**Financial guarantees [!]** The ED proposed deleting the separate definition of a financial guarantee contract contained in IFRS 4 and IAS 39 *Financial Instruments: Recognition and Measurement* 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 the 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 agreed 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 had previously 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. • The IASB agreed not to provide an exception for intra-group guarantees from the accounting for financial guarantee contracts consistent with the current provisions of IAS 39 and IFRS 4.
		FASB The FASB decided that the proposed insurance contracts standard would apply to guarantee contracts within the scope of Topic 944 *Financial Services – Insurance*, and would not apply to guarantee contracts within the scope of Topic 815 *Derivatives and Hedging*.	• In November 2012, the FASB discussed the nature of financial guarantee contracts that it wished to have subjected to the insurance contracts standard. Under current US GAAP, the nature of the guarantee, and the 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.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Scope		The FASB decided that the proposed insurance standard would apply to all guarantee contracts that meet the definition of an insurance contract (unless the guarantee meets any other scope exceptions included in the proposals), except for those having any of the following characteristics. • The insurer is not exposed to risk throughout the term of the guarantee – i.e. from inception of the contract and throughout its term – either through direct legal ownership of the guaranteed obligation or through a back-to-back arrangement with another party that is required by the back-to-back arrangement to maintain direct ownership of the guaranteed obligation. • A guarantee or an indemnification is of an entity's own future performance. • Guarantees issued by an entity are both: – unusual or non-recurring; and – unrelated to the type of risk that is the subject of other guarantees issued by the entity. • The guarantee is addressed in the following areas of the Codification: – guarantees addressed in Topic 840 *Leases*: (i) a lessee's guarantee of the residual value of the leased property at the expiration of the lease term; (ii) a contract that is accounted for as contingent rent; (iii) a seller-lessee's residual value guarantee if that guarantee results in the seller-lessee deferring profit from the sale greater than or equal to the gross amount of the guarantee; and	• In February 2013, the FASB discussed whether the wide range of guarantees currently within the scope of Topic 460 *Guarantees* that meet the definition of an insurance contract would be subject to the proposed insurance standard. The staff believed that the proposed insurance standard should be applied to all guarantees that meet the definition of an insurance contract – including those guarantees currently in the scope of Topic 460. However, they also proposed retaining the current scope exclusions in Topic 460.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Scope		(iv) a sales incentive program in which a manufacturer contractually guarantees that the buyer will receive a minimum resale amount at the time the equipment is disposed of, if that guarantee prevents the manufacturer from being able to account for a transaction as a sale of an asset, as described in paragraphs 840-10-55-12 to 55-25; – a contract that provides for payments that constitute a vendor rebate (by the guarantor) based on either the sales revenues of, or the number of units sold by, the guaranteed party or based on the volume of purchases by the buyer that are discussed in Topic 605 *Revenue Recognition*; – a guarantee or an indemnification whose existence prevents the guarantor from being able to either account for a transaction as the sale of an asset that is related to the guarantee's underlying, or recognise in earnings the profit from that sale transaction; this would include, among other items, a transaction that involves the sale of a marketable security to a third party buyer with the buyer's having an option to put the security back to the seller at a specified future date or dates for a fixed price, if the existence of the put option prevents the transferor from accounting for the transaction as a sale, as described in paragraphs 860-20-55-20 to 55-23;	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Scope		– guarantees addressed in Topic 360 *Property, Plant, and Equipment*: (i) a seller's guarantee of the return of a buyer's investment or return on investment of a real estate property; and (ii) a seller's guarantee of a specified level of operations of a real estate property; and – a guarantee for which the guarantor's obligation would be reported as an equity item rather than a liability under Topic 480 *Distinguishing Liabilities from Equity and Topic 505 Equity*. In addition, the FASB decided that the proposed insurance standard would not apply to: • a guarantee between related parties or entities under common control when the issuer of the guarantee is not also issuing similar guarantees to third parties; and • a guarantee of debt owed to a third party by a related party or entity under common control when the issuer of the guarantee is not also issuing similar guarantees of debt owed by third parties.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	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 would be an addition to the definition in IFRS 4. In measurement, the boundaries of financial instruments with a DPF would be defined as the point at which the contract holder no longer has a contractual right to receive benefits arising from a DPF.	**IASB** The forthcoming insurance contracts standard would apply to financial instruments with DPFs that are issued by insurers. It would not apply to any financial instruments issued by entities other than insurers. The contract boundary for a financial instrument with a DPF would be 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. 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. **FASB** Investment contracts with discretionary participation features would 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 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 currently exists in IFRS 4. • The IASB members had mixed views on this topic. The majority 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 this limitation, 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 (Board decisions are tentative and may be subject to change in future meetings)	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 the 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.	**Joint** The proposals in the ED have been 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 do not meet all three criteria would be considered to be insurance contracts. **FASB** Title insurance contracts would be in the scope of the insurance contracts standard, because they meet the tentative definition of an insurance contract. Charitable gift annuities that possess a donation element and are issued by not-for-profit entities within the scope of Topic 958 *Not-for-Profit Entities*, would be excluded from the scope of the proposed insurance contracts standard.	• 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 because 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. • The IASB decided not to create specific guidance on takaful arrangements (designed to offer participants protection that is comparable with conventional insurance while adhering to Shariah principles) in the future insurance standard. However, the IASB decided to establish a consultative group to help assess the relationship between IFRS and Shariah-compliant transactions.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	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 reassess the risk of the particular policyholder and, as a result, can no longer change the price to fully reflect that risk.	**Joint** Insurance contract assets and liabilities would 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 measurement of an identified onerous contract liability would be updated at the end of each reporting period. **IASB** The recognition guidance will clarify that the recognition point for deferred annuities is the earlier of: • the start of the coverage period; or • the date on which the first premium becomes due. In the absence of a contractual due date, the premium is deemed to be due when received. Risk adjustment would be considered when identifying onerous contracts and the measurement of an onerous contract liability would include a risk adjustment.	• 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.

