

# Presentation of Performance Statement

## *Technical position of the HUB Group on Insurance Contracts*

The following technical position on “Presentation” reflects a proposal by the HUB global insurance group. This technical paper is being provided to members and staff of the IASB and FASB to assist them in understanding the proposal.

This paper supplements information found in the HUB Group’s Insurance Industry Proposal Discussion Paper dated 22 March 2011 and related supporting papers. Specifically, elements of HUB technical position – paper 3, “Application of the business model to insurance contracts” (Paper 3) and HUB technical position – paper 4, “Use of OCI” (Paper 4), are incorporated in this paper.

As with all our documents, comments from the public are welcome.

### **I. Objective**

The objective of this paper is to describe an approach to the presentation of insurance contracts in the income statement and the statement of other comprehensive income in accordance with IAS 1 and IFRS 8. In fact, we believe that the insurance industry should not be treated differently from any other industry with respect to the definition and presentation of profit and loss (level playing field). In particular, IFRS 4 Phase II should not contain any prescriptive guidance on line items and formats for an income statement of an insurance entity but, instead, should be principle-based. The insurance business fundamentally involves the collection of premiums and the payment of claims and associated expenses. It also involves the collection of fees attendant to certain types of life business, such as unit-linked business. Insurers manage cash flows following one of two basic approaches: 1. Integrated Insurance Business Model (“II-BM”), and 2. Continuous Risk Re-underwriting Business Model (“CRR-BM”). These approaches are detailed in Paper 3. The presentation of performance information should be consistent with the insurer’s business model. For certain insurance contracts, the cash flow components- premiums, claims/benefits, and expenses, are essential to understanding the business. Other contracts may place greater importance on the report of margins or fees. To fully understand the different business segments a company might operate, IFRS 8 requires a reporting entity to present a measure of profit or loss for each reportable segment that is regularly reviewed by the chief operating decision maker. Also, in accordance with IFRS 8.28 a company has to provide a reconciliation of the total of the reportable segments revenue to the company’s revenue.

### **II. Introduction**

The IASB Exposure Draft *Insurance Contracts* proposed two presentation approaches for the income statement, one for the Modified Approach - where premiums, claims/benefits and expenses are included, and the summarized margin presentation approach when applying the building blocks model. The insurance business fundamentally involves the collection of premiums and the payment of claims and associated expenses. While we agree that the presentation should flow from the measurement of insurance contracts, we believe that the cash flow components, premiums, claims/benefits, and expenses, are essential to understanding the nature of insurance. However, many insurance companies typically offer different products and operate in several lines of business, such as property-

casualty, life, health, unit-linked insurance or asset management. How revenue information is conveyed to users of the financial statement will depend upon the complexity of the reporting entity and the way the business is managed, both reflective of segment reporting in accordance with IFRS 8.

Based on our review of the responses to Question 13a of the ED, a large part of those answering the question challenged the summarized margin approach for insurance contracts measured under the building blocks model. The predominant objection was the loss of “volume” information within the financial statements for these contracts.

The HUB technical position – Paper 3 notes that the conceptual framework for financial reporting emphasizes the importance that the measurement and presentation of insurance contracts should be consistent with the insurer’s business model so that useful information is provided to existing and potential investors. The II-BM approach (used primarily, but not exclusively, by life insurers) focuses on all cash flows of the business, including investment income on financial assets and the anticipated amount and timing of benefit payments. As highlighted in Paper 3, the II-BM is typical for insurers that issue long-duration insurance contracts in which the insurer accumulates over the life of the contracts significant asset portfolios used to meet the payment obligations on underlying portfolios of insurance contracts.

The CRR-BM focuses on underwriting income (loss) with the components thereof consisting of premiums received from policyholders, claims and related claims expenses, and other expenses incurred. The CRR-BM is consistent with how most property-casualty insurers throughout the world underwrite, manage, and evaluate the performance of most short-duration property-casualty insurance contracts, for which success is heavily dependent on analysis of underwriting results.

The HUB technical position – Paper 4 described an approach “that will enable insurers to report the current value of insurance liabilities in the statement of financial position while at the same time excluding artificial volatility from profit or loss (P&L). If temporary unrealized gains and losses resulting from changes in the discount rate are excluded from P&L, the result is a better reflection of the release from risks undertaken and thus would be a measure that properly reflects the performance of entities” that issue insurance contracts. In particular, this paper recommended that the IASB should introduce other comprehensive income (OCI) for the market/fulfillment value movements of assets and liabilities, to ensure a P&L that is free of such volatility.

To prescribe a certain presentation style, modified approach for short duration contracts and summarized margin or expanded margin for the building blocks approach, would be inconsistent with a management approach in accordance with IFRS 8. It would also put the insurance industry at a competitive disadvantage as compared to other industries that could present only the minimum information in profit or loss in accordance with IAS 1.82. For example, companies may employ the summarized margin approach with disclosures of volume information, whereas, other companies may want to disaggregate all information within the statement of income. In all situations, management’s objective is to provide information in a way that facilitates analysts’ understanding of the reporting entity’s business.

