

## International Financial Reporting Standards

IASB meeting, 18-22 February 2013  
Agenda paper 2B

# Overview of the Board's proposals

How an entity would report the effects of  
insurance contracts in its financial statements

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- Key features of insurance contracts
- What information the proposed model will communicate
- Impact on the financial statements
- Applications of the model for:
  - short-duration contracts
  - contracts with cash flows contractually linked to underlying items
  - reinsurance assets

# Key features of insurance contracts

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# Key features of insurance contracts (1)

Feature	How addressed
<b>Rights and obligations</b> are typically interdependent	Insurance contract is reported as a <b>bundle</b> of interrelated rights and obligations
Contracts may have <b>renewal options</b> that bind the insurer, but not the policyholder	<b>Measurement includes</b> assessment of likelihood and consequences of renewal when insurer is bound by the contract

# Key features of insurance contracts (2)

Feature	How addressed
<b>Premiums</b> received in advance of providing services (eg coverage)	<b>Revenue</b> reported when services are provided, regardless of when the premiums are received
<b>Premiums</b> received may include deposit-like amounts	<b>Revenue</b> reported excludes deposit-like amounts, ie those amounts that will be returned to the policyholder regardless of whether an insured event occurs

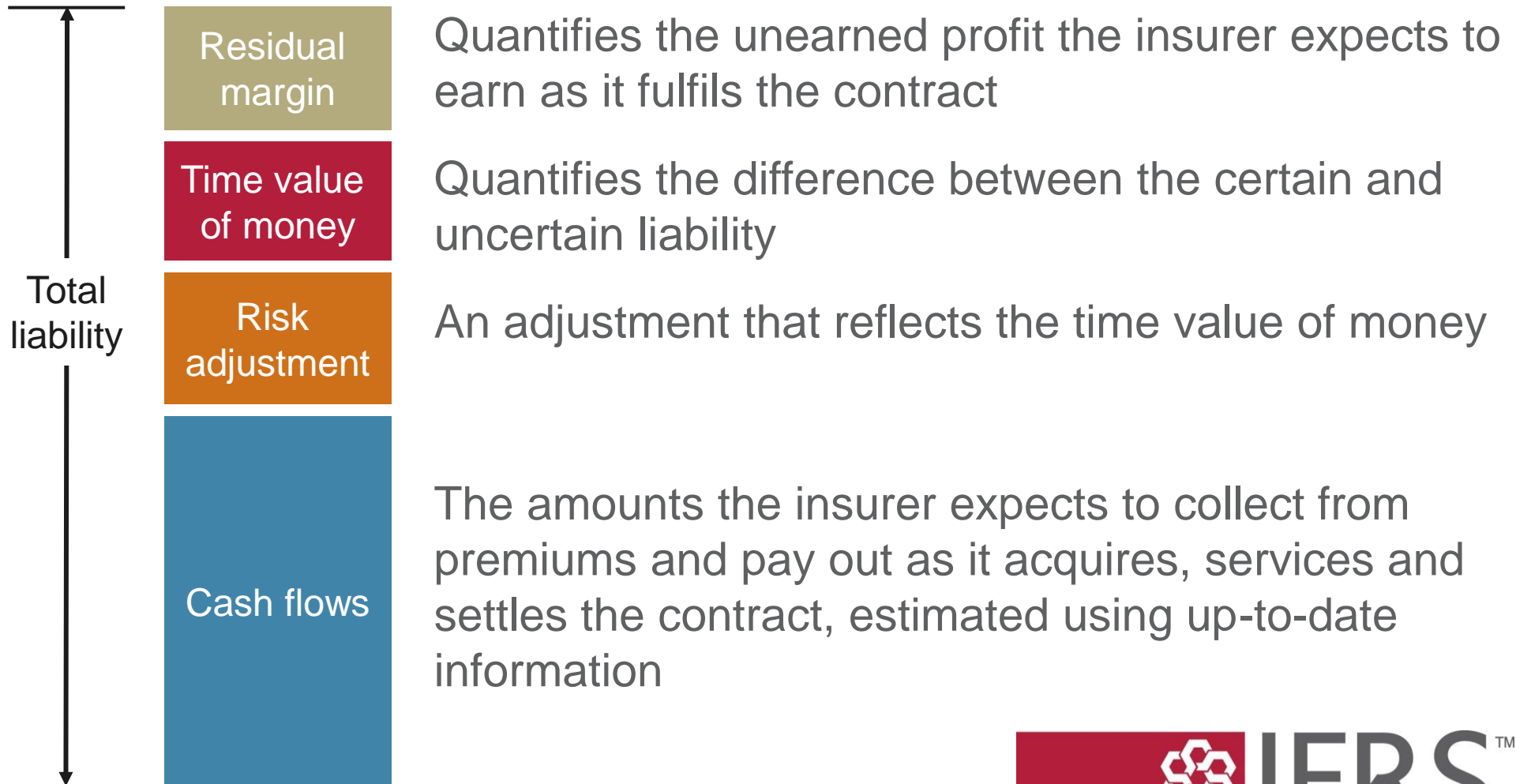
# Key features of insurance contracts (3)