The measurement model	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
	Measurement model The proposals contained 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 was 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 used certain 'building blocks' in measuring that package of cash flows.	**Joint** The proposals in the ED have been 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.
	Four building blocks (preference in the 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.	**IASB** The proposals in the ED have been confirmed.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
The measurement model	**Three building blocks (preference in the 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 'composite margin') that eliminates any gain at inception of the contract. The FASB decided that the margin at inception (single margin) would 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.	**FASB** The proposals in the ED have been 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 generally not 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.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
The measurement model	**Level of measurement (fulfilment cash flows and risk adjustment)** Under the proposals, an insurer would measure the present value of the fulfilment cash flows including 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.	**Joint** The Boards confirmed that, in general, the proposals would measure insurance contracts at the portfolio level. **IASB** A portfolio of insurance contracts would 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. No further guidance on the unit of account for the risk adjustment has been specified. **FASB** A portfolio of insurance contracts would 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 IASB and the 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 the 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.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
The measurement model	**Level of measurement (residual/single margin)** 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.	**IASB** The unit of account used to *release* the residual margin would not be prescribed. However, the release of the residual margin would 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. **FASB** The unit of account used to *determine* and *release* the single margin, and perform the onerous contract test, would be the portfolio.	• Both the IASB and FASB would allow releasing the residual/single margin on a contract basis.
	Non-performance risk The present value of the fulfilment cash flows would not reflect the risk of non-performance by the insurer, either at initial recognition or subsequently.	**Joint** The proposal in the ED has been confirmed.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
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 reassess 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.	**Joint** A contract renewal would be treated as a new contract when the insurer is no longer required to provide coverage or when the existing contract does not *confer any substantive rights* on the policyholder. All renewal rights would be considered in determining the contract boundary, whether they arise from a contract, from law or from regulation. A contract would not confer any substantive rights on the policyholder when the insurer has the right or the practical ability to reassess the risk of the particular policyholder and, as a result, can set a price that fully reflects that risk. An additional point would affect 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 reassess 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.	• 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. • 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 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.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Building blocks – Cash flows	**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 would: • 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; • 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.	**Joint** The Boards decided that: • the measurement of insurance contracts would use the expected value of future cash flows rather than a single, most likely outcome; • the measurement model would be based on current estimates; and • the measurement of an insurance contract would include all cash flows that arise as the insurer fulfils the insurance contract. The Boards confirmed that insurers would measure the insurance contract liability taking into account estimates of expected cash flows at the end of the reporting period. The Boards clarified that: • the measurement objective for expected value would refer 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.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Building blocks – Cash flows	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 clarified that the costs included in the cash flows used in measuring a portfolio of insurance contracts would be all the costs that the insurer would incur in fulfilling contracts and that: • *directly* relate to the fulfilment of the contracts in the portfolio; • are *directly* attributable 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 would be excluded. These costs would be recognised as expenses in the period in which they are incurred. Application guidance would be provided 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 would 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 would apply to contract riders. **IASB** The proposals will clarify that the cash flows relating to tax payments would be evaluated and treated like any other cash flows.	• The IASB staff noted that they had received a request for clarification on income taxes included in fulfilment cash flows, because some constituents believed that the proposal in the 2010 ED was scoping out policyholder taxes that are incremental cash flows arising as the insurer fulfils the contract.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	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 they are incurred in profit or loss. Unlike other cash flows, the determination of 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.	**Joint** Acquisition costs to be included in the initial measurement of a portfolio of insurance contracts would be all the direct costs that the insurer will incur in acquiring the contracts in the portfolio, and would 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, acquisition costs incurred before a contract's coverage period begins would be recognised as part of the insurance contract's liability for the portfolio of contracts, where the contract will be recognised once the coverage period begins. **IASB** No distinction would be made between successful acquisition efforts and unsuccessful efforts. **FASB** Acquisition costs included in the cash flows of insurance contracts would be limited to those costs related to successful acquisition efforts. Direct-response advertising would be expensed as it is incurred, consistent with other forms of advertising.	• 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 would 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 (Board decisions are tentative and may be subject to change in future meetings)	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.	**Joint** The proposals in the ED have been confirmed. The Boards clarified that the same objective would apply to the discount rate used to measure both participating and non-participating contracts. They provided 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 would 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. All insurance contracts would be measured using a discount rate that is updated each reporting period. In addition, the Boards 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. 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, would be provided.	• 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Building blocks – Discount rate	**Discount rate guidance** The ED and the DP did not provide additional guidance on the approaches used for the discount rate.	**Joint** The Boards decided to provide guidance on matters to be considered in determining the discount rate and clarified that the discount rate would reflect only the effect of risks and uncertainties that are not reflected in other building blocks in the measurement of the liability. In applying the top-down approach to determining the discount rate: • an appropriate yield curve would be determined by an insurer based on current market information and reflecting current market returns either for the actual portfolio of assets that the insurer holds or for a reference portfolio of assets with similar characteristics to those of the insurance contract liability; • the insurer would 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 would 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 used, 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 (Board decisions are tentative and may be subject to change in future meetings)	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 that 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.	**IASB** The measurement of an insurance contract would contain an explicit risk adjustment. The risk adjustment would be the compensation that the insurer requires for bearing the uncertainty inherent in the cash flows that arise as the insurer fulfils the insurance contract. In addition, the application guidance would clarify the following. • The risk adjustment would measure 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 would 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.	• Several IASB members focused on the need to have a clear objective if the techniques for estimating a risk adjustment would not be limited. • Some Board members commented that if a clear objective is defined, then insurers would use the most appropriate techniques to calculate the risk adjustment. There would be subjectivity in implementing the risk adjustment, but these differences can be shown through disclosures. • 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Building blocks – Risk adjustment		The range of available techniques and related inputs to the risk adjustment would not be limited. As examples, the three techniques proposed in the ED (confidence level, CTE and cost of capital) would be retained, together with the related application guidance.	• 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. They 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 agreed 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 decided to eliminate an explicit risk adjustment from the measurement approach.	**FASB** The FASB confirmed that a risk adjustment would not be included in measurement.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
