MINUTES

Financial Accounting Standards Board

To:	Board Members		
From:	Insurance Contracts Team (King, x340)		
Subject:	Minutes of the February 27, 2012, Joint Board Meeting: Insurance Contracts	**Date:**	March 1, 2012
cc:	Sutay		

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue an Accounting Standards Update or a Statement of Financial Accounting Concepts.

Topic:	Insurance Contracts—Eligibility Criteria for the Premium Allocation Approach, Mechanics for the Premium Allocation Approach, Measurement of Liabilities for Infrequent, High-Severity Events, Onerous Contracts, Unbundling Goods and Services Components, Financial Instruments with Discretionary Participation Features (IASB only)
Basis for Discussion:	FASB Memo Nos. 79, 79A, 79B, 79C, 79D, 79E, 79F, 79G, 79H, 79I IASB Agenda Papers 3, 3A, 3B, 3C, 3D, 3E, 3F, 3G, 3H, 3I, 14, 14A, 14B, 14C
Length of Discussion:	February 27, 2012 – 5:30 to 7:30 a.m. and 8:30 to 10:30 a.m. (EST) February 28, 2012 (IASB only) – 9:30 to 10:30 a.m. (GMT)
Attendance:	

Board members present:	FASB: Seidman, Buck, Golden, Linsmeier, Schroeder, Smith, Siegel
	IASB: Hoogervorst, Mackintosh, Cooper, Danjou, Engström, Finnegan, Gomes, Kalavacherla, McConnell, Ochi, Pacter, Scott, Smith, Zhang
Staff in charge of topic:	FASB: Weiner
	IASB: Pryde
Staff members present:	FASB: Cosper, Proestakes, Ampofo, Irwin, Alexander, Silva, King, Barton
	IASB: Lloyd, Clark, Zeitler, Ruta, Vermaak, Knubley, Obst

Type of Document and Timing Based on the Technical Plan:

Please refer to the current technical plan for information about the expected release dates of exposure documents and final standards.

Summary of Decisions Reached:

The IASB and the FASB continued their discussions on the insurance contracts project by considering the following topics: eligibility criteria and mechanics for the premium allocation approach; measurement of liabilities for infrequent, high-severity events; onerous contracts; unbundling goods and services components; and financial instruments with discretionary participating features.

Eligibility Criteria for the Premium Allocation Approach

The IASB tentatively decided that:

1. Contracts should be eligible for the premium allocation approach if that approach would produce measurements that are a reasonable approximation to those that would be produced by the building-block approach.

   (IASB: Unanimous)

2. A contract should be deemed to meet the condition in (1) without further work if the coverage period is one year or less.

(IASB: Unanimous)

3. To provide application guidance that contracts would not produce measurements that are a reasonable approximation to those that would be produced by the building-block approach if, at the contract inception date:

    a. 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 fulfill the contract; or
    b. Significant judgment is required to allocate the premium to the insurer's performance obligations for each reporting period. This may be the case if, for example, significant uncertainty exists about:

        i. The premium that would reflect the exposure and risk that the insurer has for each reporting period; or
        ii. The length of the coverage period.

    The IASB noted that it would review whether it will need to update these criteria after its future discussions on the building-block approach.

(IASB: 13 to 1)

4. An insurer should be permitted but not required to apply the premium allocation approach to contracts that are eligible for that approach.

(IASB: Unanimous)

The FASB tentatively decided that:

1. Insurers should apply the building-block approach rather than the premium allocation approach if, at the contract inception date, either of the following conditions is met:

    a. 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 fulfill the contract; or
    b. Significant judgment 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:

i. The premium that would reflect the exposure and risk that the insurer has for each reporting period; or
ii. The length of the coverage period.

(FASB: 6 to 1)

2. A contract should fall within the scope of the premium allocation approach without further evaluation if the coverage period is one year or less.

   (FASB: 4 to 3)

3. The premium allocation approach should be required for contracts that qualify for that approach.

   (FASB: 6 to 1)

Mechanics for the Premium Allocation Approach

The Boards tentatively decided that discounting and interest accretion to reflect the time value of money should be required in measuring the liability for remaining coverage for contracts that have a significant financing component, as defined according to the characteristics of a significant financing component under the revenue recognition proposals. However, as a practical expedient, insurers need not apply discounting or interest accretion in measuring the liability for remaining coverage if the insurer expects at contract inception that the period of time between payment by the policyholder of all or substantially all of the premium and the satisfaction of the insurer's corresponding obligation to provide insurance coverage will be one year or less.

