Staff Paper

Project	**Insurance Contracts**
Topic	**Residual margin for Investment Contracts with DPF**

Purpose of this paper

1. This paper discusses how to release the residual margin determined for investment contracts that contain discretionary participating features.

2. The boards reached different conclusions on whether to apply to these contracts the model proposed for insurance contracts. Therefore, this memo is **primarily written for the IASB**.

Summary of staff recommendations

3. The staff recommends that the residual margin of a discretionary participating feature is recognised in profit or loss over the life of the contract in a systematic way that best reflects the asset management services, as follows:

   (a) on the basis of passage of time, but

   (b) if the insurer expects to provide asset management services in a pattern that differs significantly from passage of time, it shall release the residual margin on the basis of assets under management.

Background

4. At the June 10 meeting, the IASB decided to include investment contracts that contain a discretionary participating feature within the scope of the forthcoming exposure draft on insurance contracts. [The FASB decided that those contracts should be accounted for under the guidance for financial instruments. Therefore, this memo is primarily written for the IASB.]

5. As a result, the proposed insurance model applies to investment contracts with discretionary participating features. However, those investment contracts do not transfer significant insurance risk. As a result, the staff identified two requirements in of the model that need to be modified when applied to investment contracts with discretionary participating features.

   (a) the principle for the contract boundary.

   (b) the release of the residual margin.

6. Item (a) contract boundary principle has already discussed by the IASB at the June xx meeting, where it decided that the boundary of these contracts should be defined as the point at which the contract holder no longer has a contractual right to receive benefits arising from a discretionary participating feature.

7. This paper discusses (b) the release of the residual margin.

Residual margin

8. The residual margin is an amount determined at inception that eliminates any day-one gain and is recognised in profit or loss over time.

9. The boards decided that the residual margin should be recognized in profit or loss over the coverage period in a systematic way that best reflects the exposure from providing insurance coverage, as follows:

   (a) on the basis of passage of time, but

   (b) if the insurer expects to incur claims and pay benefits in a pattern that differs significantly from passage of time, on the basis of the timing of expected claims and benefits incurred.

10. The boards selected this approach because the insurance coverage is an important, often predominant, factor for the performance under an insurance contract. Since insurance risk is present in every insurance contract, it can be used as the basis for release across all types of contracts. Thus, it provides consistent basis for release.

11. However, as already mentioned, investment contracts with discretionary participating features do not transfer significant insurance risk. In other words, the contracts has no insurance risk or the insurance risk is a not a prominent factor. Therefore, it is either:

    (a) not possible to apply the basis for release mentioned in paragraph 8 (if the contract contains no insurance risk at all), or

    (b) inconsistent with the boards' intention to base the release on a (pre)dominant factor of performance under the contract (if the contract contains an insignificant amount of insurance risk).

12. Instead of insurance protection, a dominant driver for investment contracts with discretionary participating features will typically be asset management services. Therefore, the assets under management for those investment contracts are likely to be a significant driver of performance under those contracts, similar to funds under management for mutual fund managers.

13. The staff therefore proposes that the residual margin of a discretionary participating feature is recognised in profit or loss over the life of the contract in a systematic way that best reflects the asset management services, as follows:

    (a) on the basis of passage of time, but

    (b) if the insurer expects to provide asset management services in a pattern that differs significantly from passage of time, it shall release the residual margin on the basis of assets under management.

14. The other requirements with respect to the residual apply equally with respect to investment contracts with discretionary participating features.

Question for the IASB
Do you agree with the staff recommendation in paragraph 13?