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 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.	**IASB** 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 was confirmed. The residual margin would not be locked in at inception. An insurer would: • adjust the residual margin for differences between current and previous estimates of cash flows relating to *future coverage or other future services*; • 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.	• The residual margin would be adjusted for differences between current and previous estimates of cash flows relating to future coverage or other future services 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 cash flows relating to future coverage or other future services 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. In applying the refined notion for unlocking the residual margin: • changes in estimates of incurred claims would be recognised in profit or loss; • the residual margin would be adjusted for experience differences if they relate to future coverage – e.g. premiums received for future coverage; • a delay or acceleration in repayments of investment components would not necessarily lead to the residual margin being adjusted; and • the residual margin for contracts with asset-dependent cash flows would be adjusted only for changes in estimates of profit for future services. Changes in the profits for services in the current period would be recognised in profit or loss immediately. If such changes related to contracts to which mirroring is applied, then the changes would be recognised and presented in a way that mirrored the recognition of asset gains or losses.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Building blocks – Margins		In addition: • the residual margin would not be negative; and • insurers would 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. It was confirmed that: • an insurer would accrete interest on the residual margin; and • the rate used for the accretion of interest would be the discount rate of the liability determined at initial recognition – i.e. a locked-in rate. No additional guidance on estimating the discount rate that related to the accretion of interest on the residual margin would be provided.	• 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 members of the Boards 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 would determine the residual margin on 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 therefore requires accretion. Using a locked-in discount rate avoids some of the problems associated with using a current rate, such as recognising amounts in other comprehensive income (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*.

Building blocks – Margins	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
	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: $\dfrac{\text{(Premium allocated to current period + current-period claims and benefits)}}{\text{(Total contract premium + total claims and benefits)}}$	**FASB** An insurance contract measurement model would 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 would not remeasure or recalibrate the single margin to recapture previously recognised margin. The single margin would not be unlocked for changes in actual or expected cash flows and, instead, such changes would be reported in profit and loss immediately. If an insurer determines that a portfolio of contracts is onerous, then an additional liability would be recognised with a corresponding offset to eliminate any remaining margin. This liability would be 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.	• 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 the FASB measurement approaches would be the remeasurement of the risk adjustment and residual margin under the IASB's model compared with the FASB's model, which would run 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 Boards' 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 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 would 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Building blocks – Margins		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. The following scenarios outline when an insurer would be released from risk for the purpose of recognising the single margin in profit. • 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 would be 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 would be 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. An insurer would 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 would include the following: • the entity's relative experience with the types of contracts; • the entity's past experience in estimating expected cash flows;	• 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'. These would include: – 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Building blocks – Margins		• 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 would 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 would disclose the methodology used to calculate the profit realisation of the single margin.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Premium-allocation approach	**Premium-allocation approach (previously referred to as the 'modified measurement approach') [!]** **Eligibility** 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 would 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 the FASB eligibility criteria. Insurers would be *permitted* rather than required to apply the premium-allocation approach. **FASB** The building-block approach would 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 disagreed 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 would be presented net and under the premium-allocation approach there would be a separate presentation of the premiums written and not yet collected and the liability for remaining coverage, which would also be 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 that further guidance was needed in this area.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Premium-allocation approach	**Measurement of pre-claims obligation** 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.	**Joint** Discounting and interest accretion to reflect the time value of money would 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, an insurer would not need to 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 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 decided that: • the measurement of acquisition costs would 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 would 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 more closely with the revenue recognition project.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	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.	**Joint** The proposal in the ED has been confirmed. **IASB** The requirements to reduce the liability for remaining coverage in the premium-allocation approach would be aligned with the requirements for releasing the residual margin in the building-block approach.	
	Measurement of pre-claims liability The pre-claims liability would be 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.	**Joint** An onerous contract test would be performed if facts and circumstances have changed, indicating that a contract has become onerous in the pre-claims period. The Boards decided that: • an insurance contract would be 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 would perform an onerous contract test when facts and circumstances indicate that the contract might be onerous. The Boards also decided that they would provide application guidance about when a contract is onerous. If an insurer elects not to discount the liability for incurred claims that are expected to be paid within 12 months, then the insurer would use an undiscounted basis in identifying whether contracts are onerous and in measuring the liability for onerous contracts.	• 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Premium-allocation approach		The measurement of an identified onerous contract liability would be updated at the end of each reporting period. The Boards confirmed that insurers would measure the onerous contract liability taking into account estimates of expected cash flows at the end of the reporting period. The Boards 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.	
