	IASB **Insurance Contracts Project**
	Field Testing Questionnaire: Margins at inception **Date of issue : October 2009** **Name of participant :**

Field Testing – Round 1

In Round 1 of the targeted field test we ask you to submit information on specific topics prior to the publication of an exposure draft (ED) in January 2010. The questions we would like you to answer are detailed below. Please ensure that you provide the name of your organisation in the box above.

This questionnaire has been made available on the IASB's public website. We shall treat any information that you provide to us in the strictest confidence.

The questionnaire is supported by background information, including the most recent decisions made by the IASB and FASB boards.

Margins at inception

Return date: 20 November

This questionnaire focuses on margins at inception. The questions are phrased to capture qualitative input from you. However, any quantitative information you could provide us with at this stage would be very useful; this may include information in relation to your existing accounting model but also that used for regulatory purposes, economic capital or supplementary reporting.

Follow-up requests

In addition to this questionnaire, we intend to send out follow-up requests on margins in the next few weeks. These follow-up requests will address in more detail:

- subsequent treatment of margins, including release to the income statement
- determination of a risk margin

Question 1:
To get an indication of the input we may expect from you, it would be useful if you could indicate to us the level of quantitative input you expect to be able to provide for this questionnaire and any follow-up requests based on the information on cash flows and margins that you have available now or are able to obtain with reasonable effort for the current field testing stage (Round 1).

Your early response to question 1 will help us design the follow up questionnaires.

Building blocks

The boards decided tentatively that the measurement of an insurance liability should consist of three building blocks, namely:

- a current estimate of the expected (ie probability weighted) present value of future cash flows;
- time value of money; and
- an explicit margin (that is, identified separately from the other building blocks)

The boards are still discussing measurement, including the topic of margins. This means that you may not yet have all the information required to answer this questionnaire. We expect that you will probably have to apply presumptions when preparing the information. Please specify any significant presumptions you have made. In addition:

- For the first building block, consider the cash flow guidance as attached in Appendix 1 to this paper [Staff does not expect that this draft guidance will result in a difference between the IASB proposals and the FASB proposals for the purposes of this questionnaire].
- For the second building block, apply a discount rate based on your input on the Discounting questionnaire.
- For the level of aggregation, presume measurement at portfolio level as specified in the discussion paper (DP) *Preliminary Views on Insurance Contracts*, paragraphs 183-202.

Under the current IASB proposals, the building block approach will not be applicable to pre-claims liabilities of short-duration contracts in many cases[1]. This means that for that type of liability, this questionnaire is not relevant. However, you may nevertheless apply this questionnaire to those contracts if you wish.

Question 2:
Are you applying a current measurement approach? By this we mean a prospective approach based on expected (ie probability-weighted) cash flows that updates those cash flows for changes in circumstances each reporting period under your

- existing accounting model or
- for any other reason (for example regulatory purposes, economic capital or supplementary reporting, such as embedded value)

If you do, why might there be a difference between the cash flows under your current model and the cash flows under the models proposed by the boards?

[1] The IASB decided tentatively to require an unearned premium approach for pre-claims liabilities of short-duration insurance contracts. See agenda paper 11B for the July 2009 IASB meeting. The FASB will discuss this topic at a future meeting.

Overall margin at inception

The overall margin at inception is the following sum:

- the expected present value of premiums (IASB: premium less incremental acquisition costs); less
- the expected present value of the future cash outflows included in the current measurement of the liability (the updated IAS 37 model for the IASB or a Current fulfilment value for FASB).

Question 3:
If quantitative information is available, readily or with reasonable effort, could you provide us with an indication of the magnitude of the overall margin at inception as a percentage of the present value of total contract premiums over the whole life of the contract?
(For this question, apply the overall margin at inception as the difference between the premiums and the cash outflows) We are looking only for an indication of the rough order of magnitude; we do not expect detailed information.

It would be useful if you could provide an analysis of how these results vary by product type and geography (if available of course).

Question 4:
Under the IASB proposal, the insurer recognises revenue at inception equal to the incremental acquisition costs. In other words, the overall margin is determined by calibrating to the premium less incremental acquisition costs. If available, could you provide us with the magnitude of the incremental acquisition costs compared to the overall margin at inception under question 3?

[We refer to the questionnaire on Acquisition costs for further details on that topic. Although we asked you to provide us with information on the magnitude of incremental acquisition costs in that questionnaire, we might not have sufficient information to link that information to the information on the overall margin.]

Question 5:
Do you expect any (practical) issues in determining the overall margin at inception? Did you identify any particular guidance that would be needed in determining the overall margin at inception? Please describe.

The boards decided tentatively to exclude day-one gains from being recognised in profit or loss at inception. This means that, at inception, the overall margin will be included in the measurement of the liability. The overall margin can be disaggregated as follows:

- **IASB:**
    - an explicitly measured risk (and possibly service) margin that flow from the amount the insurer would rationally pay to be relieved of the obligation; and
    - a residual margin as the difference between the overall margin and that risk (and possibly service) margin.
- **FASB:**
    - a single composite margin that includes the whole overall margin at inception.

Approach based on a Current Fulfilment Value (FASB)

Under the current fulfilment approach tentatively being considered by the FASB, the composite margin is established as the overall margin at inception under question 3. Therefore, no further assessment is needed for this questionnaire.

The FASB has not yet discussed whether the measurement of the liability at inception can be less than the expected fulfilment costs and whether, in addition to those fulfilment costs, it should also include a margin. The staff will send field test participants an update, and any necessary follow-up requests, when the FASB concludes tentatively on these issues.

