Staff Paper

Topic **Presentation of volume information**

Introduction

1. The Exposure Draft *Insurance Contracts* (ED) proposed a summarised margin presentation approach that highlights the underwriting margin, experience adjustments and changes in estimates and interest on insurance contract liabilities.

2. Some criticise the summarised margin presentation approach because it does not include information about revenue, claims and expenses. In particular, many believe that information about revenue is necessary to permit comparison between insurers and other entities, and between the building block approach and the modified approach.

3. This paper illustrates different presentation approaches for the statement of comprehensive income for insurance contracts. Although the examples illustrate how an insurer might present information about the modified approach and the building block approach in the same statement of comprehensive income, this paper does not specifically consider the modified approach. We intend the examples to show, at a very high level, the rough 'feel' of different approaches. We do not intend to discuss precise details on how any of the approaches might apply in practice. Therefore, we suggest that participants consider the overall presentation, rather than specific details.

4. Appendix A provides illustrative examples. Appendix B considers how we might recognise revenue from premiums.

Examples

5. The examples are as follows:

    (a) the traditional approach (Appendix A-1)

    (b) the summarised margin approach proposed in the ED (Appendix A-2)

    (c) the summarized margin approach with volume disclosure on the face (Appendix A-3)

    (d) the expanded margin approach (Appendix A-4a, 4b, and 4c)

    (e) an expected cash flows approach (Appendix A-5)

    (f) a dual statement approach (Appendix A-6)

6. The examples are taken from Agenda paper 3A from the joint IASB-FASB board meeting in the week of 14 March.

7. We included an example of a traditional approach (Appendix A-1) and the presentation model proposed in the ED (Appendix A-2) for comparison. We describe the other approaches in the table below:

Approach	Description	Advantages	Disadvantages
Summarised margin approach with volume information (Appendix A-3)	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 revenue for insurance contracts. • Premium information may combine underwriting premiums and deposits. • The volume information reported does not reconcile with the amounts in the statement of comprehensive income.

Approach	**Description**	**Advantages**	**Disadvantages**
Expanded margin approach (Appendix A-4)	Expanded margin approaches expand the summarised margin information to provide information about premiums and claims. The examples illustrate revenue determined on the following basis: • when due, with amounts that relate to future periods added to insurance liabilities • as earned through performance under the contract based on an allocated premium • on a cash flows basis, where the expected present values of cash flows for new business written during the period are	• 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.	• Do not relate directly to the fulfilment value measurement model • Could be misleading because it may not be clear what the numbers and captions represent. Some may consider at least one of the numbers to be a 'plug' with no inherent meaning.

Approach	**Description**	**Advantages**	**Disadvantages**
	presented as revenue. 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 presentation (A-1) 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. The three expanded margin approaches presented vary in the organization of line items.		

Approach	**Description**	**Advantages**	**Disadvantages**
Written (Expected Cash Flows) Approach (Appendix A-5)	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. • Displays growth and performance measures for contracts written in the period 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.

Approach	**Description**	**Advantages**	**Disadvantages**
Dual statement approach (Appendix A-6)	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.

Observations

8. In the board's view, the information provided by the summarised margin approach links clearly with the measurement approach for the insurance liability in the statement of financial position, and failure to illustrates such linkages is a significant defect of many existing models, particularly for long-duration contracts. We acknowledge that many would like to see information about premiums, claims and expenses in conjunction with the information from the summarised margin approach. However, there is no simple answer to providing that information while simultaneously providing information about margins. Any solution that provides both would inevitably result in an imperfect model. Therefore we believe that, if information about premiums, claims and expenses were to be provided, it should be driven by the needs of users and preparers.

Discussion questions
1) Which approach provides the most useful information to users of financial statements? 2) Which approach would be practicable for preparers of financial statements to provide? 3) Should summarised margin information be presented in the statement of comprehensive income or in the notes?