(FASB: Unanimous, IASB: Unanimous)

The Boards also tentatively decided that:

1. The measurement of acquisition costs should include directly attributable costs (for the FASB, limited to successful acquisition efforts only); this is consistent with the decision made for the building-block approach.

   (FASB: 5 to 2, IASB: 12 to 2)

2. Insurers should be permitted to recognize all acquisition costs as an expense if the contract coverage period is one year or less.

   (FASB: Unanimous, IASB: 12 to 2)

The Boards also agreed to explore an approach in which acquisition costs would be netted against the single/residual margin applying the building-block approach, and netted against the liability for remaining coverage applying the premium allocation approach. That amount could be separately presented from the present value of expected cash flows (plus a risk margin, for the IASB).

Measurement of Liabilities for Infrequent, High-Severity Events

The Boards tentatively confirmed that insurers should measure both an insurance contract liability by applying the building-block approach and an onerous contract liability by applying the premium allocation approach, taking into account estimates of expected cash flows at the balance sheet date.

The Boards tentatively decided to provide application guidance to clarify that an insured event (for example 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 occurs or does not occur 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-recognized event to which *FASB Accounting Standards Codification*® Topic 855, Subsequent Events, applies.

(FASB: Unanimous, IASB: 12 to 2)

Onerous Contracts

The Boards tentatively decided that the measurement of the liability for onerous contracts should be updated at the end of each reporting period.

(FASB: Unanimous, IASB: Unanimous)

The IASB tentatively decided that risk adjustment should be considered when identifying onerous contracts and that the measurement of an onerous contract liability should include a risk adjustment.

(IASB: 9 to 5)

The Boards tentatively decided that if an insurer elects not to discount the liability for incurred claims that are expected to be paid within 12 months, the insurer should use an undiscounted basis in identifying whether contracts are onerous and in measuring the liability for onerous contracts.

(FASB: 6 to 1, IASB: 11 to 3)

Unbundling Goods and Services Components

The Boards tentatively decided on the following criteria for unbundling goods and services:

1. An insurer shall identify whether any promises to provide goods or services in an insurance contract would be performance obligations as defined in the Exposure Draft, *Revenue from Contracts with Customers*. If a performance obligation to provide goods or services is distinct, an insurer shall apply the applicable IFRSs or U.S. GAAP in accounting for that performance obligation.
2. A performance obligation is a promise in a contract with a policyholder to transfer a good or 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 good or service. Performance obligations do not include activities that an insurer must undertake to fulfill a contract unless the insurer transfers a good or 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. Hence, those promised setup activities are not a performance obligation.
3. Except as specified in the following paragraph, a good or service is distinct if either of the following criteria is met:

    a. The insurer regularly sells the good or service separately.
    b. The policyholder can benefit from the good or service either on its own or together with other resources that are readily available to the policyholder. Readily available resources are goods or 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).

4. Notwithstanding the requirements in the previous paragraph, a good or service in an insurance contract is not distinct and the insurer shall therefore account for the good or service together with the insurance component under the insurance contracts standard if both of the following criteria are met:

a. The good or service is highly interrelated with the insurance component and transferring them to the policyholder requires the insurer also to provide a significant service of integrating the good or service into the combined insurance contract that the insurer has entered into with the policyholder.
b. The good or service is significantly modified or customized in order to fulfill the contract.

(FASB: Unanimous, IASB: Unanimous)

Financial Instruments with Discretionary Participation Features

The IASB considered the applicable standard for financial instruments that are not insurance contracts but that have discretionary participation features similar to those found in many insurance contracts. The discussion was not held jointly with the FASB because of the different considerations for the Boards.

The IASB tentatively decided that the forthcoming insurance contracts standard should apply to financial instruments with discretionary participation features that are issued by insurers. It should not apply to any financial instruments issued by entities other than insurers.

(IASB: 12 to 2)

Next Steps

The FASB intends to discuss the applicable standard for financial instruments with discretionary participation features at its meeting on March 7, 2012. Both Boards will continue their discussion on insurance contracts in March 2012.

<u>General Announcements</u>: None.