	Measurement of liabilities for claims incurred Liabilities for claims incurred would be measured at the present value of fulfilment cash flows in line with the general measurement model.	**IASB** The liability for incurred claims would be measured using the risk-adjusted expected present value of fulfilment cash flows. **FASB** 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.	• 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 would be no margin included in this measurement. This difference would 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Premium-allocation approach		**Joint** The Boards 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 also 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; and • 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.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Participating contracts	**Participating contracts [!]** Payments to policyholders arising from participating features in insurance contracts would be 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 decided the following for participating insurance contracts. • The measurement of the fulfilment cash flows related to the policyholder's participation would 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. • The residual margin for participating contracts would not be adjusted for changes in the value of the underlying items as measured using IFRS. • An insurer would 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 would 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 would apply to both unit-linked and participating contracts. • It would 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. • For participating contracts, some constituents support unlocking the residual margin for gains and losses arising from underlying items – e.g. assets or underlying experience – when those gains and losses are not regarded as having been earned in the period. This approach is referred to as a 'floating residual margin'. The IASB members had mixed views on the floating residual margin approach. Ultimately, the IASB did not agree with the floating residual margin approach by a slim majority • The asymmetric risk-sharing between the insurer and the policyholder could impact the measurement of the cash flows and the risk adjustment. • 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Participating contracts		**FASB** The FASB decided the following, as it relates to the measurement of insurance contract fulfilment cash flows and to the measurement of the obligation from any non-discretionary 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 would 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 would be presented in the same way within the statement of comprehensive income (that is, consistently in net income and/or OCI) as the changes in the underlying item. • No further adjustments to the measurement of the liability for the performance-linked participating features were deemed necessary for the purpose of reflecting expected cash flows. 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.	• 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. • Although the wording in the IASB and FASB decisions differs, 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Participating contracts		On measuring the insurance contracts liability, discretionary payments as a result of a contractual participation feature would be based on the insurer's expectation of payments to policyholders (considering the entity as a going concern), thus resulting in equity (deficits) for mutual insurers. **Joint** The Boards decided: • that options and guarantees embedded in insurance contracts that are not separately accounted for as a derivative under the financial instrument requirements would be measured within the overall insurance contract obligation using a current, market-consistent, expected value approach; and • 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 would include all such payments that result from that contract, whether paid to current or future policyholders. The Boards noted that the mirroring decision would take precedence over the tentative decision that insurers would 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Participating contracts	**Contracts that are affected by expected asset returns, but to which mirroring does not apply** The ED and the DP did not provide specific guidance on contracts that are affected by expected asset returns, but to which mirroring does not apply.	**Joint** 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 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 is the result of the exercise of the insurer's discretion; or • the specified assets are not held by the insurer. 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 would 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.
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 discussion below related to investment components, services and embedded derivatives.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Unbundling and embedded derivatives	**Investment components** The proposals included the following example 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 would pass on all investment performance but may be subject to a minimum guarantee.	**Joint** The Boards decided that: • an investment component in an insurance contract would be 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 would not be required to present investment components separately from the insurance contract unless the investment component is distinct. However, insurers would 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. If an investment component is distinct, then an insurer would unbundle the investment component and apply the applicable IFRS(s) or US GAAP in accounting for the investment component. An investment component would be 'distinct' if the investment component and the insurance component are not highly inter-related. Indicators that an investment component is highly inter-related with an insurance component would be: • a lack of possibility for one of the components to lapse or mature without the other component also lapsing or maturing;	• The staff recommended that an insurer separate from insurance contracts investment components that oblige the insurer to pay the policyholder regardless of whether an insured event occurs. These cash flows would not be included in revenue amounts or volume metrics used for the statement of comprehensive income. • 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 inter-related' 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.

Unbundling and embedded derivatives	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
		• 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.	
	Embedded derivatives The proposals included the following example of components that would not be closely related to the insurance coverage and that would result in unbundling: • an embedded derivative that is separated from its host contract under IAS 39.	**Joint** The Boards confirmed that an embedded derivative would be separated from its host contract under IAS 39. The Boards decided that insurers would be prohibited from applying revenue recognition or financial instrument standards to components of an insurance contract when unbundling is not required.	
	Services The proposals included the following example of components that would not be closely related to the insurance coverage and that would result in unbundling: • contractual terms related to services that are not closely related to the insurance coverage but that have been combined in a contract with that coverage for reasons that have no commercial substance.	**Joint** The Boards decided the following for unbundling services. • An insurer would identify 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 would apply the applicable IFRS or US GAAP in accounting for that performance obligation.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Unbundling and embedded derivatives		• A 'performance obligation' would be 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 would be 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Unbundling and embedded derivatives		• Notwithstanding the requirements in the previous paragraph, a service in an insurance contract would not be distinct and the insurer would therefore account 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 inter-related 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. **FASB** 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Unbundling and embedded derivatives	**Allocation of components** The proposals in the 2010 ED did not contain specific guidance on the allocation of components.	**Joint** The Boards decided the following. • An insurer would 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 would 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*. • 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 would be attributed to that component. Cash outflows related to more than one component would 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.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Unbundling and embedded derivatives	**Disaggregation on the statement of comprehensive income** The proposals in the 2010 ED did not contain specific guidance on the allocation of components.	**Joint** An insurer would 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 would be considered in determining the component to which they relate. **IASB** Insurers would 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 the measurement of the overall insurance contract liability, from the aggregate premiums presented in the statement of comprehensive income. **FASB** The amount of consideration allocated to investment components and excluded from the premium presented in the statement of comprehensive income would be equal to the cash flows that the insurer estimates it will be obligated to pay to policyholders or their beneficiaries regardless of whether an insured event occurs. At the end of each reporting period, these cash flows would be re-estimated based on current assumptions used in the measurement of the insurance contract liability, with any effect on insurance contract revenue allocated prospectively to periods in proportion to the value of coverage and any other services that the insurer estimates will be provided in those periods.	• 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.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Unbundling and embedded derivatives	**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.	**Joint** The proposals in the ED have been 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 would be carried forward to the final standard.
