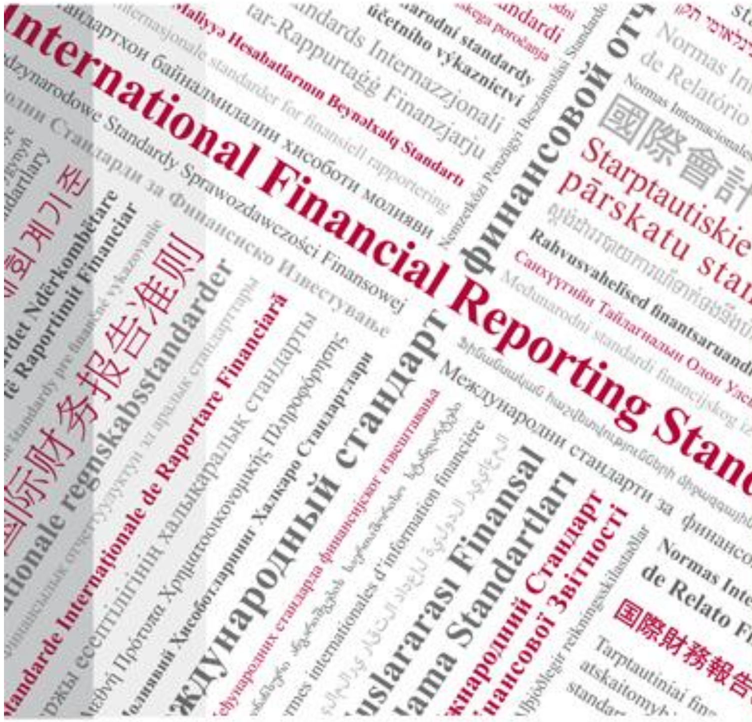
International Financial Reporting Standards



Insurance contracts

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Insurance Contracts Project

Current accounting issues		Objective: increase relevance, transparency and comparability
Variety of accounting treatments depending on the type of contracts and *entities* that issue the contracts	→	All insurance contracts measured and presented the same way regardless of entity issuing the contract
Estimates for long contracts not updated through the life of the contract	→	Accounting model reflects current market-based information
Discount rate based on estimates of investment returns not reflecting economic risks included in the insurance liability	→	Measurement that provides information about risk and uncertainty of insurance obligation
Lack of discounting for simpler contracts	→	Contracts should reflect discounting where significant
Little information about economic value of embedded options and guarantees	→	Measurement reflect value of embedded options and guarantees

Insurance Contracts Project continued

- Currently IFRS 4 *Insurance Contracts* is an interim standard:
  - Permits wide variety of accounting models (grandfathered)
  - Enhanced disclosures for insurance contracts to enhance comparability and understanding of reported amounts before the final standard would be issued
- IASB is trying to address comparability and transparency issues by proposing a single comprehensive model for all insurance contracts (see details in the Appendix*).

* Although the appendix will not be discussed in the meeting, it contains information about the accounting model for insurance contracts that may be helpful in understanding the context of the questions being asked of you at this meeting.

Insurance Contracts Project continued

The outcome of this project is also relevant for non-insurers

- Insurance is provided not only by insurance companies but also by:
  - Non-insurance financial entities (% of insurance liabilities and related in the total liabilities)
    - ING Group – at 31.12.11 equals **23%**
    - Lloyds Banking Group – at 31.12.11 equals **14%**
  - Non-financial entities (% of insurance liabilities and related in the total liabilities)
    - Sony - at 31.12.2012 equals **47%**
    - Berkshire Hathaway Inc. - at 31.03.2012 equals **37%**
- The information that is provided currently for insurance business is not comparable:
  - Between the same contracts reported in different jurisdictions; and
  - Between similar contract (or activities) within the same entity.
- The information provided currently for insurance contracts is not easily understandable.
  - That results in higher cost of capital for insurance companies.

