IASB/FASB Meeting
Week commencing 13 June 2011

IASB Agenda reference 3A

Staff Paper

FASB Agenda reference 70A

Insurance contracts

Topic **Statement of comprehensive income**

Objective

1. The purpose of this paper is to ask the boards to decide on the appropriate presentation for the statement of comprehensive income.

2. This paper considers ways it is possible to incorporate meaningful volume information about premiums, claims, and expenses for all insurance contracts and how to organize that information on the face of the financial statement.

3. This paper does not discuss other issues related to presentation, which will be discussed in future staff papers. Those topics include:

   a) How the statement of financial position should be presented

   b) How to present information about contracts ceded in reinsurance transactions.

   c) How to present policyholder participation

   d) Whether to define an "operating income" metric that excludes certain changes in the insurance liability

   e) Whether to reflect some changes in the insurance liability in "Other Comprehensive Income"

   f) Whether or not to present separately deposit components of an insurance contract that are not otherwise unbundled.

4. The staff presented Memo 58K/Agenda Paper 3K *Refresher on Presentation Models* at the February 18, 2011 meeting and Memo 60A/Agenda Paper 3A *Alternative Presentation Models* at the March 14, 2011 meeting. The feedback received on these papers provided a foundation for the staff analysis and

recommendation included in this memo. This memo includes excerpts from the earlier memos for the boards' convenience.

5. The rest of this paper is set out as follows:

   a) Staff recommendation

   b) Background

   c) Staff analysis and recommendation.

      a) Recognizing volume information

      b) Selecting a presentation model

      c) Organizing performance information

   d) Appendix A: Revised presentation alternatives

   e) Appendix B: Relevant proposals from the DP/ED

Staff recommendation

1. The staff recommend on the performance statements of insurance contracts an insurer should recognize premium information:

   a) When due from customers for contracts measured using the building-block approach

   b) For other contracts, when the preclaims obligation is reduced as the insurer provides coverage. The boards may need to update or refine this principle at a future meeting when they discuss the modified approach.

2. The staff recommend presentation of the statement of comprehensive income as follows:

   a) An insurer shall include line items for the underwriting margin of insurance contracts that present the following amounts for the reporting period:

      i) building block approach underwriting margin reflecting:

         (i) Change in/release of

1. Risk adjustment (IASB)
2. Residual margin (IASB)
3. composite margin (FASB)

(ii) experience adjustment related to the current period disaggregated as:

1. premium due
2. claims incurred
3. expenses incurred
4. expected net changes in the liability for the period

(iii) changes in assumptions

(iv) gains and losses at initial recognition

ii) modified approach underwriting margin reflecting:

(i) change in/release of

1. risk adjustment (IASB)
2. composite margin (FASB – if applicable)

(ii) premium revenue (based on the release of the preclaims obligation grossed up for amortization of acquisition costs)

(iii) claims incurred

(iv) expenses incurred

(v) amortization of acquisition costs included in the preclaims obligation

(vi) experience adjustments related to the current period

(vii) changes in assumptions

viii) changes in additional liabilities for onerous contracts

b) Investment performance:

i) Investment income

ii) Interest accreted on the expected net cash flows

c) Changes in discount rate

Background

Proposals in the DP/ED

3. The ED/DP proposed a 'margin approach', in which premiums received are recognised as a deposit receipt, i.e. a movement in a liability in the statement of financial position. Subsequently, as the insurer is released from risk (and, if applicable, provides other services), the related portion of the margin is recognised as revenue in the statement of comprehensive income. The ED discussed two types of margin approach:

    a) In the 'summarised margin approach' proposed in the ED/DP, all cash inflows associated with an insurance contract are treated as deposits received and all cash outflows are treated as repayments.

    b) In an 'expanded margin approach', the summarised margin approach is expanded to provide information about premiums and claims by presenting in the statement of comprehensive income both changes in the risk adjustment and the release of the residual margin during the period, and some or all of the policyholder claims and benefits and other expenses. The example did not specify how premium information was determined.