Reinsurance	**Reinsurance [!]** **Eligibility** A reinsurer would account for reinsurance contracts that it issues using the recognition and measurement approach for insurance contracts.	**IASB** The cedant and reinsurer would 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 would 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 for those that are produced by the building-block approach.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Reinsurance		**FASB** The FASB made the following decisions. • The cedant would 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 the premium-allocation approaches would 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 would evaluate whether the reinsurance contract would be accounted for under the building-block approach or the premium-allocation approach in the same manner in which an insurer would evaluate a direct insurance contract. In other words, insurers would 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.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations

Reinsurance	**Recognition and measurement**
	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 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
		Joint
		A cedant would 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 would recognise a reinsurance asset when the reinsurance contract coverage period begins. An onerous contract liability would be recognised if management becomes aware in the pre-coverage period that the reinsurance contract has become onerous.
		The Boards 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:
		  – less than zero and the coverage provided by the reinsurance contract is for future events, then the cedant would establish that amount as part of the reinsurance recoverable, representing a prepaid reinsurance premium, and would 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 would recognise the loss immediately; or
		  – greater than zero, then the cedant would recognise a reinsurance residual or single margin.
			• 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.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Reinsurance	• 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.	The cedant would estimate the present value of the fulfilment cash flow for the reinsurance contract, including the ceded premium. This would 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 would represent the risk being removed through the use of reinsurance. **IASB** The IASB decided that: • at inception of a reinsurance contract, a cedant would determine the residual margin by reflecting in the expected fulfilment cash flows all the effects of non-performance, including those associated with expected credit losses; and • subsequent changes in cash flows that result from changes in expected credit losses would be recognised in profit or loss. There would not be a limit on unfavourable adjustments against the positive residual margin on reinsurance contracts held by a cedant. When considering non-performance by the reinsurer: • the assessment of risk of non-performance by the reinsurer would consider all facts and circumstances, including collateral; and • losses from disputes would 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.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Reinsurance	**Retroactive reinsurance** The proposals in the 2010 ED did not contain specific guidance on retroactive reinsurance.	**Joint** For retroactive reinsurance contracts, the residual or single margin included in the cedant's reinsurance recoverable and the reinsurer's insurance contract liability would be amortised over the remaining settlement period in the same manner as the release of the single/residual margin, based on: • release from risk (FASB only); and • the pattern of services under the contracts (IASB only).	• Retroactive reinsurance contracts cover losses related to underlying insured events that have or may have taken place in the past. Consequently, the insurer (cedant) may have recognised the margin on the underlying contracts. If recognition of the margin were based on coverage under the underlying contracts, then any gain or loss on the retroactive reinsurance would be recognised up-front. 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, by amortising the margin over the settlement period.
	Cash flows from loss-sensitive features The proposals in the 2010 ED did not contain specific guidance on cash flows from loss-sensitive features.	**Joint** The Boards made the following decisions. • Cash flows resulting from loss-sensitive features that are not accounted for as investment components would be treated as part of the claims and benefits cash flows (rather than part of the premiums). • Insurers would 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 would recognise an asset or a 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).	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Reinsurance		• Insurers would treat the effects of non-loss-sensitive premium adjustments in the same way as any other changes in the estimates of premiums arising from the contract. Any premium adjustments pursuant to contractual features providing cedants with a unilateral right (but not an obligation) to reinstate a reinsurance contract would not be considered to be a loss-sensitive feature for the purpose of applying this guidance.	
	Commutations The proposals in the 2010 ED did not contain specific guidance on commutations.	**Joint** Reinsurers and cedants would present any gains or losses on commutation as an adjustment to the claims or benefits and would 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 it is 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, its analysis discusses commutations in that context. However, it notes that its recommendation is equally applicable to direct insurance commutations – e.g. policy buy-backs.
	Ceding commissions Any ceding commissions that a cedant receives would be recognised as a reduction of the premium ceded to the reinsurer.	**IASB** The IASB confirmed the proposal. **FASB** 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.	• As a result of the FASB's decision for the presentation of ceding commissions and residual margin, ceding commissions will not offset direct acquisition cost in the statement of comprehensive income.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Contract modifications	**Contract modifications** The ED and the DP did not provide guidance on contract modifications.	**Joint** An insurer would 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: • whether the contract is within the scope of the insurance contract standard; or • whether to use the premium-allocation approach or the building-block approach to account for the insurance contract. **IASB** An insurer would derecognise 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 from the one in which it was included at initial recognition. **FASB** In addition to the conditions jointly addressed above, an insurer would derecognise an existing contract and recognise a new contract if any of the following conditions exist. • The insured event, risk, or period of coverage of the contract has changed, as noted by significant changes in the kind and degree of mortality risk, morbidity risk, or other insurance risk, if any. • There has been a change in the nature of the investment return rights – e.g. whether amounts are determined by formulas specified by the contract, by a pass through of the actual performance of referenced investments, or at the discretion of the insurer – accounted for as part of the insurance contract, if any, between the insurance enterprise and the contract holder.	• Some Board members commented that the criteria for what was a 'substantial' modification were too broad, especially the proposed third criterion on 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 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. • The FASB asked the staff to perform additional analysis on modifications to insurance contracts that would result in contract extinguishment. In particular, the FASB asked them to consider conditions indicating substantial change as outlined in Subtopic 944-30 *Financial Services—Insurance—Acquisition Costs*.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Contract modifications		• Any additional deposit, premium or charge relating to the original benefit or coverage, in excess of the amounts specified or allowed in the original contract, is required to effect the transaction. • If there is a reduction in the original benefit or coverage; or if any reduction to the deposit, premiums, or charges is less than the corresponding reduction in benefits or coverage. • There is a net reduction in the contract holder's account value or the cash surrender value, if any exists – except for reductions resulting from: – distributions to the contract holder or contract designee; or – charges related to newly purchased or elected benefits or coverages. • There is a change in the participation or dividend features of the contract, if any such features exist.	• The FASB staff reviewed Subtopic 944-30 and noted that it includes six criteria to identify a substantial contract modification. One of the criteria in Subtopic 944-30 for avoiding contract extinguishment is that there is no change to the amortisation method or revenue classification of the contract. The staff believed that this condition did not need to be considered, because it had been previously addressed by decisions on the treatment of the margin and acquisition costs. However, the FASB staff noted that all of the five other criteria mentioned in Subtopic 944-30 would need to be addressed in identifying a substantial modification to an insurance contract (see additional conditions to the left).