Approach based on an updated IAS 37 model (IASB)

Under the approach tentatively selected by the IASB, the overall margin at inception would be separated into three components:

- risk margin
- margin for other services (if any) [This questionnaire does not deal with a separate service margin. We will address a service margin in a follow-up questionnaire].
- residual margin.

Risk margin

The risk margin should be an explicit and unbiased estimate of the margin for bearing risk. The overall principle of the risk margin under the updated IAS 37 model is to estimate any additional amount the entity would rationally pay to be relieved of risk.

The objective of including a risk margin in the measurement of an insurance liability is to convey useful information to users about the uncertainty associated with a liability. As a result of including a risk margin, financial reporting does not represent two liabilities as the same if one liability is more risky than the other.

Question 6: Do you currently include an explicit risk margin in the measurement of your insurance contract liabilities under your existing accounting model or for any other purposes?

Description	Life	Non Life	Health
Included			
Not included			
Only used for assessing whether it is an onerous contract			
Other (please specify)			

Question 7: If you indicated that you currently apply risk margins, which method do you apply for estimating those margins? Please briefly describe that method.

In agenda paper 5A for April 2009, staff provided the boards with a preliminary draft of the characteristics of risk margins, based on the preliminary draft of guidance on estimating risk margins (Appendix F) in the DP. Some relevant excerpts from the April 2009 agenda paper are attached in Appendix 2 to this questionnaire.

Appendix F of the DP listed various approaches that might be used for estimating risk margins and also listed those approaches that would not meet the criteria for risk margins specified in the DP. The relevant material in that Appendix is attached to this questionnaire as Appendix 3. [Although the D P features current exit value as the selected measurement model, which was rejected by the boards as the measurement attribute, significant parts of the section on Risk Margins will probably still be relevant. Staff will update this guidance at a later stage].

This draft material in appendices 2 and 3 may assist you in completing questions 8-11 of this questionnaire.

Question 8: Considering the draft material attached to this paper in appendices B and C, what approach would you select for estimating the risk margin under the future insurance standard? Please specify your rationale for selecting that approach. (Note that this questionnaire does not ask you to do an actual calculation of the risk margin at this stage. But any quantitative information you could provide to us on the risk margin would be very useful).

Question 9: If you currently apply a separate risk margin, how do expect a risk margin approach selected under question 8 to compare to the risk margin specified under question 7?

Question 10: Does the preliminary guidance attached to this questionnaire provide sufficient guidance for estimating the risk margin? If not, what additional guidance would the exposure draft in your view require? Please provide details.

Question 11: What practical issues do you expect to encounter when estimating the risk margin under the IASB proposals? What is the operational impact (cost / benefit considerations)?

Residual margin

The residual margin is determined at inception as the difference between the overall margin and the risk (and possibly service) margin. In other words, the residual margin is derived as:

(a) the overall margin at inception, determined by premium less incremental acquisition costs- see question 4, less
(b) the risk margin less
(c) the service margin (if any)

Question 12:
Considering the information about the overall margin and the risk margin [and leaving aside a separate service margin for now], could you please describe whether in your view the residual margin at inception would be significant to the overall margin at inception.

If available, could you, based on the overall margin and the risk margin, give an indication of the magnitude of the residual margin compared to the overall margin at inception? (For example, the residual margin expressed as a percentage of the overall margin.)

Please submit your results to Jane Jordan (jjordan@iasb.org) by 20 November.

Background Information

Where are the boards?

The IASB and FASB boards disagree on the nature and the purpose of the third building block – margins. They have different views on the best approach to represent uncertainty of outcomes in financial reporting.

IASB (explicit risk and service margins, plus a residual margin)

The updated IAS 37 model, as adapted to the measurement of insurance contracts, includes explicit margins for risk, service (if any) and, in most cases, also a residual margin.

Risk Margin

The overall principle of the risk margin under the updated IAS 37 model is to estimate any additional amount the entity would rationally pay to be relieved of risk.

The IASB believes that uncertainty in calculating estimates should be accounted for through the use of a current, explicit and unbiased risk margin. As a result, the liability measurement would include a risk margin based on the recognition that an insurer would charge more for a high-risk cash flow distribution than for a low-risk cash flow distribution.

Service Margin

The updated IAS 37 approach includes estimates of cash flows for service activities (if any) based on what a contractor would charge to undertake the services. (We will further develop the notion of a service activity in the context of insurance contracts at a later stage).
In the absence of a market for those services, the entity could estimate the amount it would rationally pay a contractor by estimating the amount it would itself charge another party to carry out the service. The latter amount includes the profit an entity would require for those services (a service margin).

FASB (a single ‘composite’ margin)

At its July meeting the FASB Board agreed that an explicit risk margin should not be included in the measurement of an insurance liability.

The FASB viewpoint results in a margin, described for reference purposes as a ‘composite’ margin, which includes all of the components identified separately by the IASB proposal.

Other Sources of Information

- **IASB Discussion paper** *Preliminary Views on Insurance Contracts* (paragraphs 71-89 of the main text and appendices F (F1-F10) and G.[2]

- **International Actuarial Association (IAA)** *Measurement of Liabilities for Insurance Contracts: Current Estimates and Risk Margins* (IAA Study).

- **Agenda papers**

  - IASB paper 11A Guidance on Cash Flows (March 2009 meeting)
  - IASB paper 5A Margins (April 2009 meeting)
  - IASB paper 5B Residual and Composite margins (April 2009 meeting)
  - IASB paper 17A Measurement Approaches (September 2009 meeting)
  - IASB paper 17B Measurement Approaches- Tabular Comparison (September 2009 meeting)

[2] Although the Discussion Paper features current exit value as the selected measurement model, which was rejected by the boards as the measurement attribute, significant parts of the section on Risk Margins will probably still be relevant. Staff will update this guidance at a later stage