Appendix B – Relevant proposals from the IASB ED/FASB DP

From the IASB ED:

Statement of comprehensive income

72. At a minimum, an insurer shall include for insurance contract line items in its statement of comprehensive income that present the following amounts for the period:

(a) underwriting margin, disaggregated either in the statement of comprehensive income or in the notes into:

(i) the change in risk adjustment.

(ii) the release of residual margin.

(b) gains and losses at initial recognition, disaggregated either in the statement of comprehensive income or in the notes into:

(i) losses on insurance contracts acquired in a portfolio transfer(see paragraph 40(b)).

(ii) gains on reinsurance contracts bought by a cedant(see paragraph 45(b)).

(iii) losses at initial recognition of an insurance contract(see paragraph 18)

(c) acquisition costs that are not incremental at the level of an individual contract (see paragraph 39(b)).

(d) experience adjustments and changes in estimates, disaggregated either in the statement of comprehensive income or in the notes into:

(i) differences between actual cash flows and previous estimates of those cash flows (ie experience adjustments).

(ii) changes in estimates of cash flows and changes in discount rates.

(iii) impairment losses on reinsurance assets.

(e) interest on insurance contract liabilities.

73. The changes in estimates of discount rates and the interest on insurance liabilities shall be presented or disclosed in a way that highlights their relationship with the investment return on the assets backing those liabilities.

74 An insurer shall not present in the statement of comprehensive income, except as noted in paragraph 75(a):

(a) premiums, which instead are treated in the same way as deposit receipts; and

(b) claims expenses, claims handling expenses, incremental acquisition costs and other expenses included in the measurement of the insurance contract, which instead are treated in the same way as repayments of deposits.

75 For some short-duration contracts, the pre-claims liability is measured in accordance with paragraphs 56–60. For those contracts, an insurer shall, in addition to the applicable line items in paragraph 72, include in its statement of comprehensive income line items that present the following amounts from insurance contracts for the period:

(a) the underwriting margin, disaggregated either in the statement of comprehensive income or in the notes into:

(i) premium revenue, determined as the gross release of the pre-claims obligation (ie grossed-up for the amortisation of incremental acquisition costs, see paragraph 57(a)).

(ii) claims incurred.

(iii) expenses incurred.

(iv) amortisation of incremental acquisition costs included in the pre-claims obligation (see paragraph 57(b)).

(b) changes in additional liabilities for onerous contracts (see paragraph 60).

76 An entity shall present all income and expense from insurance contracts in profit or loss.

77 An insurer shall not offset income or expense from reinsurance contracts against the expense or income from insurance contracts.

78 An insurer shall present income and expense from:

(a) unit-linked contracts as a single line item, and not commingle them with income and expense from the insurer's other insurance contract liabilities.

(b) the pool of assets underlying unit-linked contracts as a single line item, and not commingle them with income or expense from the insurer's other assets.

From the FASB DP:

Statement of Comprehensive Income

114. The Boards considered several approaches for presenting income and expenses arising from insurance contracts: a margin presentation approach and two different premium presentation approaches. The following section discusses those approaches. Additional information about those approaches is included in paragraphs BC159–BC170 of the IASB's Exposure Draft.

Margin Presentation Approach

115. Revenues and claims and benefits expenses would not be presented separately. Instead, earnings would present changes in the margins determined at initial recognition of the insurance contracts (the composite margin under the Board's preliminary views or the residual and risk adjustment margins under the IASB's proposals). Subsequent experience adjustments and changes in estimates of expected cash flows also would be presented separately.

Advantages and disadvantages of the margin presentation approach

116. Proponents of the margin presentation approach have said that it has the following advantages:

a. It links the presentation approach in the statement of comprehensive income to the measurement approach for the insurance liability.

b. Deposit receipts would not need to be unbundled from the premiums because premiums would be treated the same as deposits. Distinguishing between the deposits and the premiums may be somewhat arbitrary for some contracts.

117. Opponents of the margin presentation approach have said that it has the following disadvantages:

a. Because the amount of premiums and claims related to coverage provided by an insurer during the period would not be presented as revenue and expenses in the statement of comprehensive income, some elements of profitability, risk, and loss experience would be obscured. For example, if the contract transfers insurance risk, it would be inappropriate to present each arrangement as a deposit because:

(i) Premiums are not refunded if an insured event does not occur.

(ii) The liability could far exceed the premiums if an insured event does occur.

b. Only part of the premium received from the policyholder is depicted as income—namely the composite margin (under the composite margin approach) or the risk adjustment and residual margins (under the two-margin approach). Income presented in the statement of comprehensive income would not be comparable with presentation approaches for revenue from other activities, such as fund management.