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Contract modifications		**Joint** **Substantial modifications** When an insurer makes a substantial modification to an insurance contract, the gain or loss on extinguishment of the existing contract would 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** • 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 would derecognise that portion of its obligation (including any related portion of the residual/single margin). • If the modification entitles the policyholder to further benefits, then the insurer would treat 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.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Business combinations and portfolio transfers	**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 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 decided that, at the acquisition date, an insurer would measure insurance liabilities assumed and insurance assets acquired in a business combination at fair value. The components would 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 would 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. Insurance contracts acquired through a combination of entities or businesses under common control would apply the guidance in Subtopic 805-10. For business combinations before the effective date of the insurance contracts standard, applying the transition guidance would require insurers to re-allocate 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. **IASB** The proposals in the ED have been confirmed.	• 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 about the operational complexities in applying the transition proposals, particularly with respect to business combinations. The FASB mentioned that it was planning to review the feasibility of the transition proposals. • The IASB decided not to create explicit guidance on the allocation period of the residual margin in a business combination.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	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** 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. **IASB** The proposals in the ED have been confirmed.	• The IASB decided not to create explicit guidance on the allocation period of the residual margin in a portfolio transfer.
Foreign currency	**Foreign currency** When applying IAS 21 *The Effects of Changes in Foreign Exchange Rates* to an insurance contract that results in cash flows in a foreign currency, the insurer treats the contract as a monetary item. This requirement applies not only to the present value of the fulfilment cash flows, but also to the residual margin. That requirement also applies to the pre-claims liability of a short-duration contract.	**FASB** When remeasuring foreign currency transactions, all financial statement components related to an insurance contract would be classified as monetary. **IASB** The IASB has not deliberated on this proposal. It is expected that the proposal in the 2010 ED will be carried forward to the targeted re-exposure draft.	• The FASB members agreed that assessing each component of the insurance contract items separately would be complex and costly, and would not be warranted under cost-benefit considerations.
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 have not deliberated on this proposal. It is expected that the proposal in the 2010 ED will be carried forward to the IASB's and FASB's respective exposure drafts. The Boards' decisions on contract modifications are presented in that section, above.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
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.	**Joint** The Boards decided the following. • An insurer would 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 the remaining coverage would 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 would 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 would 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 would be presented on a gross basis – i.e. presented separately – in the statement of financial position.	• The revised proposals would result in a statement of financial position that would disaggregate contracts measured under the building-block and the premium-allocation approaches. • Many respondents to the ED and the DP thought that a gross presentation of rights and obligations would provide more relevant information for non-life contracts 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Presentation and disclosure		• Liabilities (or assets) for insurance contracts would be presented separately for those measured using the building-block approach and those measured using the premium-allocation approach. • Portfolios that are in an asset position would not be aggregated with portfolios that are in a liability position in the statement of financial position. **IASB** An entity would: • present all rights and obligations for all insurance contracts on a net basis in the statement of financial position; and • be required to present separate line items for insurance contracts and for reinsurance contracts in the statement of financial position. **FASB** • Acquisition costs would be reported as part of the margin – i.e. the margin would include the acquisition costs expected to be paid and would be reduced when those acquisition costs are paid. • 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.	• 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 *Presentation of Financial Statements* do not include insurance contracts or reinsurance contracts. Consequently, the IASB added presentation requirements in the insurance proposals. • The IASB staff paper and the 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 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. • The November 2012 staff paper 3A *Presentation and disclosures: Proposed drafting* (pages 21–23) illustrates how the IASB's tentative decisions and recommendations on presentation might be applied.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Presentation and disclosure	**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; • 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. Income and expense from unit-linked contracts would be presented as a separate single line item.	**Joint** 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 would 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. If there is a change in the expected pattern of future claims, then the remaining insurance contract revenue would be re-allocated prospectively to reflect the latest estimates of that pattern. 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.	• 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 because 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Presentation and disclosure	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 would 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 premium revenues, claims and other expenses, amortisation of incremental acquisition costs and changes in additional liabilities for onerous contracts.	In an earned premium presentation, a portion of the 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 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. **IASB** The general requirements of IAS 1 are sufficient to specify the presentation requirements for the statement of comprehensive income for insurance contracts. Cash flows relating to acquisition costs would be recognised in the statement of comprehensive income over the coverage 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 those proposals, an entity would recognise revenue when it has 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 Board 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 (Board decisions are tentative and may be subject to change in future meetings)	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 would be 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 would be based on the initial expected pattern of claims and benefits, would 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Presentation and disclosure	**Other comprehensive income (OCI) [!]** The ED and the DP did not provide guidance on OCI.	**Joint** The Boards made the following decisions. • Interest expense would be 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, would be recognised in profit or loss. The Boards 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. A loss recognition test for the purpose of recycling amounts related to the insurance liability from OCI to profit or loss would not be needed.	• Many constituents have stated that their concerns about volatility could be addressed if changes in the insurance contract liabilities arising from changes in the discount rate were presented in OCI and the financial assets that support these liabilities were also measured at fair value through OCI. • 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 are useful for some portfolios of financial assets, the IASB tentatively decided to introduce a fair value through OCI (FVOCI) measurement category for eligible debt investments to IFRS 9 *Financial Instruments*. • 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. • The comment period on the exposure draft *Classification and Measurement: Limited Amendments to IFRS ends on 28 March 2013.*

