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Staff Paper

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Project **Insurance Contracts**

Topic **Statement of Comprehensive Income**

Purpose of This Paper

1. The purpose of this paper is to discuss:
   (a) Which of the underwriting margin components should be required disclosure within the financial statements;
   (b) Whether these components should be disclosed separately for contracts measured under the building block approach ("BBA") and for contracts measured under the premium allocation approach ("PAA"); and
   (c) Whether these components should be presented as line items in the statement of comprehensive income or in the notes.

2. This paper does not address the following topics which we intend to discuss at a later date:
   (a) The presentation of reinsurance;
   (b) The presentation of unbundled components;
   (c) How to present policyholder participation; and
   (d) Whether the effect of changes in the discount rate should be presented as a component of other comprehensive income.

Summary of Staff Recommendations

3. The staff recommend the following[1]:

Disclosure of information in financial statements

(a) The insurer shall disclose the BBA underwriting margin.

(b) The insurer shall disclose the following components of the BBA underwriting margin:

(i) The total difference between actual and expected cash flows, showing separately

(1) Actual premiums received

(2) (Expected) premiums due

(3) Actual benefits paid

(4) Expected benefits

(5) Actual expenses paid

(6) Expected expenses

(ii) The change in expected future cash flows

(iii) The release of the single margin (for the FASB)

(iv) The change in residual margin (for the IASB)

(v) The change in risk adjustment (for the IASB).

(vi) Any losses on initial recognition of an insurance contract showing separately:

(1) Any losses on insurance contracts acquired in a portfolio transfer

(2) Any losses at inception of an insurance contract

(c) The insurer shall disclose the PAA underwriting margin.

(d) The insurer shall disclose the following components of the PAA underwriting margin:

[1] A description of each of these components is included in Appendix B

(i) Premiums earned (based on the release of the liability for future coverage grossed up for amortisation of acquisition costs)

(ii) Claims incurred, showing separately:

(1) Costs incurred for new loss occurrences during the period

(2) Difference between actual and expected cash flows

(3) Change in expected future cash flows

(4) Changes in additional liability for onerous contracts

(iii) Claims adjustment expenses incurred, showing separately:

(1) Costs incurred for new loss occurrences during the period

(2) Difference between actual and expected cash flows

(3) Change in expected future cash flows

(4) Changes in additional liability for onerous contracts

(iv) Amortization of acquisition costs

(v) The change in risk adjustment for the liability for incurred claims (for the IASB).

(vi) Any losses on initial recognition of an insurance contract showing separately:

(1) Any losses on insurance contracts acquired in a portfolio transfer

(2) Any losses at inception of an insurance contract

4. The staff have differing views regarding which components listed in paragraph 3 need to be presented on the face of the statement of comprehensive income, rather than in the notes to the financial statements. Therefore, the paper includes two recommendations: *Recommendation A* and *Recommendation B.*

Presentation on the face of the financial statements

Recommendation A:

(a) The insurer should disclose the underwriting margin, either in aggregate for all insurance contracts or separately for contracts measured under the BBA and PAA.

(b) For insurance contracts measured under the BBA, the insurer shall present as a minimum on the face:

- (i) Premiums due
- (ii) Expected benefits and expected expenses, either in aggregate or separately
- (iii) Any losses at initial recognition

(c) For insurance contracts measured under the premium allocation approach ("PAA contracts"), the insurer shall present as a minimum on the face:

- (i) Premiums earned (based on the release of the liability for future coverage grossed up for amortisation of acquisition costs)
- (ii) Claims and claims adjustment expenses incurred, either in aggregate or separately
- (iii) Any losses at initial recognition

(d) The insurer shall disclose the components listed in paragraphs 3(b) and 3(d) in the notes to the extent they are not presented on the face of the statement of comprehensive income.

Recommendation B:

(e) The insurer shall present the BBA underwriting margin as a separate line item in the statement of comprehensive income.

(f) The insurer shall disclose the components listed in paragraphs 3 in the notes to the extent they are not presented on the face of the statement of comprehensive income.

Other information

5. Furthermore, the staff recommend:

   (a) The removal of the requirement to separately present in the statement of comprehensive income acquisition costs that are not part of the insurance contract liability measurement;

   (b) Interest on insurance contract assets' and liabilities' expected net cash flows[2] shall not be included within underwriting margin and shall be included with investment activity.

Structure of This Paper

6. The remainder of this paper is structured as follows:

   (a) Background, including the tentative leaning from the 15 June 2011 joint board meeting (paragraphs 7-**Error! Reference source not found.**);

   (b) Staff analysis, including:

      (i) Which components should be disclosed in the financial statements (paragraphs 8-17)?

      (ii) Comparison of the presentation model tentatively approved to more traditional presentation formats (paragraphs 18-47).

      (iii) The level of disaggregation in the statement of comprehensive income (paragraphs 48-52).

      (iv) Staff recommendations (paragraphs 55-63).

   Appendix A illustrates examples of different presentation models and Appendix B describes each of the component line items considered in this paper.

[2] Insurance contract assets and liabilities include (assets) liabilities for future coverage and liabilities for incurred losses

Background and the boards' tentative leaning

7. At the 15 June 2011 Joint Board Meeting, the Boards indicated a preference that volume information should be included in the statement of comprehensive income and indicated a preference for the presentation model outlined in Example 2 of Appendix A of Agenda Paper 3A/FASB Memo No. 70 (corresponding Example 1 of Appendix A in this paper). This model separates the BBA underwriting margin and the PAA underwriting margin (and the related components of those underwriting margins). Some Board members and constituents expressed concern that the line items included in the staff recommendation would be required for insurance activities of all entities, including conglomerates and other organizations with a substantial amount of non-insurance business. The Boards asked the staff to analyze whether all insurers should be required to present each of the line items in all cases on the statement of comprehensive income, rather than in the notes.