4. Paragraph 72-78 of the ED also articulated minimum levels of disaggregation required on the face of the statement and in the notes. Appendix B provides the relevant excerpts.

5. The DP, in addition to the summarised margin approach, included two alternative premium presentation approaches, the written premium approach, and the allocated premium approach (commonly known as the earned premium approach). The DP sought feedback on the usefulness of the information provided by a margin presentation approach compared to the two alternative premium presentation approaches, as well as feedback on which contracts

would use each approach. These approaches were explored by the IASB in the development of the ED.

Feedback received on the DP/ED and Alternatives in Memo 60A/Agenda Paper 3A

Summarized Margin

6. Feedback received on the DP/ED indicated the summarized margin information was helpful but not useful enough on a standalone basis. Most respondents, including users, wanted the information supplemented by volume information regarding premiums, claims, and expenses. They argued this information was too important for disclosure in the notes to the financial statements and failure to include it in the performance statement would lead to unintended consequences. Some respondents acknowledged that while the summarized margin approach is conceptually sound for life contracts, it does not provide the key performance indicators used to evaluate insurers.

7. Respondents in favour of providing volume information were split on the significance of the “true up” for changes in the insurance liability. Some believe the amount was meaningless and significantly reduced the quality of the performance statement while others believe the volume information and related true-up was just as important to the performance of the underlying portfolio as the release of the margin. Most respondents who referred to the examples provided in the DP/ED preferred the premium written approach, acknowledging the difficulty inherent in determining premium earned for certain life contracts measured under the building-blocks approach. Under this alternative, premium is recognized when receivable from a customer. They mentioned the importance of conducting user outreach before selecting a specific presentation approach.

8. Some respondents that were uncomfortable with the summarized margin presentation expressed concern with the option to provide volume information for non-life contracts in the notes to the financial statements instead of the face of the statement. They requested clarification of the specific disaggregation requirements outlined in the DP/ED.

Other Presentation Matters

9. Feedback regarding the separation of modified approach and building-block contracts was mixed. Some respondents thought a consolidated presentation of insurance performance was desirable even if volume information was recognized on different measurement basis. Others commented that requiring the separation of the information would improve the quality of information provided.

10. Respondents also requested clarification of the experience adjustment and its interaction with claims incurred in a period. One respondent noted that disaggregating an experience adjustment is only practical when the estimates are based on explicit assumptions.

Subsequent analysis

11. In response to feedback regarding volume information the staff developed four alternatives in Memo 60A/Agenda Paper 3A including:

    a) Supplemental Face Disclosure

    b) Expanded Margin

    c) New Business Written

    d) Dual Statement

12. The following table highlights the strengths and weaknesses identified with each presentation alternative.

Approach	Description	Advantages	Disadvantages
Supplemental Face Disclosure	Volume information is provided on the statement of comprehensive income but is not a component of income or expense.	• Provides volume information on the face of the statement of comprehensive income while retaining summarized margin information. • No need to include an amount to offset the gross up effects of including the premiums within the statement of comprehensive income (because, unlike the expanded margin approach, volume information is supplementary) • May depict underwriting result as a driver of profitability more clearly than in the expanded margin approach.	• Requires Board to define premium metric for building-block insurance contracts. • Premium information may combine underwriting premiums and deposits. • The volume information reported does not articulate with the amounts in the statement of comprehensive income.
Expanded margin approach	Expanded margin approaches expand the summarised margin information to provide information about premiums and claims. Expenses incurred are presented beneath the revenue line and an item for changes in liability reduces the bottom-line impact of these numbers to zero. This is similar to a traditional GAAP presentation where revenue is recognized and offset by an expense for the change in the liability. The release of the margin(s) and various adjustments contribute to the underwriting result.	• Under some premium recognition methods, provides the volume information commonly used to evaluate an insurer's performance. • Allows for the analysis of underwriting growth and various loss and expense ratios (unlike the summarized margin approach). • May provide greater transparency about premiums and expenses, which some believe are the drivers of the margins.	• May not relate directly to the fulfilment value measurement model • Could be misleading because it may not be clear what the numbers and captions represent (i.e. some may consider this an "earned" amount if premium due is used). • Some may consider at least one of the numbers to be a 'plug' with no inherent meaning (others think this number is meaningful, particularly with proper disclosures)