Feature	How addressed
Cash outflows that are <b>uncertain in amount and/or timing</b>	<b>Uncertainty reflected</b> using current and updated: <ul style="list-style-type: none"><li>• Estimates of cash flows</li><li>• Discount rate</li><li>• Risk adjustment</li></ul>
Some contracts also provide <b>investment returns</b> . Those returns may be uncertain in amount and/or timing and may be linked to specified underlying items.	<ul style="list-style-type: none"><li>• Reflect the investment returns passed to the policyholder in the <b>measurement and presentation</b>.</li><li>• Eliminate measurement and presentation mismatches where there is <i>contractual</i> dependence</li></ul>

# What information the proposed model will communicate

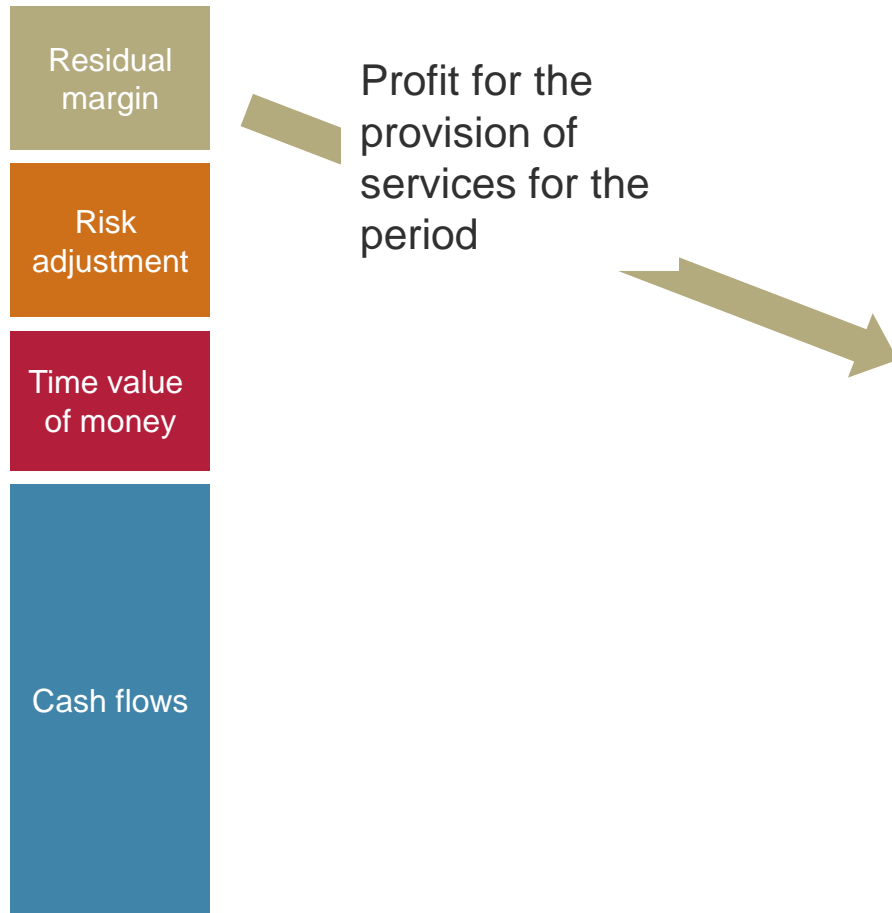
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# Measurement of liability