Staff Analysis

Which components should be disclosed in financial statements

8. As noted above, Example 1 of Appendix A in this paper shows the boards' preferred model for the statement of comprehensive income. In this section of the paper we consider which of the underwriting margin components within the example should be presented within the financial statements (either on the face of the statement of comprehensive income or the notes thereto). We do this by considering first the components that we believe should be identified in the financial statements. Those components would be either presented on the face of the statement of comprehensive income or in the notes. We next consider which of those components need to be presented on the face of the statement of comprehensive income (because disclosure in the notes is insufficient). We discuss how the components are determined in paragraphs 48-52 and Appendix B of this paper contains a description of each of these components.

9. The IASB Exposure Draft *Insurance Contracts* ("ED") proposed a presentation model for reporting income and expense consistent with the proposed building block approach measurement model. Respondent feedback to the ED and outreach to users have shown general support for presentation of the information provided by underwriting margin (in addition to strong support for presentation of volume information). The staff think that presentation of 'underwriting margin' for contracts measured using the building block approach is both relevant and consistent with the BBA proposed measurement model and recommend that it be retained as required information to be disclosed within the financial statements. Some staff think it is of sufficient relevance to require its disclosure on the face of the statement of comprehensive income.

10. Similarly, based on feedback from some users and others, the boards had tentatively decided in their June meeting that volume information was sufficiently relevant such that it should be required to be presented on the statement of comprehensive income. The boards indicated a preference for a presentation that included the following volume information: 'premiums earned', 'claims incurred', and 'expenses incurred' for contracts measured using the premium allocation approach; and 'premiums due', 'benefits expected', and 'expenses expected'[3] for contracts measured using the building block approach.

11. Based, in part, on users' descriptions of the importance of this volume information, the staff think that disclosure of such volume information should required. Furthermore, some staff think the premiums and claims volume information is of sufficient relevance to require its presentation on the face of the statement of comprehensive income. Under US GAAP separate presentation of claims incurred and claims adjustment expenses is not required, and there is diversity in practice as to which entities chose to do so. However, the staff think that the distinction between these two items provides decision

[3] Each of the premium allocation components referred to here are based on an incurred basis, whereas, each of the building block approach components are measured based on estimates of cash flows for the statement of comprehensive income period, a necessity born from perceived inoperability of reliably allocating revenue to some contracts to be measured under the building block approach and the desired cohesiveness with the measurement model (i.e., to reflect a component of the performance measurement associated with the estimated present value of cash flows building block).

useful information because these two significant elements of an entity's costs have predictive value and provide transparency about those elements, thus providing important qualitative information about the entities' claims handling philosophy and its cost structure.

12. Closely related to the volume information described in paragraph 10, are the three BBA line items titled 'actual premiums received, 'benefits paid', and 'expenses paid'. The staff think each of these provide users with decision useful information and a tool for verifying management's past assumptions about the timing and amount of cash flows. Accordingly, the staff recommend that these three actual cash flow components also be disclosed in the financial statements. Some staff also recommend that these items are required on the face of the statement of comprehensive income.

13. Under the BBA, the actual and expected premium, benefits, and expense line items referred to in the last paragraph aggregate to the line item 'total difference between actual and expected cash flows'. The staff consider this subtotal to be useful in summarizing the effect in the period of the differences from expectations. For the reasons noted in support of the components discussed in the last paragraph, the staff recommend that insurers disclose the difference between actual and expected cash flows in the financial statements, for both the BBA and PAA.

14. The staff note that some users state that the underwriting margin all by itself is hard to understand and that disaggregation of its components would provide decision useful information. In addition to the items described above, each of the following components, which are individually associated with one of the building blocks, provide additional transparency into changes of the insurance contract liability and how those changes effect the income of the entity: 'change in expected future cash flows'; 'changes in additional liability for onerous contracts'; 'release of single margin'; 'change in residual margin'; and 'the change in risk adjustment'. The change in the expected future cash flows (combined with the total difference between actual and expected cash flows) is an important figure used by users for predictive purposes regarding future loss reserve development, to confirm earlier expectations of such development and, to distinguish between the profitability of current year's and prior years'

business. Accordingly, the staff recommends that the boards require disclosure of each of these components.

15. Similarly, 'interest accreted on the expected cash flows' provide additional transparency into changes of the insurance contract liability and how those changes affect the income of the entity. Some consider this item to be part of underwriting margin because it increases the ultimate amount the insurer needs to pay, but others consider it as an implicit measure of borrowing costs. Regardless of the view, there is a relationship between the investment income and the interest accreted. Therefore, the staff recommend that it be excluded from the underwriting margin aggregation and included with investment income[4].

16. Paragraph 57 of the ED requires the PAA liability for remaining coverage to be measured net of acquisition costs. Accordingly, in order to present the premium earned as a gross (of acquisition costs) figure, that represents the compensation a policyholder pays for coverage, the 'amortization of acquisition costs' for the period becomes a separate component of the underwriting margin. Accordingly, in order to more clearly link the margin to the measurement approach of the liability for future coverage the staff recommend that this component be disclosed.