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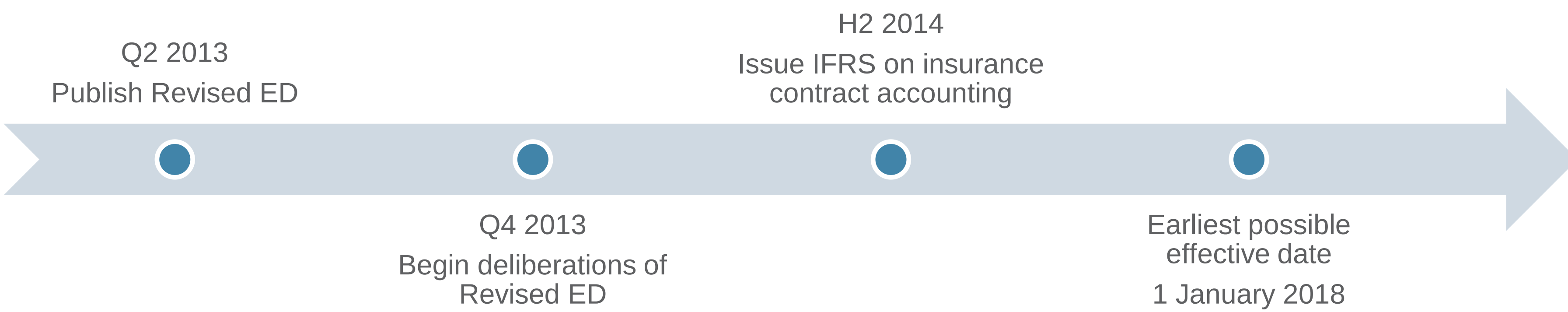
Revised exposure draft

- Revised Exposure Draft (ED) builds on the 2007 Discussion Paper and 2010 Exposure Draft
  - Reflects comments received on those initial proposals
- The IASB is seeking feedback on limited range of issues such as:
  - Significant changes from proposals in the 2010 ED (see next slide)
  - Benefits of information provided versus costs of obtaining it



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Revised exposure draft continued

Main changes from 2010 ED on which IASB is seeking feedback:

- Presentation
  - Operating profit presented in a traditional way (consistent with other industries) as a difference between premiums and expenses. **This is the subject of this meeting.**
  - Effect of changes in the insurance liability because of changes in the discount rates presented in other comprehensive income (OCI)
- Measurement
  - Adjusting the unearned profit to reflect changes in cash flows for future coverage
  - To the extent that insurance contracts are contractually linked to performance of pool of assets, the measurement and presentation of insurance liability should reflect that link
- Transition
  - When entity first applies the proposed insurance contracts standard, it should apply the requirements of the proposed standard as if it had been always effective (with some simplifications).

Issue for discussion at CMAC meeting

- One of the objectives of the project is to improve comparability across industries. One way to meet that objective is to ensure that revenue for insurers is comparable to revenue for other industries.
- The staff would like your input on:
  - what pattern of revenue is most appropriate for insurance contracts?
  - what total amount would be reported as revenue?

Should revenue be reported for insurance contracts? If so, how?

- There are different types of insurance contracts
  - Simple (and mainly short) insurance contracts (for example: car insurance, travel insurance) that are very similar to contracts that provide service (for example maintenance services).
  - More sophisticated (usually long term) contracts that combines service and investment characteristics. For example a contract that promises to pay claims on death or investment paid on maturity (such as life insurance).
- There are different views on what information should be presented in profit or loss

