Project **Insurance Contracts: Phase II**

Topic **Overall presentation approach**

Objective

1. The objective of this discussion is to consider the presentation approaches for the statement of comprehensive income proposed in the exposure draft, namely:

   (a) the summarised margin approach for insurance contracts (other than for pre-claims liabilities of short-term contracts that are measured using the modified model) (paragraphs 3-7); and

   (b) the allocated premium approach for those that are measured using the modified model (paragraphs 8-9).

2. In developing the exposure draft, the boards considered a number of presentation approaches. These approaches are summarised, with pros and cons, in the Appendix to this paper.

Summarised margin approach

3. The exposure draft proposes a summarised margin approach for presentation for insurance contracts, other than for those that are measured using the modified measurement approach (this is discussed from paragraph 8 onwards). In the boards' view, this approach presents the most relevant and useful information among the approaches that were considered for long-duration contracts.

4. Under the summarised margin approach, all cash inflows associated with an insurance contract are regarded as deposits received from the community of policyholders, and all the cash outflows as repayments to the community of policyholders. The summarised margin approach does not present in the statement of comprehensive income any items of income or expense relating

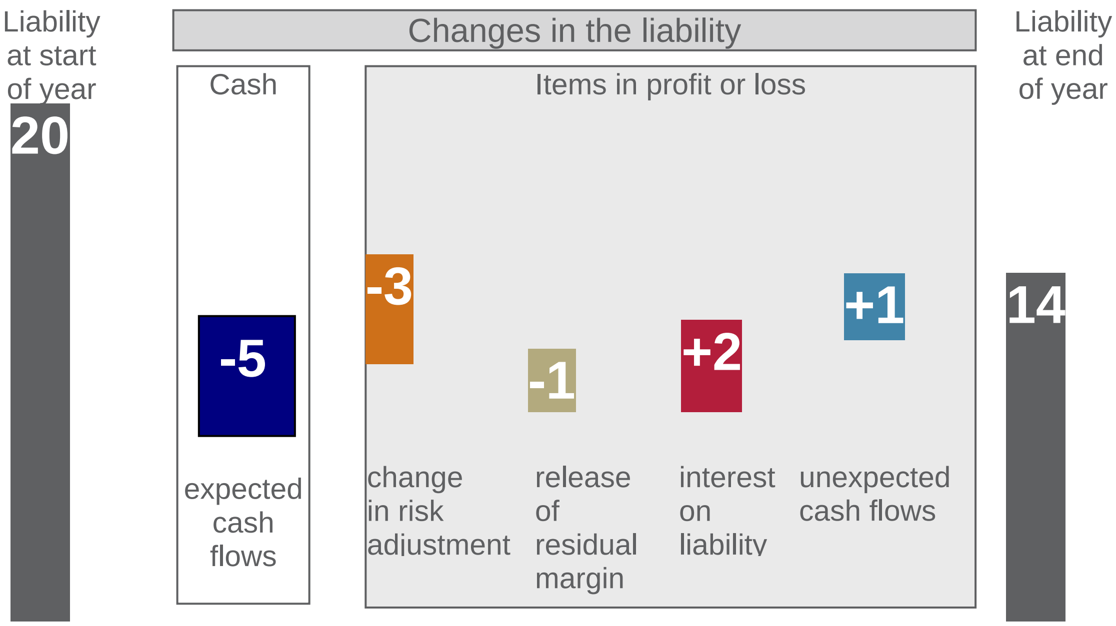
directly to fulfilment cash flows from insurance contracts. Instead, it provides information on:

(a) the underwriting margin (ie changes in the risk adjustment and the release of the residual margin);

(b) experience adjustments (ie differences between actual cash flows and previous estimates) and changes in estimates (ie changes in current estimates of cash flows and discount rates); and

(c) interest on insurance contract liabilities (presented or disclosed in a way that highlights the relationship of the interest with the investment return on assets backing those liabilities).