17. The ED (paragraph 72(c)) included as a proposal that insurers separately present on the statement of comprehensive income acquisition costs that are not included within the present value of the fulfilment cash flows. Because such costs are not part of the insurance contract measurement (and non-qualifying acquisition costs are not otherwise needed to be defined within the proposed standard), the staff recommend that this ED requirement be eliminated and that such costs be subject to otherwise applicable presentation guidance in IFRSs and US GAAP (e.g., be presented together with other period costs).

[4] This is consistent with the proposal in paragraph 73 of the ED that "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 liabilties."

Comparison of the Presentation Model Tentatively Approved to More Traditional Presentation Formats

18. During the June Joint Board Meeting, some board members expressed a preference for a more traditional presentation of the statement of comprehensive income (i.e., a format that starts with revenue at the top and shows the expenses deducted from revenue). The staff considered how a traditional format would depict the performance results of contracts measured under the BBA and contracts measured under the PAA. In particular, the staff contemplated the degree to which the income and expense relating to contracts measured under the BBA should be combined with the income and expense relating to contracts measured under the PAA in the statement of comprehensive income.

19. To address this question, five distinct presentation models were analyzed to compare the tentatively approved presentation model to more traditional presentation formats:

    (a) Example 1: Separate presentation of PAA and BBA underwriting margins (paragraphs 21-26).

    (b) Example 2: Combined underwriting margin, separate presentation of BBA and PAA premiums and claims information (paragraphs 28-34).

    (c) Example 3: Combined underwriting margin, combined premium and claims information (paragraphs 35-42).

    (d) Example 4: Separate presentation of BBA and PPA, present BBA margins as revenue, disaggregated to show volume (paragraphs 43-46).

    (e) Example 5: Present revenue and expenses disaggregated by components, no presentation of BBA underwriting margin (paragraph 47).

20. Each of these presentation models is illustrated in Appendix A.

Example 1: Presentation Model Tentatively Approved in the June Joint Board Meeting

21. The presentation model outlined in Example 1 of Appendix A separates the BBA and the PAA underwriting margin.

22. Because the concept of premiums due in the BBA is not aligned with the concept of premiums earned in the PAA, separate presentation of performance information for contracts under these two approaches in the statement of comprehensive income is useful. An appropriate method of recognizing revenue for some contracts measured under the BBA has not been identified (e.g., long duration life insurance contracts); thus, the measurement of premiums due[5] is incorporated into the BBA underwriting margin. In contrast, the measurement of premiums earned corresponds to the recognition of revenue for PAA contracts.

23. Analysts tend to focus either on life insurance or on non-life insurance, and their analyses of each differ. Consequently, key performance indicators for life insurance contracts entail margin analysis for investments, mortality, persistency/lapses, and actual-to-expected experience. In contrast, the key performance indicators for non-life insurance contracts involve the analysis of combined loss ratios and claims development. Therefore the staff think that users would benefit from disaggregation of the BBA underwriting margin (i.e., under the assumption that these are predominantly life insurance contracts) and the PAA underwriting margin (i.e., under the assumption that these are predominantly non-life insurance contracts).

24. Another benefit to users of separate presentation of the BBA underwriting margin (and its components) and the PAA underwriting margin (and its components) would be the enhanced degree of cohesiveness between the statement of comprehensive income and the statement of financial position as proposed by the staff in Paper 4C/74C *Statement of Financial Position*. The components of the BBA underwriting margin correspond to the building blocks of the insurance contract asset or insurance contract liability in the statement of financial position. Similarly, the components of the PAA underwriting margin correspond to the liability for remaining coverage and the liability for incurred claims in the statement of financial position. To illustrate

[5] Agenda Paper 3A/70A from the June meeting further discusses the rationale for premium due as a relevant volume indicator to be included within the statement of comprehensive income.

this point, the premiums earned figure and the amortization of acquisition costs correspond to the liability for remaining coverage under the PAA. Also, the claims incurred, the expenses incurred, the change in the residual margin and the change in the risk adjustment, the difference between actual and expected cash flows (related to claims and benefits), the change in additional liability for onerous contracts, and the change in expected future cash flows relate to the liability for incurred claims under the PAA.

25. Despite the above benefits, a potential issue with the presentation model outlined in Example 1 of Appendix A is that the volume of information presented might be excessive for the face of the financial statements (i.e., this information might be more appropriate in the notes). An insurance company that sells both life and non-life products under existing financial reporting standards might reasonably be expected to present five insurance contract-specific line items within the statement of comprehensive income (i.e., premiums for life insurance, premiums for non-life insurance, [life insurance] policyholder benefits, [non-life insurance] claims and claims adjustment expenses, and amortization of deferred policy acquisition costs). This compares to the more than ten line items included in Example 1. The presence of this additional information might add unnecessary complexity and distract users from the relevant content. However, the staff think that these concerns regarding a too cluttered structure of the statement of comprehensive income can be addressed by providing insurers flexibility regarding the disaggregation and whether all information has to be presented on the face or optionally in the notes to the financial statements.

26. Furthermore, the presentation model in Example 1 of Appendix A could be perceived as too industry-specific or product-specific. The separate presentation of the BBA underwriting margin and the PAA underwriting margin may result in a statement of comprehensive income that is considerably different from the statement of comprehensive income of many other industries. Some constituents stated that this may, in turn, lead users that are not familiar with the insurance industry to disregard the possibility of investing in entities that issue insurance contracts. Nevertheless, the staff would highlight that it is assumed that users "have a reasonable knowledge of

business and economic activities and accounting and a willingness to study the information with reasonable diligence." (Paragraph 7 of IAS 1 *Presentation of Financial Statements*). In addition, several users noted the need to balance the complexity of the statement of comprehensive income with the risk of burying important information in the notes to the financial statements.