Approach	Description	Advantages	Disadvantages
Written (Expected Cash Flows) Approach	Displays the total expected cash inflows and cash outflows at contract inception, for new business in the period. These amounts subtotal to the total margin for contracts written in the period. A portion of this margin is released along with the release of previous margins, similar to the summarized margin approach. This model essentially results in a building block approach for all insurance contracts.	• No imputed "revenue" amounts are displayed. Volume information may not be as misleading as expanded margin with due or earned approach • Displays growth and performance measures for contracts written in the period and are consistent with the measurement of the liability. • Some consistency in presentation between single premium contracts and recurring premium contracts, eliminating need to for metrics such as 'annual premium equivalent'.	• While some may believe expected cash flows for contracts written in the period are a better indicator of volume and growth, other users may still believe that the loss of premium information and claims information in this approach may have the same disadvantages as the summarized margin approach.
Dual statement approach	Insurers would provide a statement of comprehensive income in the traditional income statement format and a source of earnings statement which includes some of the components in the summarized margin approach. Both statements would arrive at the same net income result.	• Provides the volume information on the face of the statements while retaining the summarized margin information. • The source of earnings is important to many users of the financial statements. This approach would elevate the source of earnings to a financial statement.	• Requires Board to define revenue for insurance contracts. • Providing the summarized margin information with a source of earnings statement may not provide the same level of prominence of this important metric compared to including it on the statement of comprehensive income.

Feedback received on alternatives in Memo 60A/Agenda Paper 3A

13. The staff solicited feedback on the alternatives from the boards at the March 14, 2011 meeting. The boards directed the staff to solicit input from the Insurance Working Group and other users.

Insurance Working Group

14. Mixed feedback was received but some discussion applicable to the alternatives in Memo 60A/Agenda Paper 3A included:

    a) Premiums and claims are crucial to contracts with an insurance risk component

    b) New business written conveys useful information, particularly for the increased analytical benefit of distinguishing between previous and current period margin release. However, some feel it may not be appropriate for the performance statement

    c) Supplemental face disclosure is simple to understand

    d) Dual statements appear to provide an inferior statement for users less familiar with the industry

User Outreach

15. The staff is conducting ongoing outreach to discuss the tentative proposals with users. The feedback received to date was recently posted on the FASB website. Respondents included industry specialists and investment generalists representing buy-side, sell-side and credit rating organizations.

16. Most users found the lack of volume information unacceptable. The outreach highlighted a strong resistance to an overhaul of the current GAAP income statement. Some speculated that sensitivity to increased volatility and the summarized margin presentation would unintentionally reduce investor confidence in the industry.

17. The complexities of the transactions and underlying accounting make the analysis inherently difficult. Removing commonly understood volume information from the face of the financial statement may unnecessarily exacerbate concerns over the tentative proposals especially in an industry with

a relatively small number of specialists. Additionally, not providing volume information will accelerate the proliferation of non-GAAP measures in the industry and users will place less reliance on the GAAP financial statements.

18. Some users provided specific feedback on the alternatives in Memo 60A including:

    a) Premiums, specifically information about the amount an insurer receives annually helps determine growth

    b) New business written information is very useful, but users indicated the alternative places too much focus on new business for the income statement

    c) Dual statements depicting performance may misrepresent information and cause confusion. This approach seemed counterproductive to the desire to provide volume information that improved the understanding of the new guidance.

    d) Source of earnings analysis requires close coordination within the industry that may not be achievable globally. However, the types of information provided in a source of earnings analysis can be useful

19. Analysts referred to a variety of performance metrics they use in proprietary models that evaluate insurer performance. The statistical earnings supplement was regularly mentioned as an important source of information. The staff analyzes these supplements in the next section.