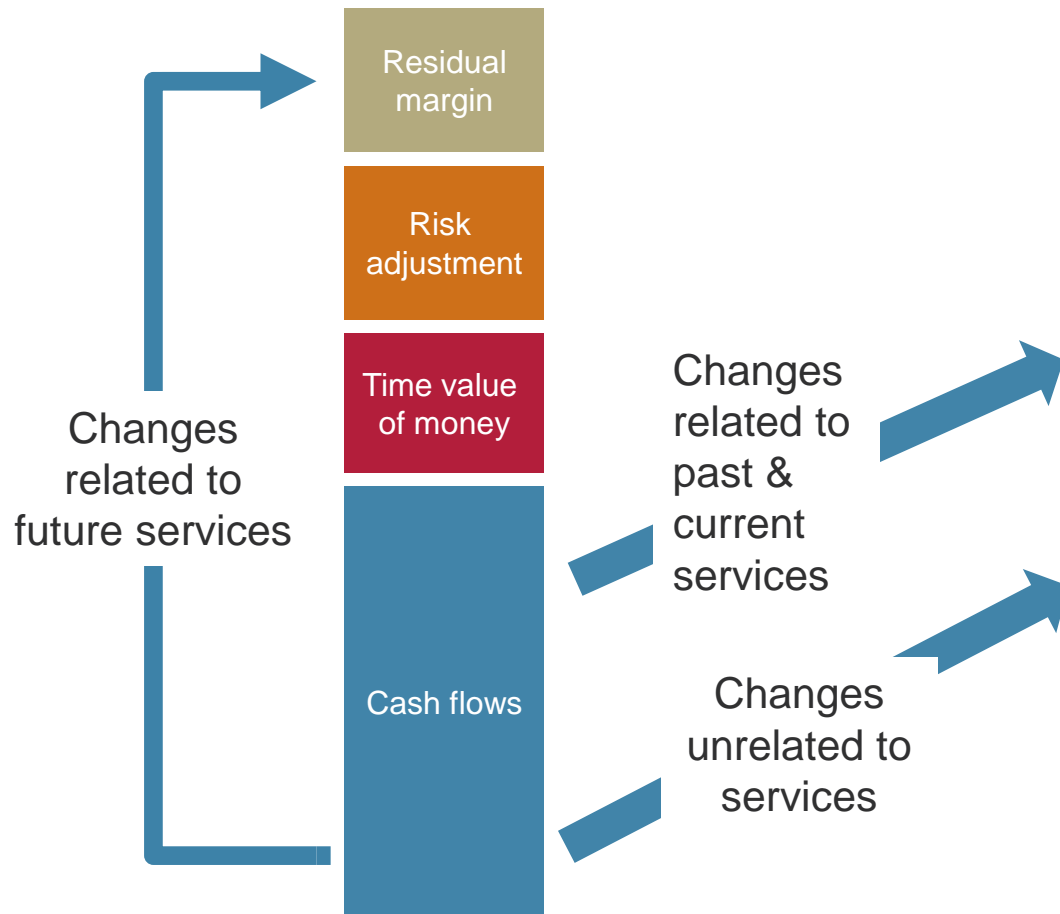
# Reporting underwriting results (1)



## Statement of Comprehensive Income

	20XX
Insurance contracts revenue	X
Incurred claims and expenses	(X)
<b>Underwriting result</b>	<b>X</b>
Investment income	X
Interest on insurance liability	(X)
<b>Net interest and investment</b>	<b>X</b>
<b>Profit or loss</b>	<b>X</b>
Effect of discount rate changes on insurance liability	(X)
<b>Total comprehensive income</b>	<b>XX</b>