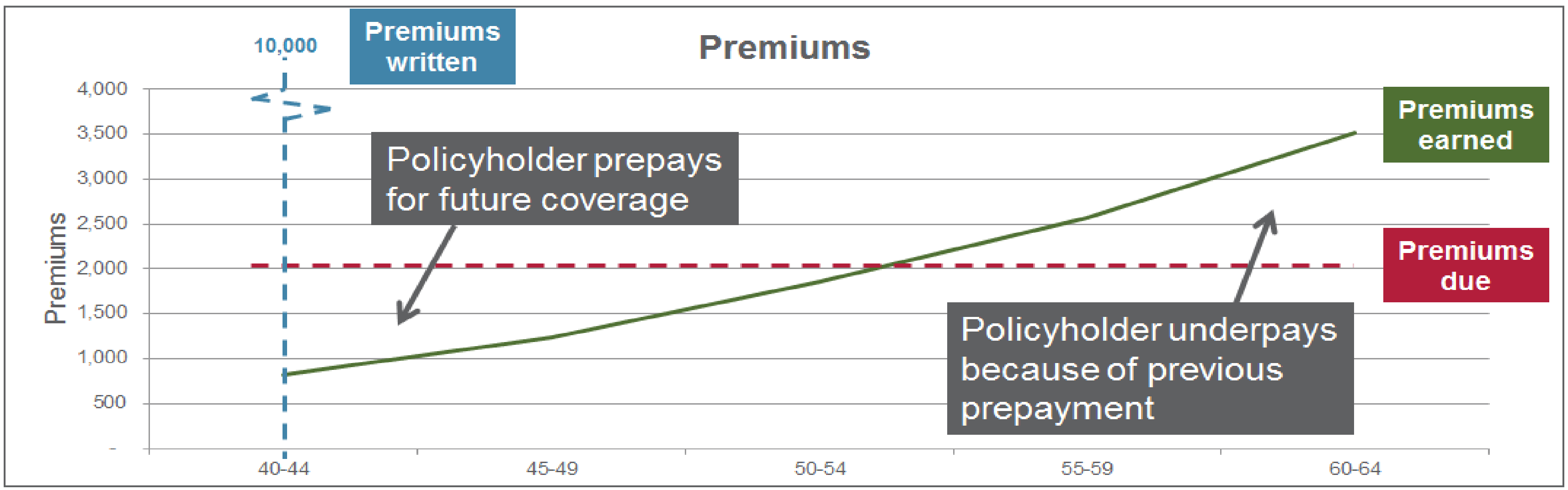
  View 1: the entity should report revenue for all insurance contracts:
  - Insurance is providing service and therefore revenue should be reported for all contracts. This would ensure consistent presentation for all insurance contracts.
  - Currently revenue reported for long contracts is not reported consistently with revenue recognition requirements which could bring misleading information.

  View 2: for long-term contracts the entity should present only sources of earnings*
  - The long-term contracts usually include mostly an investment component that would be difficult to separate.
  - Applying revenue principles to allocation of revenue to reporting periods could result in divergence in practice.

*Sources of earnings include the following: changes in insurance risk, profit from services provided in the period, changes in cash flows related to past services. More information included in the Appendix.