Traditional Presentation Alternatives

27. In response to concerns that the presentation model outlined in Example 1 of Appendix A might result in a financial statement that is too industry-specific, too product-specific and too complex (see paragraph 25), the staff developed four alternative presentation models for the Boards to consider.

Example 2: Traditional Flow with Separate Presentation of Premiums and Claims Arising From Each of the Building Block and Premium Allocation Approaches

28. The first alternative the staff developed is a presentation model in which the premiums due figure under the BBA is presented separately from the premiums earned figure under the PAA. Similarly, the claims costs under the PAA are presented separately from the benefits costs under the BBA. Each component of the BBA underwriting margin and the PAA underwriting margin would be presented in a combined fashion, resulting in the presentation of one underwriting margin in the statement of comprehensive income. This presentation model is outlined in Example 2 of Appendix A.

29. Similar to the presentation model tentatively approved by the Boards, this presentation alternative benefits from not combining the conceptually different premium items.

30. A possible advantage of separating premiums due and premiums earned and policyholder benefits and claims and claims adjustment expenses while combining the remaining components of the BBA underwriting margin and the PAA underwriting margin is that the resultant statement of comprehensive income would be more concise than a statement of comprehensive income in which the BBA underwriting margin and the PAA underwriting margin are presented separately.

31. Placing premiums due and premiums earned at the top of the statement of comprehensive income and placing each of the other components of the combined underwriting margin for BBA contracts and PAA contracts below the premiums due figure and the premiums earned figure would result in a statement of comprehensive income that is more comparable to the statement of comprehensive income of other industries.

32. However, the presentation of a combined underwriting margin may impede a user's ability to distinguish the performance results of contracts measured under the BBA from the performance results of contracts measured under the PAA. Nevertheless, the reconciliation of contract balances proposed by the ED would provide users with this information.

33. Another potential disadvantage of the presentation model outlined in Example 2 of Appendix A is the potential reduced degree of cohesiveness between the statement of comprehensive income and the statement of financial position that would ensue. If a combined underwriting margin is presented in the statement of comprehensive income, it may not be clear what portion of each component of the underwriting margin corresponds to the insurance contract asset or insurance contract liability under the BBA. Similarly, it will not be clear what portion of each component of the underwriting margin corresponds to the liability for remaining coverage or liability for incurred claims under the PAA.

34. This reduced level of cohesiveness may undermine the transparency of the financial statements of an entity that issues insurance contracts, given that users would not be able to easily distinguish clearly between the performance information of contracts measured under the BBA and the performance information of contracts measured under the PAA.

Example 3: Presentation of a Combined Underwriting Margin Components for the Building Block Approach and the PAA

35. In response to concerns that the statement of comprehensive income of entities that issue insurance contracts should more closely resemble the statement of comprehensive income in other industries, the staff also developed a presentation model in which each component of the BBA underwriting margin and the PAA underwriting margin would be presented in a combined fashion,

resulting in the presentation of one underwriting margin in the statement of comprehensive income. This model is identical to the model outlined in Example 2, except that in this model, premiums due under the BBA and premiums earned under the PAA would be combined and presented as premiums as components of the underwriting margin in the statement of comprehensive income. Also, claims and claim adjustment expenses and policyholder benefits would be combined and presented as benefits and claims incurred. This presentation model is outlined in Example 3 of Appendix A and was also included as Example 3 of Appendix A of Agenda Paper 3A/FASB Memo No. 70A.

36. A potential advantage of this presentation model could be perceived in the enhanced degree of comparability between the statement of comprehensive income of entities that issue insurance contracts and the statement of comprehensive income for other industries. Presentation of one figure for premiums at the top of the statement of comprehensive income and presentation of one underwriting margin would result in a statement of comprehensive income that bears more resemblance to a traditional statement of comprehensive income than the presentation models included in Examples 1 and 2.

37. However, application of a more traditional approach to the statement of comprehensive income for entities that issue insurance contracts may actually mislead users. Combined presentation of premiums due (i.e., a non-revenue figure) under the BBA and premiums earned under the PAA as premiums at the top of the statement of comprehensive income may lead users to view the premiums figure mistakenly as revenue. From a conceptual standpoint, combined presentation of premiums due under the BBA and premiums earned under the PAA as revenue is not justified.

38. Similar to our comments regarding the presentation format in Example 2, this presentation model would result in a tenuous connection between the statement of comprehensive income and the statement of financial position. If each component of the BBA underwriting margin and the PAA underwriting margin is presented in a combined fashion, it will not be clear what portion of each component of the underwriting margin corresponds to the insurance contract

asset or insurance contract liability under the BBA. Similarly, it will not be clear what portion of each component of the underwriting margin corresponds to the liability for remaining coverage or liability for incurred claims under the PAA.

39. Also similar to our comments regarding the presentation format in Example 2, under the presentation model outlined in Example 3 of Appendix A, presentation of the underwriting margin for the BBA and the underwriting margin for the PAA in a combined fashion would impede a user's ability to distinguish clearly between the performance results of contracts measured under the BBA and the performance results of contracts measured under the PAA.