20. Some users find statutory filings helpful in evaluating claims development and investment exposure. This information is prepared on a premium due basis and considered useful. Significant drawbacks include distorted claims development tables (Schedule P) for multinationals applying inferior foreign currency translation methods and a time delay compared to general purpose financial reporting filings.

21. Information about the earnings impact of new business was mentioned as a useful improvement to some current GAAP. An analysis of Embedded Value (common in Europe) and Source of Earnings (common in Canada) distinguishes this information from in-force contracts. However, some felt the

assumptions underlying the measurement would unnecessarily distort the volume information appropriate for a financial statement.

Staff analysis and recommendation

22. The staff prepared their analysis by considering presentation of the statement of comprehensive income in three steps:

    a) Recognizing volume information

    b) Selecting a presentation model

    c) Organizing performance information

Recognizing volume information

Expanding the summarized margin approach

23. The boards initially selected a summarized margin approach that did not include volume information. BC160 indicates a margin approach views all cash inflows associated with an insurance contract as deposits received from the community of policyholders and all cash outflows as repayments to the community of policyholders. BC165 went on to articulate that in some cases, revenue if included would not be determinable directly, but would need to be imputed.

24. However, paragraph BC166 of the IASB ED acknowledges the importance of volume information:

    > *In the Board's view, information about premiums, claims, and expenses is relevant to users of financial statements. Therefore, the Board proposes to require disclosure of such information.*

25. Some users indicated they don't use the information on the face financials however they do use the segment information which includes volume information which in total reconciles to the face financials.

26. The overwhelming support for volume information on the face of the financial statements led the staff to reconsider whether disclosure of such information is sufficient. Subsequent user outreach highlighted the need for some type of

volume information that is understandable to users of current GAAP financial statements. One user commented that the proposed presentation transformed “black box” accounting into a “black hole”. This view is supported by the efforts of the European Financial Reporting Advisory Group and related panels in a subsequent comment letter received by the boards:

> *“EFRAG TEG concluded, based on input from EFRAG User Panel and Insurance Accounting Working Group, that volume information is considered essential by users of insurers’ financial statements. In addition, users stress that disclosure of volume information in the notes to the financial statement is not an adequate substitute for disclosure on the face of the statement of comprehensive income.”*

27. The staff agree it is important to include volume information in the face of the financial statements to address user concerns that a summarized margin approach was not adequate on a standalone basis. However, recognizing volume information for building-block contracts could be perceived as a significant departure from the summarized margin approach which is inconsistent with the liability measurement. Many users suggested developing an approach that was integrated into the building-block approach.

28. This lead the staff to conclude it is important to present volume information in a manner that distinguishes the volume amounts from the other performance information in a summarized margin approach, particularly the release of margin(s).

Premium recognition criteria

29. The staff identified three recognition criteria some consider consistent with a component of the liability measurement. The three methods considered include:

    a) **Consistent with initial liability measurement (Premium written)**

       When written (expected cash flows), where the total expected present values of cash inflows and cash out flows are presented at contract inception for new business written during the period.

    b) **Consistent with the release of margin(s) (Premium earned)**

When earned through performance under the contract. This is the traditional non-life model.

c) **Consistent with the cash flow estimates in the liability (Premium due)**

When due, this is the traditional life model for recognizing premium revenue.

30. Advantages and disadvantages of each approach discussed in previous memos include:

Approach	Advantages	Disadvantages
Written (Expected cash flows)	• Clearest link to building block measurement • Shows new business results separately from in-force • Only uses information already required under proposals	• Less intuitive presentation of modified approach contracts • Period comparability hindered when timing and discount rate assumptions vary • Inconsistent with current volume information provided for any contract
Earned	• Closely aligned with *Revenue Recognition* project, improves comparability to other industries • Consistent with non-life premium recognition under current GAAP	• Feasibility concerns for certain contracts • Inconsistent with current volume information provided for life contracts
Due	• Consistent with life premium recognition under current GAAP • Can be reconciled to liability measurement and experience adjustments intuitively	• Some consider inconsistent with revenue recognition • Inconsistent and less conceptually sound than current volume information for non-life contracts