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Presentation and disclosure			• 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 because 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 members were concerned that duration mismatches would not be transparent in profit or loss, they thought that 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 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. • They were particularly concerned about contracts that were contractually linked to assets such as unit-linked contracts and participating products, which are often supported by equity investments. They thought that when contracts were contractually linked to assets, their measurement attribute should match that of the assets.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Presentation and disclosure	**Disclosures** Under the proposals, an insurer would disclose quantitative and qualitative information about: • 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.	**Joint** 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 would 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. • 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 decisions on risk disclosures for financial institutions, as reached in its project on financial instruments. Those disclosures would apply to insurance entities.	• 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. • 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 *Financial Instruments: Disclosures*. 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 decided that an entity would be required to present in tabular format any roll-forward retained by or added to the disclosure requirements.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Presentation and disclosure		**IASB** The proposed requirement in paragraph 90(d) to disclose a measurement uncertainty analysis would be deleted. The FASB decided to retain this disclosure. The confidence level disclosure in paragraph 90(b)(i) of the ED would be retained. The IASB 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 would: • 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. More guidance on the level of disaggregation of the reconciliation of carrying amounts would not be added 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 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 would be deleted.	• 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Presentation and disclosure		The IASB made the following decisions for contracts with cash flows contractually linked to underlying items. • An insurer would 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 it would disclose the extent to which the difference between the fair value and the carrying value of underlying assets would be passed to policyholders.	
		For all insurance contracts, an insurer 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 that are attributable to losses on initial recognition (for the premium-allocation approach, this would 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 would be the additional liabilities for onerous contracts); and • the liabilities for incurred claims.	• November 2012 staff Paper 3A *Presentation and disclosures: Proposed drafting* (pages 24–28) illustrates how the IASB's tentative decisions and recommendations on reconciliation disclosures might be applied.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Presentation and disclosure		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. 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 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. 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 would not be required. A disclosure of a reconciliation from premium receipts to revenue would be required. For contracts accounted for using the premium-allocation approach, an insurer would be provided with relief from disclosing a maturity analysis of cash flows for the liability for remaining coverage.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Transition	**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.	**Joint** An insurer would do the following when it first applies the new insurance contracts standard. • 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 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 single or residual 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 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 need to be determined only 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 when 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.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Transition		– 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 would 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 would not need to undertake exhaustive efforts to obtain objective information, but would 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 would apply the general requirements of Topic 250-10 *Accounting Changes and Error Corrections* / IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* that are relevant to situations in which there are limitations on retrospective application. • 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.	• 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. • 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 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.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Transition		a) Calculate the discount rate in accordance with the standard for a minimum of three years before 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. **IASB** 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.	• Some constituents suggested that the Boards specify the retrospective period 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 therefore profitability of business. • A key issue discussed at the IASB Insurance Working Group meeting in June 2012 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). • 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. Certain members and some staff mentioned that a practical expedient may be considered for these contracts.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Transition		**FASB** The FASB decided on the following practical expedient. 1. When determining the margin at contract inception, insurers would be able to measure the insurance contract liability and the margin using the insurers' determination of the portfolio immediately before transition. 2. Contracts written or substantially modified after the date of transition would be grouped into portfolios in accordance with the proposed guidance, which, if they are different from those determined under point 1, may require separate portfolios.	• The FASB decided on a practical expedient for determining the margin at contract inception because this practical expedient might avoid data collection issues by allowing insurers to determine the margin using existing accumulations of data. • The Boards also considered what discount rate should be used in the retrospective period when determining if 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 therefore consider whether further restrictions were needed to avoid scenarios in which the calculated or 'proxy' liability rate is lower than the risk-free rate.
	Transition related to insurance contract revenue The ED and the DP did not provide guidance on transition related to insurance contract revenue.	**IASB** On transition, an insurer would estimate the amount of revenue to be recognised in future periods by estimating the residual margin or initial loss included in the liability for remaining coverage. In estimating that residual margin or loss, an insurer would assume that the risk adjustment at inception is equal to the risk adjustment on transition. When retrospective application is impracticable, an insurer would estimate the residual margin by maximising the use of objective data. In other words, an insurer would not calibrate the residual margin to the insurance liability as it was measured using previous GAAP.	• One IASB member was concerned that the IASB staff recommendation might result in an overstatement of the residual margin on transition. This is because the risk adjustment on transition would probably be lower than the risk adjustment would have been at inception, because the insurer would often be released from risk over time. The premium used to calibrate the liability would not be adjusted for this revised estimate of risk, and therefore the residual margin as the balancing figure would be overstated. He was concerned that this would lead to a systematic overstatement of the residual margin on transition, and thought that a less biased approach should be used.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Transition		**FASB** For contracts accounted for under the building-block approach that are in force on transition, the amount of the revenue to be recognised after transition would be determined as follows. • For contracts for which the margin is determined through retrospective application, the insurance contract revenue remaining to be earned as of the date of transition would be determined retrospectively using the assumptions applied in determining the margin retrospectively. • For contracts for which retrospective application is impracticable for determining the margin because it would require significant estimates that are not based solely on objective information, the remaining insurance contract revenue to be earned would be presumed to equal the amount of the liability for remaining coverage (excluding any investment components) recorded at the date of transition, plus accretion of interest. – The liability for remaining coverage for these contracts at the date of transition would be presumed not to consist of any losses on initial recognition or changes in estimate of future cash flows recognised in profit or loss after the inception of the contracts. – The remaining insurance contract revenue to be earned would be limited to the total expected cumulative consideration for in-force policies in the portfolio *plus* interest accretion, and *less* investment component receipts.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Transition		– The remaining insurance contract revenue would be allocated to periods after the date of transition in proportion to the value of coverage (and any other services) that the insurer has provided for the period – i.e. applying the pattern of expected claims and expenses and release of margin. The FASB tentatively decided that for business combinations before the effective date of the insurance contracts standard, applying the transition guidance would require insurers to re-allocate 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.	