40. The staff considered the possibility that the components of the underwriting margin for the BBA and the components of the underwriting margin for the PAA could be presented separately in the notes to the financial statements. Disclosure of this information would provide users with an understanding of the performance results of contracts measured under the BBA and the performance results of contracts measured under the PAA.

41. However, as previously stated, if the performance results of contracts measured under the BBA and the performance results of contracts measured under the PAA are not presented separately on the face of the statement of comprehensive income, the transparency of the statement of comprehensive income will be undermined. Under existing financial reporting standards, most insurers that issue both life and non-life contracts break out the components of premium and claims / benefits (i.e., similar to example 2) today.

42. The feedback obtained from outreach activities with users indicates that many users look to the segment information or the regulatory filings, rather than the statement of comprehensive income, in their analyses. This is because that information provides disaggregation by line of business and product. However, some staff believes that these users may potentially rely more heavily on the statement of comprehensive income if the components of premiums and of claims/benefits are displayed separately. Thus, distinct presentation of the

information that is incorporated into a user's analysis of an entity's performance is warranted.

Examples 4 and 5: Gross Presentation of Revenues and Expenses

43. The presentation model outlined in Example 4 of Appendix A builds on the earlier presentation examples, but this presentation format reflects a separation of revenues and expenses, rather than a pure margin-focused statement of comprehensive income. Under this presentation, the margin for BBA contracts measured in their entirety is reflected as revenue, a presentation the staff believes to be comparable to the presentation banks follow for the margin they earn on financial instruments. This presentation model provides further comparability between the statement of comprehensive income of entities that issue insurance contracts and the statement of comprehensive income of non-insurance entities. In order to be consistent with the Boards' tentative conclusion to provide volume information on the face of the statement of comprehensive income, the components of the BBA margin are also separately presented. With the exception of inclusion of the margin information for the BBA contracts, the presentation model outlined in Example 4 also bears resemblance to the presentation format used by many non-life insurance companies in current practice.

44. Similar to Example 1, the presentation model in Example 4 separates the presentation of performance information for BBA contracts and performance information for PAA contracts. As such, users may similarly benefit from this disaggregation and may be better able to analyze life and non-life insurance business separately. For the reasons referred to in our analysis of Example 1, this presentation is also more consistent with the presentation of the statement of financial position. This presentation model also has some of the disadvantages of the presentation in Example 1, in terms of the volume of information presented on the face of the statement of comprehensive income.

45. Although the presentation model in Example 4, due to separate presentation of PAA and BBA line items, allows for a more transparent view of contracts measured under the BBA and PAA than the presentation models in Example 2 and 3, the marked presentation difference between contracts measured under

the PAA versus the BBA might be less understandable to those unfamiliar with insurance than the presentation model tentatively approved by the Boards and included in Example 1.

46. Another potential disadvantage of the presentation model in Example 4 of Appendix 1 is the fact that investment income and investment expense are displayed in separate sections of the statement of comprehensive income. Consistent with the Boards' tentative conclusion, investment income and investment expense are displayed together in Examples 1, 2, and 3 and separate from the components of underwriting margin. Presentation of investment income and investment expense together implies that investment activities are distinct from the insurance activities of the entity (i.e., they are related predominantly to investing and financing elements of transactions rather than to underwriting or operating elements of transactions). However, Example 4's display of investment income and interest accreted on expected cash flows within separate revenue and expenses sections of the statement of comprehensive income is considered by the staff to be consistent with current practice. For example, the unwinding of the discount on insurance contracts whose measurement currently includes an adjustment for the time value of money is presented within the expenses section of the statement of income (i.e., as part of policyholder benefits and claims and claims adjustment expenses). Similar presentation within expenses occurs currently for the unwinding of the discount on liabilities for pensions and post retirement benefits.

47. The staff also included an Example 5, which attempts to disaggregate the statement of comprehensive income into revenue and expense line items, without attempting to reconcile that information to an underwriting margin subtotal. Along the spectrum of the examples included in the paper, this presentation most closely resembles the presentation used by preparers currently and, as such, might be considered more understandable to users and better facilitate their analysis of companies that write insurance contracts. Disadvantages of this presentation as compared to Example 4 include: its portrayal of premium due as a revenue item, that inclusion of the BBA components as they are presented might not be well understood by users as

revenue or expense items; and that this presentation no longer explicitly states the BBA underwriting margin, which some users think useful.

Level of disaggregation in the statement of comprehensive income

Guidance in IFRS

48. According to IAS 1 paragraph 82 the profit or loss section of the statement of comprehensive income include line items that present the following amounts:

   – revenue
   – gains and losses arising from the derecognition of financial assets measured at amortised cost
   – finance costs;
   – if a financial asset is reclassified so that it is measured at fair value, any gain or loss arising from a difference between the previous carrying amount and its fair value at the reclassification date (as defined in IFRS 9);
   – share of the profit or loss of associates and joint ventures accounted for using the equity method;
   – tax expense;
   – a single amount for the total of discontinued operations;

49. Other IFRSs require separate presentation of additional line items.

50. Further general requirements relating to the disaggregation of line items in the statement of comprehensive income results especially from paragraphs 30, 85 and 97 in IAS 1. These requirements are similar to those of US GAAP:

> *If a line item is not individually material, it is aggregated with other items either in those statements or in the notes. An item that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes. (Paragraph 30 of IAS 1)*
>
> *An entity shall present additional line items, headings and subtotals in the statement(s) presenting profit or loss and other comprehensive income, when such presentation is relevant to an understanding of the entity's financial performance. (Paragraph 85 of IAS 1)*

> *When items of income or expense are material, an entity shall disclose their nature and amount separately. (Paragraph 97 of IAS 1)*

51. The separate information required to comply with paragraph 97 of IAS 1 can be presented on the face or disclosed in the notes to the financial statements.