### III. Proposal

The accounting guidance for the presentation of profit and loss in IFRS 4 should be principle-based and not prescriptive. Presentation should reflect the way the business is managed. Dependent on the complexity of the reporting entity, information within the group financial statements may need to be aggregated. Reconciliation of the components of the income statement along with the segment information provided in accordance with the principles of IFRS 8 will help statement users understand the insurance entity’s performance in the different business segments it operates. The level of disaggregation and the subtotals presented on the face of the income

statement (and in the segment report) should be based on a management approach in accordance with the business model. Ultimately, management must identify the material drivers to earnings that reflect the nature of its business. Where it is not practicable to present information in sufficient detail in the statement of income and the statement of comprehensive income, detailed information should be presented in the notes to achieve the reporting objective.

The following **guiding principles** for the presentation of performance for insurance contracts are proposed:

- ❖ A presentation model for profit and loss of all insurance contracts should be based on the minimum format required in IAS 1.82 and be reconcilable with the segment information required by IFRS 8, which is based on a management approach and reflecting an entity's different businesses
- ❖ Written premiums should be defined in IFRS 4 as revenue for contracts measured under the building blocks approach and earned premiums should be defined as revenue for contracts measured under the modified approach.
- ❖ Written premium should be defined as the contractually determined amount charged by the reporting entity to the policyholder for the effective period of the contract based on the expectation of risk, policy benefits, and expenses associated with the coverage provided by the terms of the insurance contract.
- ❖ For the building blocks approach information on the release of margins, experience adjustments, changes in estimates and unwinding of interest should be presented either within the segment report or as supplementary disclosure in the notes.
- ❖ Underwriting results should be separately presented from investment income
- ❖ Unrealized changes in the market value of assets and changes in the current fulfillment value of insurance liabilities due to changes in interest rates should be presented in OCI (Other Comprehensive Income)
- ❖ Disclosures should supplement and complement the information presented in the income statement and the segment report so that sufficient information is provided to users to understand the nature of the business

## IV. Appendix

The following represent just two of the many possible presentation examples and are based on the guiding principles articulated herein. They reflect two possible presentations by an insurance enterprise who is applying our interpretation of ED IFRS 4 for the measurement of insurance contracts and the provisions of IAS 1 for the presentation of net income and comprehensive income.

The numbers on the left of each of the rows in the examples are for reference purposes and can be used to direct the reader to the appropriate line. The column labeled “ED / DP Reference” contains the paragraph number of the IASB Exposure Draft or the FASB Discussion Paper, which currently calls for the presentation. Example 1 purposefully does not include any dollar amounts so that the focus can be just on the financial statement presentation. Other than the subtotal and total rows, cells which would have a balance are highlighted in green.

Important note: we provide the ED / DP references to demonstrate that the IAS 1 presentation is in the spirit of the measurement rules and intended presentation as currently outlined in ED IFRS 4.72-78, however, consistent with the proposals in this paper, we recommend removing the prescriptive presentation rules from IFRS 4. Only those provisions which are required for an insurer to meet the minimum requirements of IAS 1 would be included in IFRS 4. For example, IFRS 4 would need a definition of revenue (see IAS 1.82(a)) and may also need provisions which reflect the unique character of the insurance business, such as presentation of unit-linked business (see IAS 1.29, 1.32 regarding aggregation and offsetting).

### **Example 1**

Example 1 is a proposed presentation format for a Statement of Net Income and a Statement of Comprehensive Income for an enterprise that issues insurance contracts. This example is not intended to be an exact template to be followed, but rather represents one possible presentation format. The level of aggregation / disaggregation presented, the grouping of rows and the related subtotal labeling is in accordance with the minimum requirements of IAS 1, and reflects the discretion of management and consistency with the entity’s business model.

A discussion of this example presentation is as follows (also see “Important note” above regarding the references to the ED / DP):

Rows 1 – 13 These rows include the items required to be presented for certain short-duration contracts as per paragraph 75 of the IASB ED, as well as the items to be presented as per paragraph 72(a), 72(b) and 72(d). The cash flow items for long-duration contracts that are required to be disclosed in the reconciliation of contract balances as per paragraph 87 are presented on the same rows as those use to present the similar short-duration contract items. Row 6 presents the “Other changes in insurance liabilities”. This row is necessary to report the unwinding of the estimated cash flow items contained in the liability measurement. This row can be thought of in the same way as the “Other changes in insurance liability” row included in the Financial Accounting Standards Board (FASB) Discussion Paper (DP) *Preliminary Views on Insurance Contracts*, paragraph 126 *Alternative 2: Written Premium Presentation Approach* example. Example 2 in the Appendix provides details on how the amount to be included on this row would be presented.

Rows 16 – 18 Investment contract expense assessments and fees, net investment income and interest credited is presented on rows 18 through 20 with a subtotal for net investment contract results.