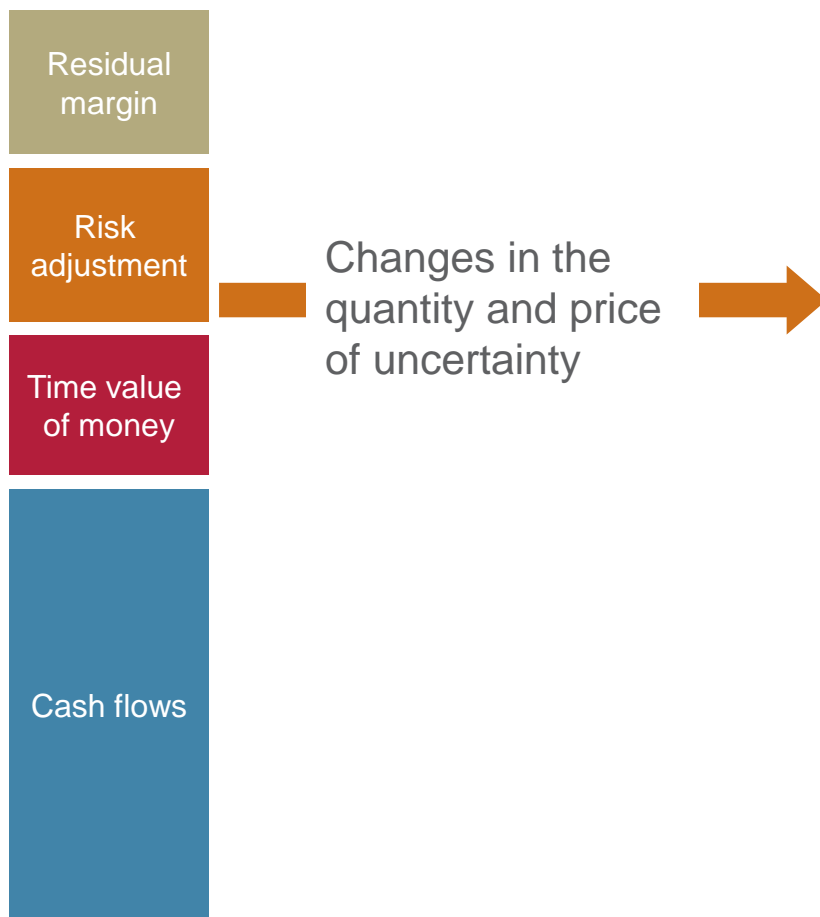
# Reporting underwriting results (2)



## Statement of Comprehensive Income

	20XX
Insurance contracts revenue	X
Incurred claims and expenses	(X)
<b>Underwriting result</b>	<b>X</b>
Investment income	X
Interest on insurance liability	(X)
<b>Net interest and investment</b>	<b>X</b>
<b>Profit or loss</b>	<b>X</b>
Effect of discount rate changes on insurance liability	(X)
<b>Total comprehensive income</b>	<b>XX</b>

# Reporting underwriting results (3)



## Statement of Comprehensive Income

	20XX
Insurance contracts revenue	X
Incurred claims and expenses	(X)
<b>Underwriting result</b>	<b>X</b>
Investment income	X
Interest on insurance liability	(X)
<b>Net interest and investment</b>	<b>X</b>
<b>Profit or loss</b>	<b>X</b>
Effect of discount rate changes on insurance liability	(X)
<b>Total comprehensive income</b>	<b>XX</b>

# Reporting of time value changes

Residual margin

- The cost view of the time value of the money for services provided,
- Reflects the investment returns provided to the policyholder

Time value of money

Risk adjustment

Cash flows

- Reflects the amounts that self reverse
- Allows reconciliation of a cost and current view of time value

## Statement of Comprehensive Income

	20XX
Insurance contracts revenue	X
Incurred claims and expenses	(X)
<b>Underwriting result</b>	<b>X</b>
Investment income	X
Interest on insurance liability	(X)
<b>Net interest and investment</b>	<b>X</b>
<b>Profit or loss</b>	<b>X</b>
Effect of discount rate changes on insurance liability	(X)
<b>Total comprehensive income</b>	<b>XX</b>

# Impact on the financial statements

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# What will the balance sheet show?