5. The following figure sets out pictorially the relationship of the building blocks approach and the information reflected in the financial statements.



6. Under the summarised margin approach, the information above may be reflected in the statement of comprehensive income as follows.

Statement of comprehensive income

Year	20X0	20Y9
Risk margin	3	2
Residual margin	1	1
Underwriting margin	**4**	**3**
Experience adjustment	(0.5)	1
Changes in estimates	(0.5)	0
Underwriting result	**3**	**4**
Investment income	X	X
Interest on insurance liability	(2)	(1.5)
Net interest and investment	**(2)**	(1.5)
Net Profit	***1***	***2.5***

7. The boards expect that the proposed disclosures of the reconciliation of insurance contract balances, and other disclosures required in the notes, will provide information that has traditionally been presented in the primary financial statements (see paragraphs 79-97 of the exposure draft) and will enable users of financial statements to identify and calculate financial metrics (eg ratios) that are used at present to evaluate the insurance business.

Questions

Q1. Will the proposed summarised margin presentation be useful to users of financial statements? Why or why not? If not, what presentation approach would you recommend and why?

Q2. Will the information provided in the financial statements and in the notes allow users to calculate the key performance metrics used to analyse insurance business? If not, what information is missing? Why is that missing information useful?

Allocated premium approach

8. For pre-claims liabilities of short-duration contracts that are measured using the modified approach, the exposure draft proposes a presentation approach showing the allocated premium (similar to earned premium under many existing non-life models) as revenue and incurred claims as an expense. This approach is consistent with the proposed revenue recognition model and, in the boards' view, would provide users with relevant information that faithfully represents the performance of these contracts. These contracts are more akin to service contracts.

9. However, there are challenges in reconciling the summarised margin and allocated premium approaches. The exposure draft therefore proposes that pre-claims liabilities of short-duration contracts should be presented the underwriting margin either (1) net or (2) disaggregated. If the insurer presents the net underwriting margin in the statement of comprehensive income, then the exposure draft would require the insurer to disclose in the notes disaggregated information using the allocated premium approach (see paragraph 75(a) of the exposure draft).

Questions
Q3. For liabilities measured using the modified measurement approach, will the proposed premium approach provide relevant information to users of financial statements? Why or why not? If not, what would you recommend and why? Q4. Do you agree with the option to present in the statement of comprehensive income the disaggregated underwriting margin either (1) net or (2) disaggregated, for those liabilities measured using the modified measurement approach? Why or why not? If not, what would you recommend and why?

Appendix: Background on presentation approaches considered

Margin or premium approaches?

A1. In developing the exposure draft, the boards considered two main approaches for presentation in the statement of comprehensive income:

(a) premium approaches, which record the premium received as revenue (and costs as expenses); and

(b) margin approaches, in which changes in the risk adjustment and the release of the residual margin are presented in the statement of comprehensive income.

A2. The boards also considered combining a margin approach with a premium approach (discussed in paragraph A12 below).

Premiums approaches

A3. The boards considered premium approaches for the recognition of income and expense in the statement of comprehensive income as follows:

(a) In a 'written premium' approach, premiums received are presented as revenue when receivable and at the same time the corresponding increase in the liability is presented as an expense. Many existing accounting models apply this approach to life insurance contracts.

(b) Under an approach based on allocation of the premium (or 'allocated premium'), premiums received are presented as a pre-claims obligation ('unallocated premium') in the statement of financial position (ie as performance obligations). As the insurer performs under the contract by providing insurance coverage, the pre-claims liability is released and recognised in the statement of comprehensive income as premium revenue. Many existing accounting models apply this approach to non-life insurance contracts.

A4. Supporters of premium approaches believe that the information about the amount of premiums relating to coverage provided by these approaches is a key performance measure for an insurer. Further, for short-duration contracts it would better fit the nature of such contracts because they are seen as being akin to service contracts.