Premium Presentation Approaches

118. The Boards also considered the following two premium presentation approaches for revenues and expenses in the statement of comprehensive income:

a. Written premium presentation approach—Premiums would be presented as revenue when receivable. The corresponding increase in the liability would be presented as an expense when incurred. Many existing accounting models apply this approach to life insurance contracts.

b. Allocated premium presentation approach—Premiums received would be presented as preclaims liabilities in the statement of financial position (that is, as performance obligations). As the insurer performs under the contract by providing insurance coverage, the preclaims liability would be recognized in the statement of comprehensive income as premium revenue. Claims liabilities would be recognized as expenses when incurred. Many existing accounting models apply this approach to nonlife insurance contracts.

119. Under both of the premium presentation approaches, an amount equal to the difference between premium revenue and the claims and benefits expenses recognized would be separately reported in the statement of comprehensive income each period. This amount would be necessary because the presentation of premium revenue and claims and benefits expenses each period would not correspond with the net measurement of the carrying amount of the insurance contract under the building block approach.

Advantages and disadvantages of a premium presentation approach

120. Supporters of a premium presentation approach note the following:

a. It would provide information about the amount of premiums relating to coverage provided during a period. Many users of financial statements regard such information as an important performance measure for an insurer.

b. Reported revenue would correspond with the customer consideration received for the premiums, which is consistent with the proposed Accounting Standards Update on revenue recognition.

c. It would provide information about claims expenses during the period including claims incurred but not reported and changes in the insurance liability.

121. Opponents of a premium presentation approach note the following:

a. The pattern of premium payments may not reflect the services provided by the insurer during the contract term because of the deposit element inherent in certain contracts. Therefore, a premium approach would be inconsistent with existing practices for recognizing and presenting revenue for noninsurance contracts.

b. Allocation of the premium or a part of that premium would be inherently difficult for some types of insurance contracts (for example, immediate annuities, stop-loss contracts, and contracts that contain significant guarantees and options).

c. A premium approach would not reflect changes in the individual components of the building blocks that are included in the measurement of an insurance contract.

IASB's Exposure Draft

122. The IASB proposes a presentation model for insurance contracts measured using the building-block approach based on the margin presentation approach. That presentation model would be consistent with the building-block approach because the line items presented would represent the changes in the individual building blocks. Specifically, the statement of comprehensive income would provide separate information about the following:

a. The change in the risk adjustment margin

b. The recognition of the residual margin in earnings (or the composite margin for the approach preferred by the Board)

c. The difference between the actual cash flows for the current period and previous estimates of those cash flows (that is, an experience adjustment)

d. Changes in estimates of future cash flows (remeasurements) during the period

e. Accretion of interest on insurance liabilities (presented or disclosed in a way that highlights the relationship between interest expense, changes in discount rates, and investment return on the assets that back those liabilities).

123. Although a margin presentation approach for the statement of comprehensive income would be required, information about total premiums, total claims, and administrative and acquisition expenses would be disclosed in the notes to the financial statements. The IASB proposes a different approach—the allocated premium presentation approach—for contracts accounted for under the modified approach (see paragraph 104). In the IASB's view, presenting the allocated premium (earned premium) as revenue and incurred claims as expenses for contracts accounted for under the modified approach would more faithfully represent those contracts.

124. For specific guidance and further detail on the proposed presentation requirements for the statement of comprehensive income, see paragraphs 72–78 of the IASB's Exposure Draft.

FASB's Preliminary Views

125. The majority of Board members agree with the IASB's proposal to use a margin presentation for insurance contracts measured under the building-block approach. Additionally, the Board has indicated a preference for the use of a premium presentation for contracts measured under the modified approach. However, the Board has not determined which contracts would be measured according to the modified approach and is concerned about the use of two different presentation approaches for insurance contracts. As such, the Board is soliciting additional feedback from stakeholders on the usefulness of the information provided by either a margin presentation approach or a premium presentation approach for insurance contracts and which contracts would use each approach.

Presentation Example

126. The following example illustrates the margin and premium presentation approaches under the two-margin approach and the composite margin approach. The example has significant simplifications, and rounding differences may exist. Furthermore, the example assumes that the effect of mortality experience on the total amount of the maturity benefits is not material.

Alternative 1: Margin Presentation Approach

The margin presentation approach is the preferred approach of the IASB, as noted in paragraph 122. Under the margin presentation approach, premiums are treated as deposits while claims and claims handling expenses are treated as repayments of deposits.