## Balance sheet

20XX

### Assets

Reinsurance assets

XX

Other assets

XX

Total assets

XXX

### Liabilities

Insurance contract liabilities

XX

Other liabilities

XX

Total liabilities

XX

Equity

XX

Total equity and liabilities

XXX

- *Reinsurance assets* measured consistently with underlying insurance liabilities
- *Other assets* measured consistently with other IFRS entities

- *Insurance liabilities* measured taking account of amount, timing and uncertainty of all the cash flows generated from the contract's rights and obligations
- Reflects a current, market-consistent (ie 'economic') view

- *Other liabilities* measured consistently with other IFRS entities

# What will revenue and expenses show?

## Statement of Comprehensive Income

	20XX
Insurance contracts revenue	X
Incurred claims and expenses	(X)
<b>Underwriting result</b>	<b>X</b>
Investment income	X
Interest on insurance liability	(X)
<b>Net interest and investment</b>	<b>X</b>
<b>Profit or loss</b>	<b>X</b>
Effect of discount rate changes on insurance liability	(X)
<b>Total comprehensive income</b>	<b>XX</b>

### Revenue

- Consistent with other industries
- Reflects value of service in the current period
- Excludes deposit-like amounts

### Expenses

- Consistent with other industries
- Reflects the costs incurred to provide services in the current period
- Reflects any changes in expectations for past services and when the contract is onerous
- Excludes deposit-like amounts

# What will net profit or loss show?

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## Statement of Comprehensive Income

	20XX
Insurance contracts revenue	X
Incurred claims and expenses	(X)
<b>Underwriting result</b>	<b>X</b>
Investment income	X
Interest on insurance liability	(X)
<b>Net interest and investment</b>	<b>X</b>
<b>Profit or loss</b>	<b>X</b>
Effect of discount rate changes on insurance liability	(X)
<b>Total comprehensive income</b>	<b>XX</b>

### Underwriting result reflects:

- Changes in measurement of uncertainty.
- Profit(loss) for services provided in the period
- Changes in cash flows for past services

### Net spread

- Investment income reported applying other IFRS (not within the scope)
- Expense reflects the investment returns provided to the policyholder
- For services provided, the cost view of the time value of the money

**Underwriting result + Net spread =  
Net profit or loss**



# Two views of performance

## Statement of Comprehensive Income

	20XX
Insurance contracts revenue	X
Incurred claims and expenses	(X)
<b>Underwriting result</b>	<b>X</b>
Investment income	X
Interest on insurance liability	(X)
<b>Net interest and investment</b>	<b>X</b>
<b>Profit or loss</b>	<b>X</b>
Effect of discount rate changes on insurance liability	(X)
<b>Total comprehensive income</b>	<b>XX</b>

### Net profit or loss

reflects the performance of providing services using a cost view of the time value of money (ie reflecting time value at inception)

### OCI

- Reconciles both views of performance
- Reflects the amounts that self reverse

**Total comprehensive income** reflects the performance of providing services using a current view of the time value of money

# What will disclosures show?

## Amounts

Expected present value of future payments and receipts

Changes in the amount of risk during the period

Changes in the amount of the unearned profit during the period

Effects of new contracts written in period (eg premiums)

## Judgements

Processes for estimating inputs and methods used

Effect of changes on methods and inputs used

Explanation of reason for change, identifying type of contracts affected

## Risks

Nature and extent of risks arising from insurance contracts

Extent of mitigation of risks arising from reinsurance and participation features

Quantitative information about exposure to credit, market and liquidity risk

# Applications of the model for:

- short-duration contracts
- contractually linked cash flows
- reinsurance assets

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# Applications for short-duration contracts

Balance sheet	<ul style="list-style-type: none"><li>• Simplifications<ul style="list-style-type: none"><li>• Measurement during the coverage period</li><li>• Discounting expedients</li></ul></li></ul>
Income statement and other comprehensive income	<ul style="list-style-type: none"><li>• Consistent with Revenue Recognition proposals and also with building block approach</li></ul>
Disclosures	<ul style="list-style-type: none"><li>• Relief from some disclosures</li></ul>

# Applications for contracts with cash flows contractually linked to underlying items

Balance sheet	<ul style="list-style-type: none"><li>• Net insurance contract position for affected cash flows determined on same measurement basis as the specified underlying items</li></ul>
Income statement and other comprehensive income	<ul style="list-style-type: none"><li>• Amounts in profit and loss and other comprehensive income reported consistently with gains and losses on specified underlying assets</li></ul>
Disclosures	<ul style="list-style-type: none"><li>• Highlighting that the mirroring approach is being used</li></ul>

# Balance sheet: contractually linked to underlying items

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## Balance sheet

20XX

### Assets

Financial assets

XX

Cash

XX

Total assets

XXX

### Liabilities

Insurance contract liabilities

XX

Other liabilities

XX

Total liabilities

XX

Equity

XX

Total equity and liabilities

XXX

- Reported consistently with all other IFRS entities
- Not within scope of project