Appendix A: Illustrative examples

APPENDIX A-1 Traditional Model Presentation

	Building Block Approach	Modified Approach	Total
Premium income	6,392	2,139	8,532
	-	-	-
Investment Income	1,657	157	1,815
Realized investment gains and losses	(710)	123	(587)
Investment income attributable to unit-linked policyholders	903	-	903
Total investment income	1,850	280	2,130
Total income	8,243	2,419	10,662
	-	-	-
Claims and benefits paid	(4,826)	(1,336)	(6,162)
Movements in insurance liabilities due to change in interest rates	843	9	852
Changes in unit-linked liabilities	(903)	-	(903)
Other movements in insurance liabilities	(1,486)	(42)	(1,528)
Acquisition costs	(319)	(444)	(763)
Other costs	(768)	(341)	(1,110)
Total expenses	(7,459)	(2,155)	(9,614)
Profit before tax	784	265	1,048
Income tax expense	(200)	(68)	(267)
Profit for year	584	197	781

NOTE: This represents a statement of comprehensive income under current IFRS 4;practice varies and more or less line items may be presented. This was used as the baseline for alternative presentation approaches.

Performance Statement (includes risk margin in modified approach)

APPENDIX A-2 ED Proposed Presentation

	Modified Approach	Building Block Approach	Total
Premium revenue	2,139		2,139
Claims incurred	(1,422)		(1,422)
Expenses incurred	(341)		(341)
Amortisation incremental acquisition costs	(331)		(331)
Underwriting margin short duration contracts	**45**		**45**
Release of risk adjustment claims liabilities, gross	144		
Release of risk adjustment claims liabilities, reinsurance	(22)		
Release of risk margin claims liabilities	**123**		**123**
Release of risk margin		169	169
Release of residual margin		83	83
Underwriting margin long duration contracts		**252**	**252**
New business losses		(57)	(57)
Non-incremental acquisition costs	(113)	(83)	(196)
Experience results	(22)	50	28
Operating assumption changes	3	(39)	(36)
Change in discount rates	9	951	960
Interest accretion	(60)	(1,239)	(1,300)
Accretion unit linked liabilities		(903)	(903)
Other expenses	(183)	(1,319)	(1,502)
Investment income own account	280	948	1,228
Investment income unit linked		903	903
Total investment income	**280**	**1,850**	**2,130**
Profit before tax	265	784	1,048
Income tax expense	68	200	267
Profit for the year	197	584	781

NOTE: This example presents an interpretation of the presentation proposed in the IASB ED with revenue recognized on a due basis.

Performance Statement (includes risk margin in modified approach)

APPENDIX A-3 ED Proposed Presentation[1] with face disclosure of revenue

	Modified Approach	Building Block Approach	Total
Premium revenue	2,139	6,392	2,139
Claims incurred	(1,422)	(4,826)	(1,422)
Expenses incurred	(341)	(768)	(341)
Amortisation incremental acquisition costs	(331)		(331)
Release of risk adjustment	123	169	169
Release of residual margin	45	83	83
Underwriting margin	**168**	**252**	**420**
New business losses		(57)	(57)
Non-incremental acquisition costs	(113)	(83)	(196)
Experience results	(22)	50	28
Operating assumption changes	3	(39)	(36)
Change in discount rates	9	951	960
Interest accretion	(60)	(1,239)	(1,300)
Accretion unit linked liabilities		(903)	(903)
	(183)	(1,319)	(1,502)
Investment income general account	280	948	1,228
Investment income for account of policyholders		903	903
Total investment income	**280**	**1,850**	**2,130**
Profit before tax	265	784	1,048
Income tax expense	68	200	267
Profit for the year	197	584	781

NOTE: This example shows a summarized margin presentation for both approaches with volume information disclosed on the face of the statement but not as part of the components of income

