

‘Earned premiums’

A volume measure for the statement of comprehensive income

An introduction to Agenda papers 10 and 10A

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Exposure draft proposals

- **Earned premium presentation** for contracts accounted for using premium allocation approach

Statement of comprehensive income (ignoring acquisition costs)	Currency units
Premium revenue	1,200
Claims and expenses incurred	-1,050
Underwriting margin	150
Change in additional liabilities for onerous contracts	-
Interest accreted on liability	-30
Profit or loss on insurance contracts	120

Exposure draft proposals

- **Summarised margin presentation** for contracts accounted for using building block approach

Statement of comprehensive income (ignoring acquisition costs and changes in estimates)	Currency units
Release of risk adjustment	90
Release of residual margin	80
Underwriting margin	170
Experience adjustments – difference between actual cash flows and previous estimates of those cash flows	- 20
Interest accreted on liability	- 30
Profit or loss on insurance contracts	120

Feedback on exposure draft proposals

- Summarised margin presentation gives helpful and valuable information.
- But statement of comprehensive income not comparable with those for:
 - contracts accounted for using premium allocation approach
 - other industries.
- And omits useful volume information about premiums, claims and expenses
 - key information about new business.
- Measuring a ‘revenue’ number might be difficult, but premium information could provide a reasonable proxy.

- Aims to be a similar measure to:
 - ‘revenue’ presented by other industries
 - ‘premium revenue’ presented for contracts accounted for using premium allocation approach
- To achieve that aim it:
 - measures premiums received and receivable for insurance coverage and other services only, ie excludes premiums for investment.
 - allocates premiums to reporting periods in proportion to value of coverage and other service provided each period, as estimated at outset of contract.

Comparing the presentations in statement of comprehensive income

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Summarised margin

Statement of comprehensive income	Currency units
Release of risk adjustment	A
Release of residual margin	B
Underwriting margin	A+B
Cash flow experience adjustments – initial estimates (C) + previous changes in estimates (D) less actual cash flows (E)	C+D-E
Current changes in estimates of cash flows	-F
Interest accreted on liability	-G
Profit or loss on insurance contracts	A+B+C+D-E-F-G

Earned premiums

Statement of comprehensive income	Currency units
Earned premiums	A+B+C
Claims incurred	-E
Changes in estimates of cash flows	-F
Reversals of changes in estimates of cash flows	D
Interest accreted on liability	-G
Profit or loss on insurance contracts	A+B+C+D-E-F-G

Possible method of measuring earned premiums

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Measurement of earned premiums	Currency units
PREMIUMS RECEIVED	1,390
ADJUST FOR PREMIUMS RELATING TO FUTURE COVERAGE	
- increase in liability for remaining coverage	-400
- Excluding: increase in liability caused by changes in estimates and reversals of changes in estimates.	100
- And also excluding: increase in liability caused by reduction in discount rate.	80
	<u>-220</u>
ACCRETION OF INTEREST ON LIABILITY FOR REMAINING COVERAGE	30
EARNED PREMIUMS	<u>1,200</u>

Operational challenges of liability method

1. Need to separate total liability measured using building block approach into two components: liability for remaining coverage and liability for incurred claims.
2. Need to track timing of reversals of changes in estimates.
3. Others?

- **‘written premium’**
 - presents as income the expected present value of all premiums receivable within the boundary of contracts initially recognised in the period.
 - presents as expenses:
 - expected present value of all cash outflows within the boundary of these contracts
 - risk adjustment and residual margin initially recognised as liabilities.
- **‘premiums due’**
 - allocates written premiums according to periods in which the premiums are expected to be receivable
 - expenses (cash flows, risk adjustment and residual margin) allocated on same basis as premiums.
- **summarised margin**
 - as described on slide 3, with disclosure of volume measure(s) in notes to accounts.

Example illustrating alternatives

Expected cash flows and margin release pattern



	Period 1	Period 2	Period 3	Total
Cash inflow pattern	420.0	400.0	380.0	1200.0
Cash outflow pattern	-200.0	-350.0	-500.0	-1050.0
Fulfilment cash flows	220.0	50.0	-120.0	150.0
Change in risk adjustment	32.0	30.0	28.0	90.0
Change in residual margin	23.0	19.0	18.0	60.0
Profit	55.0	49.0	46.0	150.0

	Period 1	Period 2	Period 3	Total
Premiums earned	255.0	399.0	546.0	1200.0
Claims and benefits	-200.0	-350.0	-500.0	-1050.0
Underwriting result	55.0	49.0	46.0	150.0

Reconciliation of underwriting result (disclosures)

	Period 1	Period 2	Period 3	Total
Change in risk adjustment	32.0	30.0	28.0	90.0
Change in residual margin	23.0	19.0	18.0	60.0
	55.0	49.0	46.0	150.0

Earned premium presentation



Example illustrating alternatives (continued)

Written premium presentation



	Recognition	Period 1	Period 2	Period 3	Total
Premiums written	1200.0	0	0.0	0.0	1200.0
Claims and benefits	-1050.0	0	0.0	0.0	-1050.0
Change in risk adjustment	-90.0	32.0	30.0	28.0	0.0
Change in residual margin	-60.0	23.0	19.0	18.0	0.0
Underwriting result	0.0	55.0	49.0	46.0	150.0

	Period 1	Period 2	Period 3	Total
Premiums due	420.0	400.0	380.0	1200.0
Claims and benefits*	-367.5	-350.0	-332.5	-1050.0
Change in risk adjustment				
Increase in risk adjustment*	-31.5	-30.0	-28.5	-90.0
Release of risk adjustment	32.0	30.0	28.0	90.0
Change in residual margin				
Increase in residual margin*	-21.0	-20.0	-19.0	-60.0
Release of residual margin	23.0	19.0	18.0	60.0
Underwriting result	55.0	49.0	46.0	150.0

Premium due presentation



* The three amounts asterisked add up to the same amount as premiums due in each period