#### **Insurance liability reflects both the:**

- *policyholder's share of the contractually linked items as reflected on the balance sheet and*
- *the current value of embedded options and guarantees*

- *Equity is the remainder after the liabilities are settled with the assets*
- **Reflects the entity's share in the contractually linked underlying items**

# What will net profit or loss show?

## Contractually linked to underlying items

### Statement of Comprehensive Income

	20XX
Insurance contracts revenue	X
Incurred claims and expenses	(X)
<b>Underwriting result</b>	<b>X</b>
Investment income	X
Interest on insurance liability	(X)
Changes in the value of O&Gs	± (X)
<b>Net interest and investment</b>	<b>X</b>
<b>Profit or loss</b>	<b>X</b>
Effect of discount rate changes on insurance liability	(X)
<b>Total comprehensive income</b>	<b>XX</b>

- Interest expense reflects the investment returns provided to the policyholder
- The cost view of the time value of the money (ie at inception) for services provided

- Changes in the current value of the options and guarantees ('O&Gs')
- Reflects economic mismatches between the liability and linked items

- Reflects the policyholder's share of the gains or losses on linked items presented in OCI
- Reflects the changes in discount rate that self reverse for services provided

# Applications for reinsurance contracts the entity (cedant) holds

Balance sheet	<ul style="list-style-type: none"><li>• Net reinsurance contract position represents the right to future receipts under the contract, net of the future cost of obtaining reinsurance services</li></ul>
Income statement and other comprehensive income	<ul style="list-style-type: none"><li>• Changes in expectation of credit losses of the reinsurer recognised in profit and loss</li><li>• Amounts received treated as other income (not revenue)</li><li>• Amounts paid treated as other expenses</li></ul>
Disclosures	<ul style="list-style-type: none"><li>• Credit risk information</li><li>• Extent of mitigation of risks arising from reinsurance</li></ul>



# What is reported in the balance sheet for reinsurance assets?

## Balance sheet

20XX

### Assets

Reinsurance assets

XX

Other assets

XX

Total assets

XXX

### Liabilities

Insurance contract liabilities

XX

Other liabilities

XX

Total liabilities

XX

Equity

XX

Total equity and liabilities

XXX

- **Reinsurance assets measured consistently with underlying insurance liabilities**
- Measured taking account of amount, timing and uncertainty of all the cash flows generated from the contract's rights and obligations
- Reflects a current, market-consistent (ie 'economic') view

# Reinsurance assets: What will comprehensive income show?

## Statement of Comprehensive Income

	20XX
Insurance contracts revenue	X
Other Income: - Resinsurance (recoveries)	X
Incurred claims and expenses	(X)
Other expense: - Reinsurance (premiums paid)	(X)
<b>Underwriting result</b>	<b>X</b>
Investment income	X
Interest on insurance liability	(X)
<b>Net interest and investment</b>	<b>X</b>
<b>Profit or loss</b>	<b>X</b>
Effect of discount rate changes on insurance liability	(X)
<b>Total comprehensive income</b>	<b>XX</b>

- Reflects the income from the reinsurance service
- Reported consistently with income from other sources

- Reflects the cost of the reinsurance service in the period
- Consistent with other expenses
- Changes in credit risk of the reinsurer

- Effects of changes in discount rate presented in the same way as direct contracts

# Reinsurance assets: How is the time value of money reflected?

## Statement of Comprehensive Income

	20XX
Insurance contracts revenue	X
Other Income:	
- Resinsurance (recoveries)	X
Incurred claims and expenses	(X)
Other expense:	
- Reinsurance (premiums paid)	(X)
<b>Underwriting result</b>	<b>X</b>
Investment income	X
Interest on insurance liability	(X)
<b>Net interest and investment</b>	<b>X</b>
<b>Profit or loss</b>	<b>X</b>
Effect of discount rate changes on insurance liability	(X)
<b>Total comprehensive income</b>	<b>XX</b>

Interest income reflects the reinsurers share in the direct insurer's:

- obligation to provide amounts dependent on investment returns
- cost of the time value of money for services provided

OCI

- Reconciles both views of performance
- Reflects the amounts that self reverse