Guidance in US GAAP

52. US GAAP does not contain requirements equivalent to IAS 1 for the presentation of the statement of financial position. Requirements for the line items to be included in the statement of financial position are set out in SEC Regulation S-X *Form and Content of and Requirements for Financial Statements*.

53. SEC Regulation S-X *Form and Content of and Requirements for Financial Statements* delineates the line items which an insurance company is required to present on the face of the statement of comprehensive income. Specifically, §210.7-04 ("Article 7") indicates that premiums; net investment income; benefits, claims, losses, and settlement expenses; and underwriting, acquisition, and insurance expenses should appear on the face of the statement of comprehensive income of an insurance company. However, diversity exists as to whether there is any further disaggregation and how it is presented. For example, some present separately on the income statement line items for short duration and long duration business whereas others provide such detail in the footnotes. Additionally, many companies combine for presentation purposes the claims incurred and the claims related expenses.

54. In addition, conglomerates and other organizations which are not principally insurance companies, may issue insurance contracts. As Article 7 is intended for insurance companies only, these organizations would not likely be subject to those requirements. Some entities that are not primarily insurance entities but have a substantial insurance business include all insurance business in a single "other income" line item, while others separated premiums from other non-insurance revenue amounts, with disclosure of the policy and additional information about insurance activities in the notes to the financial statements.

Staff Recommendations

Disclosure of information in financial statements

55. In the staff's view, insurers should provide separate information about the underwriting margin for contracts accounted for using BBA and those accounted for using PAA. This would be achieved using the presentation model outlined in Example 1 of Appendix A. The staff believes that this approach would:
    - (a) result in faithful representation of the performance of an entity that issues insurance contracts.
    - (b) enhance a user's ability to understand and analyze an entity's performance results.
    - (c) provide volume information in a manner that clearly articulates the relationship between the amounts and the underlying insurance liability.
56. In providing this information, the staff recommend the disaggregation of the components of the underwriting margins as follows:
    - (a) The insurer shall disclose the following components of the BBA underwriting margin:
        - (i) The total difference between actual and expected cash flows, showing separately
            - (1) Actual premiums received
            - (2) (Expected) premiums due
            - (3) Actual benefits paid
            - (4) Expected benefits
            - (5) Actual expenses paid
            - (6) Expected expenses
        - (ii) The change in expected future cash flows
        - (iii) The release of the single margin (for the FASB)
        - (iv) The change in residual margin (for the IASB)

(v) The change in risk adjustment (for the IASB).

(vi) Any losses on initial recognitiofn of an insurance contract showing separately:[6]

(1) Any losses on insurance contracts acquired in a portfolio transfer

(2) Any losses at inception of an insurance contract

(b) The insurer shall disclose the following components of the PAA underwriting margin:

(i) Premiums earned (based on the release of the liability for future coverage grossed up for amortisation of acquisition costs)

(ii) Claims incurred, showing separately:

(1) Costs incurred for new loss occurrences during the period

(2) Difference between actual and expected cash flows

(3) Change in expected future cash flows

(4) Changes in additional liability for onerous contracts

(iii) Claims adjustment expenses incurred, showing separately:

(1) Costs incurred for new loss occurrences during the period

(2) Difference between actual and expected cash flows

(3) Change in expected future cash flows

(4) Changes in additional liability for onerous contracts

(iv) Amortization of acquisition costs

(v) The change in risk adjustment for the liability for incurred claims (for the IASB).

(vi) Any losses on initial recognition of an insurance contract showing separately:

(1) Any losses on insurance contracts acquired in a portfolio transfer

[6] This proposal was carried forward from the ED.

(2) Any losses at inception of an insurance contract

57. The staff recommends that further disaggregation– for example disaggregation by mortality, morbidity etc. – should not be required under the insurance contract standard and that the general guidance on disaggregation and presentation in IFRSs and US GAAP should apply.

Presentation in face of financial statements

58. The staff have differing views regarding the line items that should be required for presentation on the face of the statement of comprehensive income, rather than in the notes to the financial statements. Therefore, the paper includes two recommendations: *Recommendation A* and *Recommendation B.*

Recommendation A:

59. Some staff recommend that:

(a) The insurer should disclose the underwriting margin, either in aggregate for all insurance contracts or separately for contracts measured under the BBA and PAA.

(b) For insurance contracts measured under the building block approach (“BBA contracts”), the insurer should present as a minimum on the face:

(i) Premiums due

(ii) Expected benefits and expenses, either in aggregate or separately

(iii) Any losses at initial recognition

(c) For insurance contracts measured under the premium allocation approach (“PAA contracts”), the insurer should present as a minimum on the face:

(i) Premiums earned (based on the release of the liability for future coverage grossed up for amortisation of acquisition costs)

(ii) Claims and claims adjustment expenses incurred, either in aggregate or separately

(iii) Any losses at initial recognition

Recommendation B:

60. Other staff are concerned that an overly prescriptive presentation model may prevent reporting entities from communicating their performance to users of financial statements in the way that they believe to be most informative. This applies especially to entities that do not operate exclusively in the insurance sector. While the presentation model in Example 1 of Appendix A may be useful on segment level, it may not necessarily be useful on a group level for conglomerates. The staff think entities are, generally, well positioned to determine how the statement of comprehensive income should be organized in order to best highlight and communicate decision useful information and facilitate users understanding of the entities' performance and business model.