Premium written approach

31. The staff considered the premium written [1]approach in context of feedback received. Based on our review of earnings supplements and registrant filings, investors currently rely on disclosures that reflect information that distinguishes new business from in-force blocks of policies including:

a) First year premium

b) Source of earnings – which distinguishes capitalized profit on in-force policies and new business

[1] The premium written approach defined in this memo refers to the expected cash flows of new business written during a period. This is inconsistent with premium written defined in the DP/ED , defined as premium due. This approach is more comparable to a premium due approach, discussed below.

c) Embedded value – which distinguishes the value of future new business from existing policies

32. Changes in premium written across periods can give users information to predict growth potential. For instance, analysts use the information to evaluate how an insurer is pricing their contracts relative to the market by considering the underlying source of premium growth (rates or policyholders). The insurance industry is a cyclical market characterized by periods of premium increases (hard markets) and decreases (soft markets) per unit of coverage provided. During a soft market, unusual increases in premium written could indicate an insurer is increasing their exposure using aggressive pricing to attract customers. This may give an early indicator of under pricing and future underperformance.

33. However, the amount of assumptions embedded within the measurement of new business written is a significant drawback to performance statement presentation. It is possible that a competitively priced policy is the result of a competitive advantage that reduces adverse selection during the underwriting process. Pricing decisions are reflected in all of the volume information considered. However, premium written provides less direct insight into the current impact of mispricing. The actual underwriting performance of some policies written in a period will not be known for decades as the liability unwinds.

34. Many respondents indicated the usefulness of new business written volume information in conjunction with other data, but did not think it was the most appropriate indicator of current period performance.

Premium earned approach

35. Recognizing premium earned on a consistent basis could significantly enhance comparability to other industries. The revenue recognition project proposes recognizing revenue as follows:

a) Identify the contract(s) with a customer

b) Identify the separate performance obligations in the contract

c) Determine the transaction price

d) Allocate the transaction price to the separate performance obligations

e) Recognize revenue when the entity satisfies each performance obligation

36. The staff applied the revenue recognition framework to contracts within the scope of the insurance project to determine whether a consistent method of calculating "premium revenue" provides useful volume information for the statement of comprehensive income. The following table summarizes the staff's conclusions.

Revenue Recognition	**Modified Approach**	**Building Block Approach**
Step 1: Identify the contracts with the customer		
Agreement between two or more parties that creates enforceable obligation	**Embedded Derivatives** Typically not significant in modified approach contracts **Investment components** Typically not significant in modified approach contracts **Goods and Services** Determined based on unbundling criteria tentatively consistent with revenue recognition criteria on identifying performance obligations	**Embedded Derivatives** Bifurcate derivatives not closely related to underlying insurance risk **Investment components** Unbundle explicit account balances. Future decisions TBD. May result in total customer consideration including deposit components **Goods and Services** Determined based on unbundling criteria tentatively consistent with revenue recognition criteria on identifying performance obligations
Step 2: Identify the performance obligations		
Separate performance obligations with different patterns of transfer and a distinct function	Not defined in project, most agree a stand ready obligation to provide protection against insurance risk(s) . Tentative decision to reduce preclaims obligation based on passage of time (or payment of claims) is consistent with a single obligation perspective Some believe multiple performance obligations exist, potentially separated under	Not defined in project, most agree a stand ready obligation to provide protection against insurance risk(s) Some believe multiple performance obligations exist, potentially separated under revenue recognition framework depending on level of integration. If separated, allocation in step 4 may be arbitrary. If not