APPENDIX A-4a Expanded Margin Approach

		Modified Approach	Building Block Approach	Total
Premium due		2,139	6,392	8,532
Claims		(1,422)	(4,826)	(6,247)
Expenses		(341)	(768)	(1,110)
Amortization of incremental acq. costs		(331)	(236)	(236)
Change in insurance liability			(562)	(562)
Release of risk adjustments		123	170	
Release of residual margin			83	375
Underwriting result		168	252	751
Onerous contract loss	1	-	(57)	(57)
Non-incremental acquisitions costs	2	(113)	(83)	(196)
Experience adjustments	3	(22)	50	28
Change in estimate	4	3	(39)	(36)
Change in discount rates	5	9	951	960
Interest accretion on insurance liability	6	(60)	(1,239)	(1,300)
Other expenses		(183)	486	303
Investment income		280	948	1,228
Net investment results		280	45	325
Profit for the year		265	784	1,379
Income Tax		68	200	267
Profit for the year		197	584	781

NOTE: This example presents an expanded margin approach. Revenue is recognized on a due basis. Policyholder(unit-linked) accounts are not included.

The line "change in insurance liability" offsets the volume information (premium due, claims, expenses, amort. of acq. costs) in order to remove duplicate accounting of these items which is recorded in the release of margins over time.

APPENDIX A-4b Expanded Margin Approach (alternative grouping)

		Modified Approach	Building Block Approach	Total
Premium due		2,139	6,392	8,532
Claims		(1,422)	(4,826)	(6,247)
Expenses		(341)	(768)	(1,110)
Amortization of incremental acq. costs		(331)	(236)	(567)
Change in insurance liability			(562)	(562)
Release of risk adjustment		123	170	293
Release of residual margin			83	83
Experience adjustments	3	(22)	50	28
Operating assumption changes	4	3	(39)	(36)
Interest accretion on insurance liability	6	(60)	(1,239)	(1,300)
Change in discount rates	5	9	951	960
Onerous contract losses	1	-	(57)	(57)
Underwriting result		98	(81)	17
Non-incremental acquisitions costs	2	(113)	(83)	(196)
Other expenses		(113)	(83)	(196)
Investment income		280	948	1,228
Net investment results		280	948	1,228
Profit for the year before net investment remeasurements		265	784	1,049
Investment fair value changes				
Net investment Remeasurements		-	-	-
Income Tax		68	200	267
Profit for the year		197	584	781

NOTE: This example presents an alternative grouping of the expanded margin approach to include all items impacting the measurement of the insurance contract(the present value of the expected cash flows) shown in Appendix A-3.

Another alternative grouping suggested proposes including changes in discount rate separately with investment fair value changes to isolate the components of the presentation responsible for volatility concerns.

For consistency, line "net investment remeasurements" was not changed in examples where it is not applicable.

APPENDIX A-4c - Expanded margin approach alternate grouping w/ separate accounting for policyholder accounts

		Modified Approach	Building Block Approach	Total
Premium due		2,139	6,392	8,532
Premium for accounts of policyholders			929	929
Claims		(1,422)	(4,826)	(6,247)
Claims for accounts of policyholders			(1,831)	(1,831)
Expenses		(341)	(768)	(1,110)
Amortization of incremental acq. costs		(331)	(236)	(567)
Change in insurance liability			(562)	(562)
Release of risk adjustment		123	170	292
Release of residual margin			83	83
Experience adjustments	3	(22)	50	28
Operating assumption changes	4	3	(39)	(36)
Interest accretion on insurance liability	6	(60)	(1,239)	(1,300)
Change in discount rates	5	9	951	960
Onerous contract losses	1	-	(57)	(57)
Underwriting result		98	(983)	(885)
Non-incremental acquisitions costs	2	(113)	(83)	(196)
Other expenses		(113)	(83)	(196)
Investment income		280	948	1,228
Investment income unit-linked accounts			903	903
Net investment results		280	1,850	2,130
Investment fair value changes				
Net investment Remeasurements		-	-	-
Income Tax		68	200	267
Profit for the year		197	584	782

NOTE: This example includes "premiums" and caims" for policy holder accounts (i.e. unit linked, segregated accounts, separate accounts, etc).

Another alternative grouping suggested proposes including changes in discount rate separately with investment fair value changes to isolate the components of the presentation responsible for volatility concerns.