A5. However:

(a) for a written premium model, the pattern of premium payments may not reflect the services provided by the insurer during the contract term. Consequently, a written premium approach would be inconsistent with existing practices for recognising and presenting revenue for contracts other than insurance contracts, and would also be inconsistent with the proposed model in the exposure draft *Revenue from Contracts with Customers*.

(b) allocation of the premium or a part of that premium is inherently challenging for some types of insurance contracts (eg immediate annuities, stop-loss contracts, and contracts that contain significant guarantees and options).

(c) premium approaches do not reflect changes in the building blocks that make up the measurement of the insurance contract.

Margin approaches

A6. A summarised margin approach:

(a) presents the drivers of the measurement in the statement of comprehensive income, which are:

(i) release of the risk adjustment and residual margin;

(ii) difference between expected and actual cash flows;

(iii) changes in estimates; and

(iv) interest on insurance liabilities.

(b) treats premiums, claims and benefits as movements in the insurance liability.

A7. Arguments for a summarised margin approach are:

(a) that it complements the building block approach proposed for the measurement model; and

(b) that it presents a information about key profit drivers.

A8. However, a summarised margin approach has the following disadvantages:

(a) it is inconsistent with the proposed revenue recognition model, in which entities report gross the consideration received by customers for goods and services. Consequently, it will be challenging to integrate in the statement of comprehensive income a summarised margin presentation with presentation models that report customer consideration on the revenue line.

(b) a summarised margin presentation would not show revenue and expenses in the income statement. (Information on premium inflows and expenses would have to be provided in disclosures).

A9. An expanded margin approach presents the information provided by the summarised margin approach and expands it with further information on revenue and expenses. Basically, it would construct a revenue line item by adding the residual margin with claims and expenses (other than those relating to deposits).

A10. An expanded margin approach would eliminate the disadvantages of a summarised margin approach, because:

(a) it is consistent with the proposed revenue recognition model, because it reports as revenue the consideration that the customer pays for services under the contract. Hence, it is arguably reconcilable with presentation models that report a revenue line.

(b) it provides information about costs that some believe should be reported in the income statement.

A11. However, the expended margin approach raises a number of issues, particularly for contracts with no readily determinable customer consideration amount. Examples of such contracts are those for which (a) the premium includes a significant deposit element and (b) it is impracticable to separate the part of the premium for services from the deposit element, because those contracts do not have explicit charges. In such a case, the customer consideration has to be imputed. These imputations may make the presentation approach complicated, for example because significant tracking of historic information is necessary. Furthermore, as a result of such imputations, the number that is reported as revenue may not be a precise reflection of the actual customer consideration under the contract.

Combination of a margin and premium approach

A12. The boards considered combining the margin and premium approaches, by using an explicit measurement of insurance coverage to identify premiums as revenue as the insurer performs under the contract. However, a combined approach would require an insurer to apply two models: (1) the proposed insurance contracts model for liability measurement and margin release from insurance contracts and (2) the model proposed in the revenue recognition project to determine the amount recognised as revenue. Hence, such an approach might be unduly costly and burdensome. In addition, applying an allocation of premiums based on the proposed revenue recognition model may be challenging for some types of insurance contracts.

Comparison of presentation approaches

A13. The following table sets out the different presentation approaches considered and their effect on revenue recognition.

Approach	**When is revenue reported?**	**Which part of the premium is reported as revenue?**
Written premium	On receipt.	All elements of the premium.
Allocated premium	As ‘earned’ through performance under the contract.	All elements of the premium.
Combination of margin and premium	As ‘earned’ through performance under the contract.	The part of the premium that the policyholder pays for services under the contract.
Summarised margin	As ‘earned’ through performance under the contract.	Only the part of the premium that is released as a margin over the life of a contract.
Expanded margin	As ‘earned’ through performance under the contract.	The part of the premium that is released as a margin over the life of a contract, plus some or all of the insurance losses and expenses.