	revenue recognition framework depending on level of integration. If separated, allocation in step 4 may be arbitrary. If not separated, measurement of progress in step 5 may be arbitrary.	separated, measurement of progress in step 5 may be arbitrary.
Step 3: Determine the transaction price		
Total amount of consideration to be received based on prob. –weighted or best estimate for provision of goods or services. Time value of money (for contracts greater than one year)	Premium received at inception plus present value of future premiums (when time value of money is material) Deposit components typically not present	Expected premium inflows for entire portfolio reflecting time value of money Depending on unbundling decisions, some customer consideration could reflect deposit components that are not part of the transaction price.
Step 4: Allocate transaction price to performance obligations		
Relative selling price basis	Consistent with measurement of preclaims obligation Difficult when identifying multiple performance obligations since standalone prices may not be unobservable	Difficult when identifying multiple performance obligations since standalone prices may not be unobservable
Step 5: Recognize revenue when the entity satisfies the performance obligations		
When customer obtains control of the good. For continuously satisfied obligation, measure progress using: -Inputs -Outputs, or -Time	Tentative decision - On the basis of time, but when that pattern of transfer differs significantly from the passage of time, on the basis of expected timing of incurred claims	Possible indicators of progress: **Inputs** Premiums received Uncertainty reduced **Outputs** Claims incurred/paid Incremental increase in benefit “reserves” in the period **Passage of time**

37. The staff found the reduction of preclaims obligation under the modified approach consistent with the revenue recognition framework. The staff has not been able to identify an approach that is applicable to all building-block contracts, does not place an onerous burden on preparers, or require arbitrary allocations. Specific issue identified include:

a) **Measuring satisfaction of performance obligation-** difficult to identify appropriate indicator of progress for some longer term contracts.

b) **Unbundling embedded derivatives** – separating certain derivatives may make liability measurement arbitrary or onerous. However, measuring satisfaction of performance obligation with embedded derivatives becomes difficult due to variability and uncertainty in cash flows.

c) **Unbundling investment components-** separating certain account balances may be unnecessary or arbitrary for measurement of the liability. However, premium for bundled components may reflect deposit component that is difficult to identify separate from the transaction price for insurance coverage

d) **Identifying separate performance obligation** – difficult to determine whether it is useful to identify multiple performance obligations (relating to claims handling, renewal options, etc). Pattern of transfer may or may not be different.

38. The staff attempted to develop an allocation principle that would calculate earned premium for life contracts, including the change in gross premiums less the incremental increase in the actuarially determined gross benefit reserves. However this approach and others explored proved to be difficult to apply to certain life contracts especially those with cash values. In several cases the results were not meaniningful when considered the type of product operationally, the calculation would be cumbersome and complex.

Premium due

39. The proposed building-block model requires an insurer to estimate the timing and amount of cash flows in a portfolio at recognition. These amounts are updated to reflect current assumptions. At the beginning of the period, a portion of the liability reflects the expectations of cash in-flows for the year. Some would argue this reflects the true “premium due” in a period. Similarly, expected cash outflows related to claims, benefits, and fulfillment expenses are also included in the liability. The differences between actual and expected

amounts for the period are recognized as income for the period under the "experience adjustment" item.

40. Some believe that premium due is not a conceptually sound performance indicator and misleads investors. The staff believe this criticism preemptively assumes premium due represents an earned or revenue recognized metric. Premium due is a useful performance measure on a standalone basis that indicates changes in growth potential or policy mix. The volume information recognized on a due basis can complement the recognition of margin released during a period through a robust presentation. Some staff believe that earned premium is less useful than premium due for this reason. One respondent highlighted another advantage of providing premium due (or written as described in the DP/ED) volume information instead of an earned amount:

> "Premiums and benefits represent financial statement items that are comparable among companies, well understood, verifiable and not based on assumptions selected. On the other hand, the release of margin is based on allocations, estimates, and incorporates significant management judgment, all of which can vary greatly among companies.[…] We support the written premium presentation…"

41. The staff recognize future decisions on unbundling may require the staff to address whether or not to present separately deposit components of an insurance contract that are not otherwise unbundled. For some contracts with significant investment features, premium is never recognized under current practices and instead it is treated as a deposit. Fees charged for insurance and investment services are recognized according to the amounts explicitly charged to the customer. Distinguishing which cash flows in the liability are representative of premium is a matter of presentation that should not impact the decision to provide volume information on a due basis.