	Transition requirements for contracts acquired through a business combination The ED and the DP did not provide guidance on transition requirements for contracts acquired through a business combination.	**IASB** In applying the transition requirements for insurance contracts, an insurer would account for the in-force contracts that were previously acquired through a business combination using: • the date of the business combination as the date of inception of those contracts; and • the fair value of those contracts at the date of the business combination as the premium received. When an insurer first applies the proposed insurance standard to insurance contracts previously acquired through a business combination, any gains or losses would adjust retained earnings (rather than goodwill).	• One IASB member asked the staff whether the staff recommendation would conflict with the current guidance in IFRS 3 *Business Combinations* when an insurer enters into a business combination within 12 months of transitioning to the insurance proposals. Specifically, he was referring to the IFRS 3 guidance that allows an entity to adjust goodwill recognised in a business combination within 12 months to reflect new information about facts and circumstances that existed as at the acquisition date. The staff noted that they had considered this guidance in IFRS 3, and did not believe that there was any conflict; this was because adjustments arising from the application of the insurance proposals would generally not result in "new information about facts and circumstances that existed at the acquisition date" as considered in IFRS 3. The staff said that they would reword the guidance to make this clear.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Transition	**Disclosure** 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.	**Joint** An insurer would not need to 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 would disclose that fact. This decision confirms the proposal in the IASB's ED. Insurers would be required to make the disclosures required by Topic 250-10 *Accounting Changes and Error Corrections* / IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. In addition, insurers would 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.	

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Transition		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 Topic 250-10 would be required. **IASB** 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 would not be required.	
	Restatement of comparative financial information The ED and the DP did not provide guidance on restatement of comparative financial information.	**IASB** The IASB decided that entities would be required to restate comparative information on first application. **FASB** The FASB decided that insurers would be required to restate all comparative periods presented.	• In its deliberations on IFRS 9, the IASB concluded that restatement of comparative financial statements would not result in useful information about the 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.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Transition			• 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.
	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.	**IASB** The IASB confirmed the proposal in the ED.	
	Redesignation of assets in the scope of IAS 16 and IAS 40 The ED and the DP did not provide guidance on redesignation of assets in the scope of IAS 16 *Property, Plant and Equipment* and IAS 40 *Investment Property*.	**IASB** 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. It 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Transition	**Redesignation of financial assets** At the beginning of the earliest period presented, when an insurer first applies the insurance standard, it would be 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 would be a change in accounting policy and IAS 8 would apply. 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.	**IASB** An insurer would follow the reclassification guidance in IFRS 9 except that an insurer would 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. **FASB** 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 amortised cost, fair value through profit and loss, or fair value through OCI, as if IFRS 9 had been initially applied at the same time as the insurance standard is applied. – Limited reconsideration of the fair value option and permitting 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 (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Effective date and early application	**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. 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.	**IASB** 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 period of at least three years between the publication of the final insurance standard and the mandatory effective date. Although the IASB generally allows at least 18 months between the publication of a new standard and its mandatory effective date, it supported a longer period because the proposed insurance standard will be a fundamental change to insurers' current practices 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 had 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.

	Key proposals in the 2010 ED	Update to proposals (Board decisions are tentative and may be subject to change in future meetings)	KPMG observations
Effective date and early application		**FASB** The FASB decided that its upcoming exposure draft, *Insurance Contracts Update*, will not include a minimum time period between the issuance of the proposed insurance contracts standard and the effective date, but rather ask a question about the key drivers affecting the timing of implementation. In addition, the effective date for non-public entities would be a minimum of one year after the effective date for public entities.	• FASB members had different views on whether its exposure draft should indicate an effective date for the proposed insurance standard. There was no firm consensus on the minimum timeframe – e.g. two or three years – that should be allowed for implementation from the issuance of the proposed insurance standard. As a result, most FASB members agreed not to specify or indicate an effective date. • A few FASB members thought that the effective date should also be delayed for public non-insurance companies (currently not within the scope of the insurance standards under US GAAP), because they may not have adequate systems in place to implement the proposed insurance standard. Most FASB members did not want to delay the effective date for non-insurance companies. However, they supported asking constituents for their view on this in their upcoming exposure draft.
	Early application The ED and the DP did not provide guidance on early application.	**IASB** The IASB decided to permit entities to apply the final standard before the mandatory effective date. **FASB** The FASB decided that insurers would not be allowed to early adopt the proposed insurance standard.	

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.

Visit KPMG's *Global IFRS Institute* at kpmg.com/ifrs to access KPMG's most recent publications on the IASB's major projects and other activities. Recent publications that are relevant to the insurance project include:

- New on the Horizon: Classification and Measurement – Proposed limited amendments to IFRS 9 (December 2012)
- IFRS Newsletter: Financial Instruments

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