For consistency, line "net investment remeasurements" was not changed in examples where it is not applicable.

APPENDIX A-5 Expected cash flows of new business written

	Modified	Building Block	Total
Expected undiscounted cash flows of premiums	2,127	7,061	8,562
Expected undiscounted cash flows of claims and benefits	(1,348)	(7,722)	(7,347)
Expected undiscounted cash flows of expenses	(348)	(236)	
Effect of discounting	36	1,704	
Risk adjustment	(90)	(55)	
Acquisition Costs	(331)	(236)	(566)
New business written residual/composite margin	46	516	649
Increase in composite/residual margin balance for contracts written during current period	20	496	
New business written residual/composite margin recognized	26	20	46
Existing Contracts			
Release of risk adjustment	123	170	292
Release of residual margin	110	63	
Experience adjustments	(107)	50	(57)
Change in estimates	(3)	(39)	(41)
Onerous contract losses	-	(57)	(57)
Underwriting Results	149	207	356
Non-incremental acquisitions costs	(113)	(83)	(196)
Other expenses	(113)	(83)	(196)
Investment income	280	948	1,228
Interest accretion on insurance liability	(60)		(60)
Net investment results	220	(292)	(72)
Profit for the year before net investment remeasurements	256	(168)	88
Investment fair value changes			
Change in insurance liability due to financial assumptions	9	951	960
Net investment Remeasurements	9	951	960
Income Tax	(68)	(200)	(267)
Profit for the year	198	583	781

NOTE: This example presents information on the expected cash flows of new business written separately from performance of contracts in-force at the beginning of the period. This provides volume information using building block approach components.

APPENDIX A-6 Dual Statement Example Approach

Source of Earnings [1]

Expected profit from in-force business	5,645
Impact of new business	(960)
Experience gains (losses) [1,2]	(2,208)
Management actions and changes in assumptions	(5,319)
Earnings (loss) on surplus funds	718
Other	35.07
Income (loss) before income taxes	(2,089)
Income tax recovery (expense)	1,436
Net income (loss) attributed to shareholders	(653)

This is a source of earnings statement meant to show the following

Expected profit from in-force business	Formula-driven release of PfADS (Provisions for Adverse Deviations) on the non-fee businesses and expected profit on fee businesses.
Impact of new business	For non-fee income businesses, the capitalized value of future profits less PfADs in respect of new business. For fee income businesses, the non-capitalized acquisition expenses.
Experience gains (losses)	Earnings impact of any differences between actual experience in the current period relative to expected experience implicit in the actuarial liabilities, and differences in current period fee income due to market performance.
Management actions and changes in assumptions	Earnings impact of: -management initiated actions in the period that generate a non-recurring current period impact -changes in methods and assumptions that impact actuarial liabilities or other liabilities -integration expenses from acquisitions that flow to income
Earnings (loss) on surplus funds	Actual investment returns on the Company's surplus (shareholders' equity).
Other	Earnings items not included in any other line of the SOE, including non-
Income taxes	Tax charges to income, consistent with the amount on the statement of operations.

Statement of Comprehensive Income

Revenue	
Premium income	30,646
Investment income1	15,825
Other revenue	10,454
Subtotal revenue	56,925
Realized/ unrealized gains (losses) on assets supporting policy liabilities and consumer notes2,3	5,922
Total revenue	62,847
Policy benefits and expenses	-
To policyholders and beneficiaries	7,204
Death, disability and other claims	9,365
Maturity and surrender benefits4	5,053
Annuity payments	1,882
Policyholder dividends and experience rating refunds	127
Net transfers (from) to segregated funds	23,008
Change in actuarial liabilities4	6,232
General expenses	1,622
Investment expenses	6,273
Commissions	1,799
Interest expense3	438
Premium taxes	1,735
Goodwill impairment	67
Non-controlling interest in subsidiaries	64,804
Total policy benefits and expenses	(1,957)
Income (loss) before income taxes	1,436
Income tax recovery (expense)	(521)
Net income (loss)	132
Net income (loss) attributed to participating policyholders	(653)
Net income (loss) attributed to shareholders	(132)
Preferred share dividends	(785)
Net income (loss) available to common shareholders	