61. Therefore, those staff recommend that:

    (a) The insurer shall present the BBA underwriting margin as a separate line item in the statement of comprehensive income because it provides information about a key driver of information for those contracts.

    (b) The insurer shall disclose the components listed in paragraph 56 in the notes to the extent they are not presented on the face of the statement of comprehensive income.

Differences between recommendation A and recommendation B

62. The differences between the two recommendations are:

    (a) Recommendation B requires that the BBA underwriting margin is presented on the face of the statement of comprehensive income, while Recommendation A requires the separate presentation of the combined underwriting margin.

    (b) Recommendation B would allow the presentation of the disaggregated components of the PAA and BBA underwriting margins in the notes of the financial statements, rather than requiring it on the face of the statement of comprehensive income. (We note this means that

Recommendation B would not *require* the presentation of volume information on the face of the statement of comprehensive income.)

63. Nevertheless, Recommendation B would also permit the entity to present all the information provided in Recommendation A on the face in the statement of comprehensive income.

Question 1: disclosure of information in financial statements
Do the boards agree that insurer should disclose: (a) the BBA underwriting margin (b) the components of the BBA underwriting margin listed in paragraph 56(a) (c) the PAA underwriting margin (d) the components of the PAA underwriting margin listed in paragraph 56(b)?

Question 2: Presentation on the face of the financial statements
Do the boards agree with recommendation A in paragraph 59 or recommendation B in paragraph 61? If the boards do not agree with either staff recommendation, which line items should be presented at a minimum on the face of the statement of comprehensive income?

Question 3: Other information
Do the boards agree: (a) to remove the requirement to separately present in the statement of comprehensive income acquisition costs that are not part of the insurance contract liability measurement (b) interest on insurance contract assets' and liabilities' expected net cash flows shall not be included within underwriting margin and shall be included with investment activity.

Appendix A: Illustrative examples

		Appendix A - Example #1		
		Premium Allocation Approach		
		Premiums earned		2,300
①		Claims incurred		(1,422)
①		Expenses incurred		(341)
①	ED*	Total difference between actual and expected cash flows		(21)
①		Change in expected future cash flows		3
①	ED	Changes in additional liability for onerous contracts		-
		Amortization of acquisition costs		(331)
		Change in risk adjustment		-
	ED	**Underwriting margin(premium allocation approach)**		188
		Building Block Approach		
		Premiums received	4,228	
		less premiums due	(4,221)	7
		Actual benefits paid	(2,992)	
②		less benefits expected	2,919	(73)
		Actual expenses paid	(607)	
②		less expenses expected	611	4
	ED*	Total difference between actual and expected cash flows		(62)
		Change in expected future cash flows		(39)
		Release of single margin		252
		Change in residual margin		-
		Change in risk adjustment		-
③	ED	**Underwriting margin(building block approach)**		151
		Other		
	ED	Non-capitalized acquisition costs		(196)
				143
		Investment Income		
	ED	Interest accreted on the expected net cash flows		(1,300)
		Investment income		1,228
				(72)
	Profit before change in discount rate			71
	Change in discount rates			9
	Income before tax			80
	Income tax expense			(11)
	Net Income			69
	ED	**These line items are required on the face of SCI per ED; additionally day 1 losses are req'd**		
	ED*	**These line items are required on the face (per ED), albeit not separated between PAA and BBB**		
	①	**These lines are able to be merged on the SCI, per our proposal**		
	②	**These lines are able to be merged on the SCI, per our proposal**		
	③	**Recommendation B includes the proposal to require presentation of the BBA underwriting margin. Recommendation B would not require separate presentation of volume information.**		
	④	**Recommendation A includes the proposal to permit combined or separate presentation of the BBA and PAA underwriting margins. Recommendation A would require separate presentation of volume information.**		

Example #1 disaggregates the net expected change in the liability for the period by premiums, claims/benefits, and expenses. The staff note that the volume information can be provided parenthetically, in a footnote, or as shown here. The staff note the following changes in nomenclature: Total difference between actual and expected cash flows was formerly referred to as the experience adjustment. Change in expected future cash flows was formerly referred to as the change in assumptions. Premiums received was formerly referred to as premiums due.

Appendix A - Example #2	
Premiums earned	2,300
Premiums due	4,221
Claim and claim adjustment expenses	(1,763)
Policyholder benefits	-3,599
Expected net changes in the liabilities for the period	(1,242)
Total difference between actual and expected cash flows	(83)
Change in expected future cash flows	(36)
Changes in additional liability for onerous contracts	-
Amortization of acquisition costs	(331)
Release of single margin	252
Change in residual margin	-
Change in risk adjustment	-
Underwriting margin	339
Other	
Non-capitalized acquisition costs	(196)
	143
<u>Investment Income</u>	
Interest accreted on the expected net cash flows	(1,300)
Investment income	1,228
	(72)
Profit before change in discount rate	71
Change in discount rates	9
Income before tax	80
Income tax expense	(11)
Net Income	69

Example #2 integrates building block approach contracts with premium allocation approach contracts but separately presents premiums earned under the premium allocation approach and premiums due under the building block approach.