Statement of Comprehensive Income

	Two-Margin Approach				**Composite Margin Approach**			
	20X1	**20X2**	**20X3**	**Total**	**20X1**	**20X2**	**20X3**	**Total**
Risk adjustment margin	40	50	110	200	-	-	-	-
Residual margin	33	36	41	110	-	-	-	-
Composite margin	-	-	-	-	60	60	179	300
Insurance underwriting margin	73	86	151	310	60	60	179	300
Investment income[(a)]	96	81	67	244	96	81	67	244
Experience adjustment	(10)	(5)	5	(10)	(10)	(5)	5	(10)
Change in estimates	(28)	(14)	-	(42)	(28)	(14)	-	(42)
Interest accreted on the expected future cash flows	(45)	(38)	(30)	(113)	(45)	(38)	(30)	(113)
Interest accreted on the residual margin	(5)	(4)	(2)	(11)	-	-	-	-
Non-incremental acquisition costs	(20)	-	-	(20)	(20)	-	-	(20)
Other expenses[(b)]	(40)	(40)	(40)	(120)	(40)	(40)	(40)	(120)
Profit	22	66	151	239	14	44	181	239

(a) Based on the investment rate of 8 percent noted in the assumptions.

(b) General and administrative expenses.

Alternative 2: Written Premium Presentation Approach

Under the written premium presentation approach, the entire premium is reported as revenue on receipt. The change in the insurance liability represents significant events from accruing the premiums received at initial recognition and recognizing the part of the liability that covers the maturity benefit at the end of the contract.

Statement of Comprehensive Income

	Two-Margin Approach				**Composite Margin Approach**			
	20X1	**20X2**	**20X3**	**Total**	**20X1**	**20X2**	**20X3**	**Total**
Premium revenue	1,200			1,200	1,200			1,200
Investment income[a]	96	81	67	244	96	81	67	244
Residual/composite margin	33	36	41	110	60	60	179	300
Total income	1,329	117	108	1,555	1,356	142	246	1,744
Claims and benefits expenses	(210)	(220)	(625)	(1,055)	(210)	(220)	(625)	(1,055)
Non-incremental acquisition costs	(20)			(20)	(20)			(20)
Interest expense[b]	(50)	(42)	(32)	(123)	(45)	(38)	(30)	(113)
Other changes in the insurance liability[c]	(988)	251	740	3	(1,028)	201	630	(197)
Other expenses[d]	(40)	(40)	(40)	(120)	(40)	(40)	(40)	(120)
Total expenses	(1,307)	(51)	43	(1,315)	(1,342)	(97)	(65)	(1,505)
Profit	22	66	151	239	14	44	181	239

(a) Based on the investment rate of 8 percent noted in the assumptions.
(b) Interest accreted on the expected future cash flows (and residual margin under the two-margin approach).
(c) Determined as the sum of the experience adjustment, the change in estimates of future cash flows, the change in the risk adjustment margin (for the two-margin approach), and the difference between the premiums received and the claims and benefits paid during the period. That difference is included because the presentation of premium revenue and claims and benefits expenses each period does not correspond with the net measurement of the liability under the building block approach.
General and administrative expenses.

Alternative 3: Allocated Premium Presentation Approach

Under the allocated premium presentation approach, the premium is recognized as revenue based on performance of the contract over the coverage period in a systematic manner that best reflects the exposure from providing insurance coverage. In order to present premium revenue and claims and benefits expenses separately in the statement of comprehensive income but also measure the liability on a net basis, an amount representing the difference between the premium revenue allocated to the current period and the actual claims and benefits expenses incurred must be recognized so that profit is not changed as a result of using the allocated premium presentation approach. In the statement of comprehensive income below, that difference is included in the change in the insurance liability.

Statement of Comprehensive Income

	Two-Margin Approach				**Composite Margin Approach**			
	20X1	**20X2**	**20X3**	**Total**	**20X1**	**20X2**	**20X3**	**Total**
Premium revenue[(a)]	240	240	720	1,200	240	240	720	1,200
Investment income[(b)]	96	81	67	244	96	81	67	244
Residual/composite margin	33	36	41	110	60	60	179	300
Total income	369	357	828	1,555	396	382	966	1,744
Claims and benefits expenses	(210)	(220)	(625)	(1,055)	(210)	(220)	(625)	(1,055)
Non-incremental acquisition costs	(20)	-	-	(20)	(20)	-	-	(20)
Interest expense[(c)]	(50)	(42)	(32)	(123)	(45)	(38)	(30)	(113)
Other changes in the insurance liability[(d)]	(28)	11	20	3	(68)	(39)	(90)	(197)
Other expenses[(e)]	(40)	(40)	(40)	(120)	(40)	(40)	(40)	(120)
Total expenses	(347)	(291)	(677)	(1,315)	(382)	(337)	(785)	(1,505)
Profit	22	66	151	239	14	44	181	239

(a) Allocated based on the expected timing of claims and benefits payments at initial recognition of the contracts.
(b) Based on the investment rate of 8 percent noted in the assumptions.
(c) Interest accreted on the expected future cash flows (and residual margin under the two-margin approach).
(d) Determined as the sum of the experience adjustment, the change in estimates of future cash flows, the change in the risk adjustment margin (for the two-margin approach), and the difference between the premiums received and the claims and benefits paid during the period. That difference is included because the presentation of premium revenue and claims and benefits expenses each period does not correspond with the net measurement of the liability under the building block approach.

General and administrative expenses.