This is a traditional statement of comprehensive income used to demonstrate comparability to the source of earnings statement and would be converted to one of the appraches previously discussed

Appendix B: Recognising revenue from premiums

1. Exposure Draft *Revenue Recognition* proposes that an entity recognises revenue when it satisfies a performance obligation in the contract. If the approach in *Revenue Recognition* were to be applied to premiums arising from insurance contracts, it is unclear how revenue should be defined. This appendix describes three methods for recognising revenue from premiums:
   (a) When due (ie as written), with amounts that relate to future periods added to insurance liabilities. This is the traditional life model for recognizing premium revenue).
   (b) As 'earned' through performance under the contract. This is the traditional non-life model.
   (c) As 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.
2. We consider the advantages and disadvantages of the three approaches below.

Advantages and disadvantages of the when due approach

3. An advantage of the when due approach is that, if all deposit components are excluded, reported revenues would correspond in total amount with the customer consideration received for the premiums. This would be consistent with the ED *Revenue Recognition* (though the timing of their recognition as revenue would, in most cases, be different). In addition, this would be consistent with how life insurers in most countries recognise revenue under their current accounting.
4. The amounts recognised as revenue could be limited to those which are not refundable, and therefore this approach could be applied to non-life contracts as well as life contracts. For example, a policyholder pays 1,200 on 1 January for auto coverage for the year. If the policyholder sells their car on 28 February and no

longer needs the contract, the insurer will refund 1,000 for 10/12ths of the premium not earned. Thus, the insurer would recognise revenue of 200 at 28 February.

5. Suppose now that same policyholder pays a single premium of 12,000 on 1 January for a traditional life product. Suppose also there is no surrender value. If they die on 28 February their beneficiary will receive the death benefit but there is no return of premium. The life insurer would therefore recognise revenue of 12,000 on 1 January.

6. A disadvantage of the when due approach is that the pattern of premium payments may not reflect the services provided by the insurer during the contract period, therefore resulting in potentially recognizing revenue before services are performed. In this respect, the when due approach is inconsistent with the revenue recognition ED.

Advantages and disadvantages of the earned approach

7. Like for the when due approach, an advantage of the earned approach is that reported revenues would correspond with the customer consideration received for the premiums, which is consistent with the ED on revenue recognition. Additionally, by allocating the premium, the pattern of recognition could be aligned with the period over which service is performed.

8. A disadvantage of the earned approach is that the allocation of the premium or 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 deposit components or guarantees or options).

9. Some have suggested allocating expected premiums under the policy to the expected periods of claims and benefit payments however, this could result in an imputed number reported as revenue based on claims, rather than an amount that can be derived directly. The boards had previously rejected such an approach, in their discussions of an expanded margin approach in the ED/DP. Another suggestion to derive earned premium is to recognise as revenue the change in the expected present value of cash in-flows less out-flows, plus interest accretion on the

liability. However, this is still difficult with certain long duration contracts, especially for life contracts with cash values. Additionally, some have suggested that such an allocation may not be viable for contracts with significant investment components, which could result in different models of recognition between short and long term contracts. It would be difficult to derive an earned premium that can be applied consistently across product types.

Advantages and disadvantages of the as written (expected cash flows) approach

10. An advantage of the written (expected cash flows) approach is that it is consistent with the measurement of the net insurance liability. Insurers applying the proposed liability measurement model would only need to rely on data already existing to implement this approach. In this alternative, like in the summarized margin approach, no “revenue” amounts are displayed, but rather the components of the building block are presented for contracts written during the period. This could be applied to both short and long term contracts.

11. A disadvantage of the written (expected cash flows) approach is that it is inconsistent with the revenue recognition model, in that the present value of the contract cash inflows and outflows are presented at inception, rather than as the insurer performs under the contract.