Appendix A - Example #3

Premiums	6,521
Benefits/claims incurred	(5,362)
Expected net changes in the liabilities for the period	(1,242)
Total difference between actual and expected cash flows	(83)
Change in expected future cash flows	(36)
Changes in additional liability for onerous contracts	-
Amortization of acquisition costs	(331)
Release of single margin	252
Change in residual margin	-
Change in risk adjustment	-
Underwriting margin	339
Other	
Non-capitalized acquisition costs	(196)
	143
Interest accreted on the expected net cash flows	(1,300)
Investment income	1,228
	(72)
Profit before change in discount rate	71
Change in discount rates	9
Income before tax	80
Income tax expense	(11)
Net Income	69

Example #3 integrates building block approach contracts with premium allocation approach contracts using an approach similar to Example #2 in this Appendix.

Appendix A - Example #4

Revenues		
Premiums earned under premium allocation approach		2,300
Underwriting margin(building block approach)		151
Consisting of:		
Premiums Received	4,228	
less Premiums Expected	(4,221)	7
Actual Benefits Paid	(2,992)	-
less Benefits Expected	2,919	(73)
Actual Expenses Paid	(607)	-
less Expenses Expected	611	4
Total difference between actual and expected building block approach cash flows		(62)
Change in expected future building block approach cash flows		(39)
Release of building block approach single margin		252
Change in building block approach residual margin		-
Change in building block approach risk adjustment		-
Investment income		1,228
Total Revenues		3,679
Expenses		
Claims and claim adjustment expenses incurred under premium allocation approach		(1,763)
Total difference between actual and expected premium allocation approach cash flows		(21)
Change in expected future premium allocation approach cash flows		3
Change in additional liability for onerous contracts under premium allocation approach		-
Amortization of acquisition costs under premium allocation approach		(331)
Non-capitalized acquisition costs		(196)
Interest accreted on expected cash flows		(1,300)
Total Expenses		(3,608)
Profit before change in discount rate		71
Change in discount rates		9
Income before tax		80
Income tax expense		(11)
Net income		69

Appendix A - Example #5	
Revenues	
Premiums earned under premium allocation approach	2,300
Premiums Received	4,228
Investment income	1,228
Total Revenues	7,756
Expenses	
Claims and claim adjustment expenses incurred under premium allocation approach	(1,763)
Policyholder benefits and expenses paid under building block approach	(3,599)
Expected net changes in the liability for the period	(712)
Change in expected future premium allocation approach cash flows	3
Change in expected future building block approach cash flows	(39)
Change in additional liability for onerous contracts under premium allocation approach	-
Amortization of acquisition costs under premium allocation approach	(331)
Release of building block approach single margin	252
Change in building block approach residual margin	-
Change in building block approach risk adjustment	-
Non-capitalized acquisition costs	(196)
Interest accreted on expected cash flows	(1,300)
Total Expenses	(7,685)
Profit before change in discount rate	71
Change in discount rates	9
Income before tax	80
Income tax expense	(11)
Net income	69

Appendix B – Description of the Intended Use of Line Items Used in Examples and Referenced in the Paper

1. Premiums earned – Premium revenue allocated to the current period as a result of the coverage the entity has provided during the period for contracts under the PAA.

2. Premiums received (less premiums expected) – Gross premium amounts that are received during the current period (less gross premium amounts the entity had previously estimated as due on or before the period-end date) for contracts under the BBA.

3. Claims incurred – Cost of payout for all claims related to insured events that occur during the current period, including claims incurred but not reported, under the PAA.

4. Actual benefits (less benefits expected) – Cost of payout as a result of insured events that occur during the current period (less estimated cost of payout based on previous assumptions about the timing of insured events) under the BBA.

5. Expenses incurred – Cost of servicing claims related to insured events that occur during the current period, including claim adjustment expenses, under the PAA.

6. Actual expenses (less expenses expected) – Cost of providing benefits, including commissions, related to insured events that occur during the current period (less previously estimated cost of providing benefits based on previous assumptions about the timing of insured events) under the BBA.

7. Total difference between actual and expected cash flows – Difference between actual cash flows and previously estimated cash flows for items (1) through (6).

8. Change in expected future cash flows – Difference between revised estimate of present value of future contractual cash flows and previous estimate of present value of future contractual cash flows under the BBA (relating to items (2), (4), (6), and (15)).

9. Changes in additional liability for onerous contracts – Amount of additional liability for onerous contracts that is recognized in the current period, plus the difference between revised estimate and previous estimate of the additional liability for onerous contracts under the PAA.

10. Amortization of acquisition costs – Amount of capitalized acquisition costs that is charged to earnings for the current period under the premium allocation approach.

11. Release of single margin – Amount that corresponds to the reduction in the variability of cash flows under the BBA during the current period and is thus recognized in earnings.

12. Change in residual margin – Difference between revised estimate and previous estimate of profit, plus the amount of profit that is allocated under the BBA to the current period as a result of the coverage provided.

13. Change in risk adjustment – Increase or decrease in the amount that reflects the variability in the cash flows included in the measurement of the insurance contract liability for the current period.

14. Underwriting margin – Amount that reflects the overall performance results of contracts, consisting of items (1) through (13).

15. Non-capitalized acquisition costs – Amount of acquisition costs not included in the measurement of the insurance contract cash flows but charged to earnings for the current period.

16. Interest accreted on the expected cash flows – Amount that represents the unwinding of the discount rate applied to the cash flows for the current period.