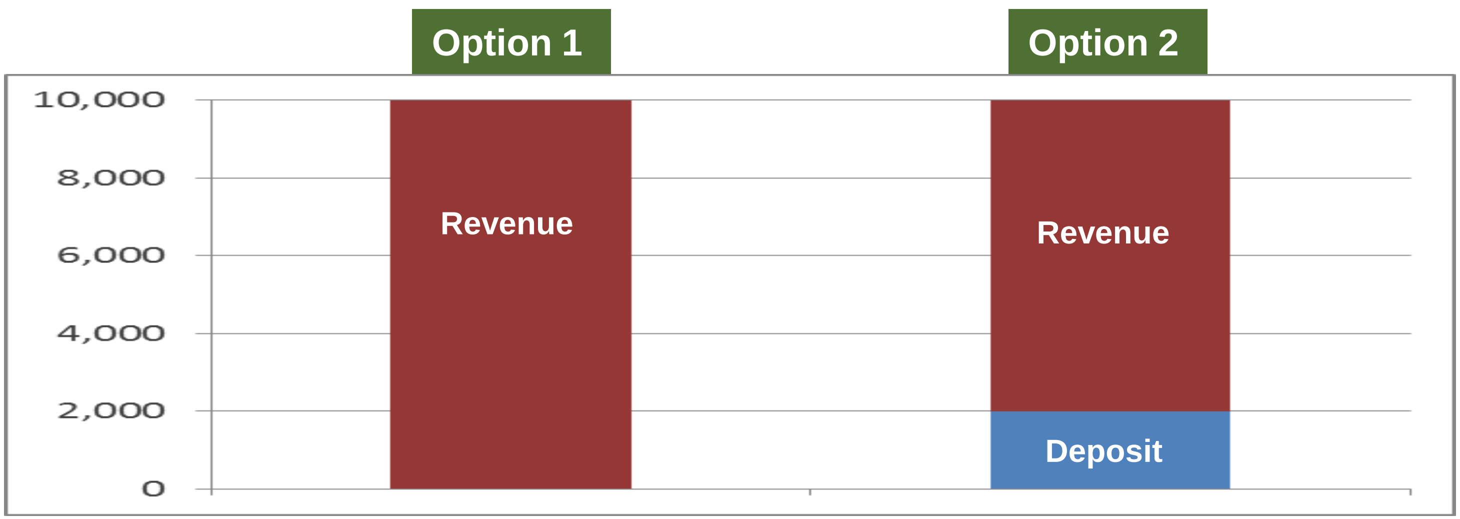
Question 1: pattern of revenue

- Assumptions in the example:
  - Premium of CU2,000 is invoiced and paid each period (total = 10,000)
  - Entity will pay CU10,000 upon death of policyholder
  - Time value of money is assumed to be immaterial
- What pattern of revenue should be reported for those contracts?
  - Premiums written: all expected premiums to be received over the contract life are reported at initial recognition
  - Premiums due: premiums are reported when billed (irrespective when service is provided). This is consistent with current presentation for most long-term contracts.
  - Premiums earned: premiums are reported as the coverage is provided (irrespective of when they are received). IASB proposed this approach because it's most consistent with other industries.



Question 2: amount of total revenue

- Assumptions in the example:
  - The same as in previous slide.
  - Additionally, the entity promises to repay the total amount of CU2,000 to policyholder during the contract period (deposit). This payment is not dependent on insured event.
- How much total revenue should be recognised?
  - Option 1: Total revenue should equal total consideration received CU10,000. This is current practice for most of the insurance contracts.
  - Option 2: Total revenue should equal total consideration received CU10,000 minus repayments not dependent on insurance event (deposit) CU2,000. IASB proposed this approach because deposit are not presented as revenue by other industries for example banks.



Appendix

More detailed information on insurance contracts and the IASB project

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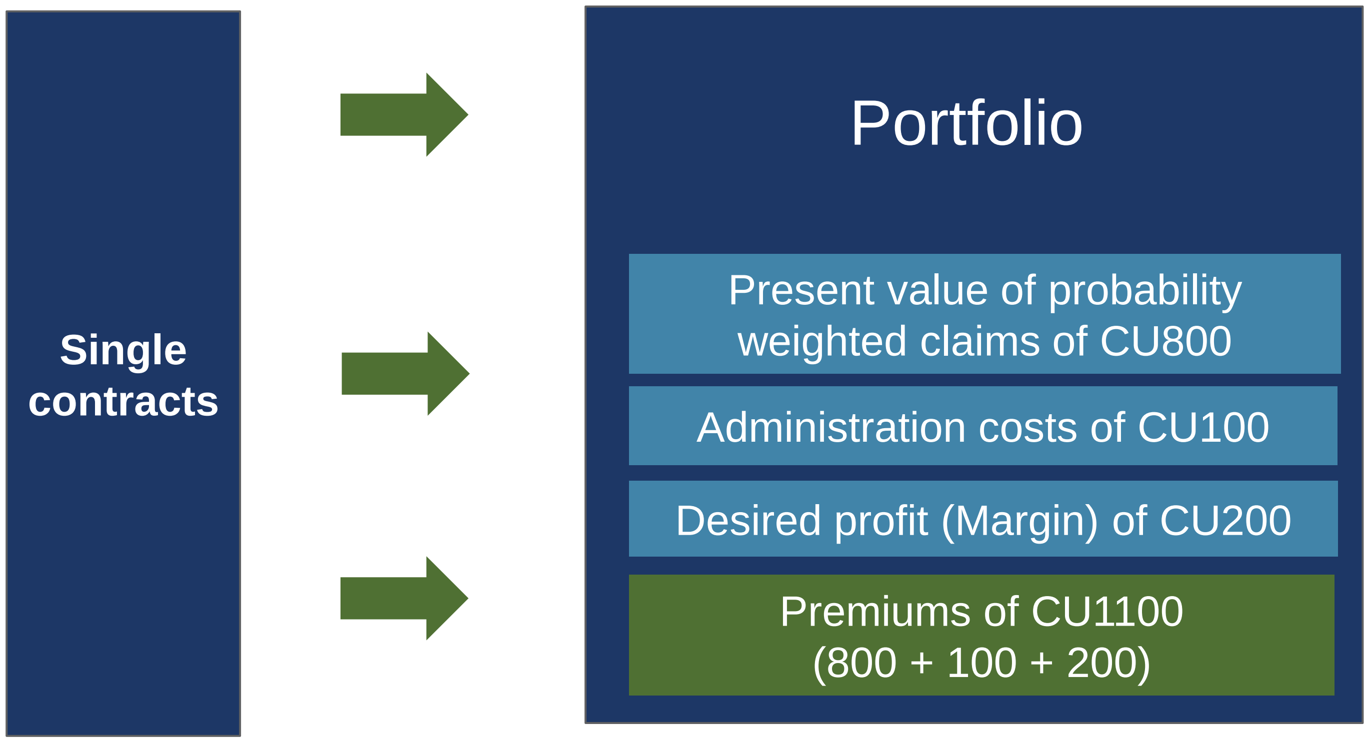
How is insurance contract priced?