42. Many users insisted on providing information comparable to current GAAP used in many jurisdictions. Presenting volume information on a due basis, subject to possible restrictions for limited payment terms and deposit components, could meet the volume information needs of constituents without the difficulty in developing, measuring, and explaining a method of earned premium for the building-block approach.

Staff recommendation

43. The staff believe the boards should reaffirm their decision to recognize revenue for modified approach contracts when the preclaims obligation is reduced as the insurer provides coverage. The boards may need to update or refine this principle at a future meeting when they discuss the modified approach.

44. The staff recommend for contracts measured under the building block approach premium due be included in the statement of comprehensive income but with no indication that this is revenue.

45. The staff's understanding is that the difference between premiums earned and premiums due for the contracts that will potentially meet the eligibility criteria to use the modified approach would not be material in substantially all situations.

Selecting a presentation model

Alternatives in Memo 60A/Agenda Paper 3A

46. Three of the four alternatives proposed in Memo 60A/Agenda Paper 3A are compatible with recognizing premium due and earned volume information in the statement of comprehensive income, including:

    a) Supplemental Face Disclosure

    b) Dual Statement

    c) Expanded Margin

47. The alternatives in Memo 60A/Agenda Paper 3A also included a transposition between a traditional GAAP income statement with volume information and a summarized margin income statement to illustrate the relationship between the two.

48. The supplemental face disclosure is simple and does not obscure any other information on the face of the financial statement. However, there is no clear articulation of the interaction with the performance of an insurer. The staff agree with subsequent user feedback indicating the approach was not cohesive

and may lead investors to rely on the information without considering the useful information provided in the summarized margin approach.

49. The dual statement alternative proposed two statements that would provide a summarized margin statement (similar to a source of earnings statement) and a traditional volume statement. Distinguishing between profitability on in-force policies and new business written in the summarized margin statement was an additional alternative that could increase similarity to the source of earnings analysis provided by some insurers.

50. Two performance statements would require one or more extensive reconciliations to appropriately reflect the interrelationships between a gross volume and summarized margin presentation. An approach involving two primary performance statements is unprecedented for business enterprises in all jurisdictions. From an operational perspective the preparation of both statements and reconciliations in a short timeframe to meet reporting timelines could be cumbersome. This perpetuates the “black box” view of insurance accounting and diminishes the simplicity relative to the other compatible approaches. Furthermore, some staff believe that presenting two statements sends an unintended message that the summarized margin information is inferior independently.

51. The expanded margin alternative integrates all information into a cohesive statement. However, the premiums and claims are also included in the margin as a net amount. This creates the need for a “change in insurance liability” line item to prevent double-counting. Some consider this undesirable and view the amount as a plug.

Subsequent Alternatives

52. The staff revised the expanded margin to incorporate feedback received during user outreach and address concerns that the presentation of the “change in insurance liability” could mislead investors to rely on volume information as the measurement of earned amounts during the period.

53. As mentioned, cash inflows expected during a period are included in the insurance liability net of cash outflows expected for claims, benefits, and expenses during a period. Differences between the expected and actual

amounts are recognized in income for the period as an experience adjustment. Paragraph 72(d) of the IASB ED describes the presentation of revisions to estimates for current and future liability cash flows as follows:

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.

54. Appendix A includes three alternatives that emphasize the relationship of actual and expected cash flow amounts with the experience adjustment. These alternatives address concerns about the alternatives in Memo 60A/Agenda Paper 3A by isolating the effect of the volume information on the experience adjustment from other information related to the release of margin and changes in future estimates.

55. Example #1 disaggregates the experience adjustment to provide more detail about the actual levels of premiums, claims/benefits, and expenses experience actually incurred during the period versus expected.

56. This presentation provides more useful information than the summarized margin approach and better articulates how the volume information relates to the insurance liability compared to the expanded margin presentation in Memo 60A/Agenda Paper 3A. Example #2 further disaggregates the expected change in insurance liability by the types of actual information

57. Both alternatives provide additional transparency over the expanded margin approach developed in previous memos and the summarized margin approach proposed in the DP/ED.