- Insurance contracts are managed at an aggregate level (portfolio)
  - to establish objective measure (based on statistics) of expected claims and other expenses
  - as a bundle of rights and interrelated obligations (ie both inflows and outflows)



Proposed measurement reflects the economic of insurance contract

- Financial statement would present the interrelated bundle of rights and obligations arising from the insurance contracts
- At each reporting period reflect:
  - an updated estimate of the expected future profit arising from the insurance contracts
  - an updated estimate of the expected *present value* of *cash flows* (both inflows and outflows) the entity expects will arise as it fulfils the contract, *adjusted for the risk and uncertainty* of cash flows

Presentation in the statement of financial position

Statement of financial position	
	20XX
Assets	
Financial 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

Assets / other liabilities

- measured using other IFRS
- not within the scope of the project

Insurance contract liabilities (rarely a net asset) reflect :

- current information about amount, timing and uncertainty of all expected cash flows related to fulfilling the insurance contract
- expected profit to be earned

Sources of profit from insurance contract

- Insurance contracts bundles different activities:
  - Insurance protection – the entity promise to compensate the policyholder if/when insured event happens (involves insurance risk)
  - Investment activity – the entity will repay some amount of money with investment return (involves financial risk)
  - Other non-insurance services – the entity is providing service as other non-financial entity
- Different activities causes variety of sources of earnings:
  - Changes in insurance risk and profit or loss on changes in cash flows related to past services
  - Investment gains or losses
  - Profit from from providing services in the period
- It is important to maintain comparability of results reported between other industries with similar earnings

ED proposal for presenting sources of earnings in SCI

Statement of Comprehensive Income (SCI)

	20XX
Insurance contracts revenue	X
Incurred claims and expenses	(X)
Operating result	X
Investment income	X
Interest on insurance liability	(X)
Investment result	X
Profit or loss	X
Effect of discount rate changes on insurance liability	(X)
Total comprehensive income	XX

Operating result

- The profit or loss on insurance activity and other services provided
- Consistent with other industries

Investment result

- The profit or loss on investment activity reflect cost view of performance for eligible assets and insurance liabilities

OCI

- Reconciles cost (presented in investment result) with current view of performance
- Reflects the amounts that self reverse

Alternative view for presenting sources of earnings in SCI

Statement of Comprehensive Income (SCI)

	20XX
Release of profit	X
Change in risk	X/(X)
Changes in cash flow assumptions	X/(X)
Operating result	**X**
Investment income	X
Interest on insurance liability	(X)
Investment result	**X**
Profit or loss	**X**
Effect of discount rate changes on insurance liability	(X)
Total comprehensive income	**XX**

Operating result

- Present gains or losses by sources of earnings as follows:
  - changes in insurance risk,
  - profit from services provided in the period,
  - changes in cash flows related to past services
- Reflect directly changes in insurance liability

Investment result and OCI

- Presented the same way as in the ED proposal included in previous slide

Additional explanations in the notes

Amounts

- Disaggregate balances into expected cash flows, risk and unearned profit
- Explain changes in cash flows and risk in the period
- Explain changes in unearned profit in the period
- Present effects of new contracts signed in period

Judgements

- Explain processes for estimating inputs and methods used
- Explain effect of changes on methods and inputs used

Risks

- Explain nature and extent of risks
- Explain extent of mitigation of risks
- Provides information about exposure to risks

Thank you

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