58. Alternative #3 combines modified approach and building block contracts into a presentation that is similar to Example #1. The summarized margin results of both measurement models are presented separately or could be combined.

Staff recommendation

59. The staff recommend presenting the statement of comprehensive income using the approach in Example #1. The staff believe this provides useful volume information in a manner that clearly articulates the relationship between the amounts and the underlying insurance liability.

Organizing performance information

One or two presentation models

60. The staff considered whether to require disaggregation of performance for contracts measured using the modified approach and the building-block approach, noting respondents were mixed on the importance of a single presentation model. The statistical supplements that investors cited during user feedback efforts often segment different types of insurance business to highlight profitability within segments. The primary financial statements of several multiline insurers follow similar practice.

61. Furthermore, the staff developed the alternatives to emphasize the relationship with the underlying liability measurement. For modified approach contracts, premium revenue is recognized as the preclaims obligation is reduced; this is not identical to premium due reflected in the building-block measurement but is not anticipated to be materially different.

62. The staff believe any disadvantage in appearance caused by the additional volume line items is outweighed by the increased insurer comparability and reporting period consistency. To enhance comparability, the volume information should be required for both measurement approaches on the face of the financial statements. The language in the ED that attempts to separate the underwriting margin of building-block and modified approach contracts should be clarified to produce a presentation similar to Example #1.

    In addition, providing the information separately would be more meaningful. Users of the financial statements analyze the types of contracts that would be accounted for under the building block approach and those that would be accounted for under the modified approach differently.

63. The staff believe the boards should also allow further disaggregation by line of business as long as the results of contracts measured under different approaches are not combined.

Separating underwriting and investing activities

64. The staff agree with respondents that it is useful to distinguish the effects of investing from underwriting activities. The staff believe the investment component should also include interest accretion on the insurance liabilities. This distinguishes the financing elements of insurance contracts from the performance related to premiums, claims/benefits, and expenses.

65. The staff also agree with feedback from users indicating that distinguishing changes in discount rate from the underwriting and investment performance groups described above is also appropriate. This will allow users to easily identify the causes of volatility that some do not consider economic. The examples in Appendix A calculate profit before and after changes in discount rate. Future decisions on the use of other comprehensive income may require the boards to revisit the presentation of this item.

Staff Recommendation

66. The staff recommend on the performance statements of insurance contracts an insurer should recognize premium information:

    a) When due from customers for contracts measured using the building-block approach

    b) For other contracts, when the preclaims obligation is reduced as the insurer provides coverage. The boards may need to update or refine this principle at a future meeting when they discuss the modified approach.

67. The staff recommend presentation of the statement of comprehensive income as follows:

    a) An insurer shall include line items for the underwriting margin of insurance contracts that present the following amounts for the reporting period:

i) building block approach underwriting margin reflecting:

(i) Change in/release of

1. Risk adjustment (IASB)
2. Residual margin (IASB)
3. composite margin (FASB)

(ii) experience adjustment related to the current period disaggregated as:

1. premium due
2. claims incurred
3. expenses incurred
4. expected net changes in the liability for the period

(iii) changes in assumptions

(iv) gains and losses at initial recognition

ii) modified approach underwriting margin reflecting:

(i) change in/release of

1. risk adjustment (IASB)
2. composite margin (FASB – if applicable)

(ii) premium revenue (based on the release of the preclaims obligation grossed up for amortization of acquisition costs)

(iii) claims incurred

(iv) expenses incurred

(v) amortization of acquisition costs included in the preclaims obligation

(vi) experience adjustments related to the current period

(vii) changes in assumptions

viii) changes in additional liabilities for onerous contracts

b) Investment performance:

   i) Investment income

   ii) Interest accreted on the expected net cash flows

c) Changes in discount rate

Question for the boards
Do the boards tentatively agree with the staff recommendations regarding the presentation of the statement of comprehensive income?