Rows 20 – 21 These rows present the income from unit-linked assets and the expense from unit-linked liabilities. We believe the presentation guidance in Paragraph 78 should be retained in IFRS 4, yet redrafted consistent with FASB guidance as codified from Statement of Position 03-1, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts*, as follows:

Unit-linked assets should be reported in the insurance enterprise's financial statements as a summary total, with an equivalent summary total reported for related liabilities. The related investment performance (including interest, dividends, realized gains and losses, and changes in unrealized gains and losses) and the corresponding amounts credited to the contract holder should be offset within the same statement of operations line item netting to zero.

Row 24 – 26 Presents the investment income from dividend, interest income and realized gains/losses from sales or financial assets measured at fair value through profit and loss.

Row 40 – 41 Presents the change in insurance liabilities due to changes in discount rates and the unrealized changes in fair value of financial assets separately from net income in the statement of OCI.

### Example 1

ED / DP Reference	Statement of Net Income		
Row #			
1	ED 75(a)i, 87(c)	Insurance premium (written/earned)	\$ -
2	ED 75(a)ii, 87(d)i	Claims and benefits incurred	-
3	ED 75(a)iii, 87(d)ii	Expenses incurred on insurance contracts	-
5	ED 75(a)iv	Amortization of incremental acquisition costs	-
6	DP 126	Other changes in insurance liabilities	-
7	ED 72(a)	Release of margins	-
8	ED 72(b)	Net gains and losses at initial recognition	-
9	ED 72(d)	Experience adjustments and changes in estimates:	
10	ED 72(d)(i)	Difference between actual and expected cash flows	-
11	ED 72(d)(ii)	Change in estimates of cash flows	-
12	ED 75(b)	Change in additional liabilities for onerous short-duration contracts	-
13	ED 72(e)	Interest on insurance contract liabilities	-
<b>14</b>		<b>Net insurance income</b>	<b>-</b>
15			
16	ED 8	Investment contract expense assessments and fees	-
17	ED 8(a)	Interest credited on investment contracts	-
<b>18</b>		<b>Net investment contract income</b>	<b>-</b>
19			
20	ED 78(b)	Investment income attributable to unit-linked policyholders	-
21	ED 78(a)	Expense from unit-linked liabilities	-
<b>22</b>		<b>Net unit-linked contract income</b>	<b>-</b>
23			
24		Dividends	-
25		Interest	-
26		Realized gain (loss)	-
<b>27</b>		<b>Net investment income (expense)</b>	<b>-</b>
28			
29		Other income	-
30	ED 72(c)	Other expenses (including non-incremental acquisition costs)	-
<b>31</b>		<b>Net other income (expense)</b>	<b>-</b>
<b>32</b>		<b>Income (loss) from continuing operations before taxes</b>	<b>-</b>
33		Income tax expense (benefit)	-
<b>34</b>		<b>Net Income (Loss) from Continuing Operations</b>	<b>-</b>
35		Income (loss) from discontinued operations, net of income tax expense (benefit)	-
<b>36</b>		<b>Net Income (Loss)</b>	<b>\$ -</b>

ED / DP Reference	Statement of Comprehensive Income		
<b>37</b>		<b>Net Income (Loss)</b>	<b>\$ -</b>
38			
<b>39</b>		<b>Other Comprehensive Income</b>	
40		Unrealised Change in Fair Value of Assets	-
41	ED 72(d)(ii)	Change in insurance liabilities due to changes in discount rates	-
<b>42</b>		<b>Net Other Comprehensive Income</b>	<b>-</b>
43			
<b>44</b>		<b>Total Comprehensive Income</b>	<b>\$ -</b>

## **Example 2**

Example 2 uses a 10 year term policy to illustrate how the amounts presented on the row labeled “Other changes in insurance liabilities” would be calculated.

The presentation example starts with a baseline scenario using the 10 year term contract contained in the ACLI October 26, 2010 letter to the Boards on explicit margins. The following example presents a Statement of Net Income, a Statement of Comprehensive Income and a Reconciliation schedule for 6 years.

The elements of the contract are:

### **10 year Term insurance contract**

At inception:

PV of future benefits	\$1,384.3
PV of expenses (acquisition & maintenance)	1,026.3
PV of gross premiums	2,484.3
Margins	73.7

### **Years 1 and 2**

For years one and two, actual results equal expected. Therefore, no changes have been made to any assumptions

### **Year 3**

In the third year, there were no changes in assumptions for the insurance contracts, i.e., actual equals expected. Interest rate change was introduced at the end of year 3. The investment portfolio earned rate continues to be 6%, interest rates decline resulting in a fair value rate of 5.5%. A corresponding reduction to 4% was applied to the insurance contract assets/liabilities.

### **Year 4**

In the fourth year, there were no changes in assumptions for the insurance contracts, i.e., actual equals expected. Interest rate change was introduced at the end of year 4. The investment portfolio earned rate continues to be 6%, but interest rates rose resulting in a fair value rate of 6.25%. A corresponding change to 4.6% was applied to the insurance contract assets/liabilities.

### **Year 5**

In the fifth year, changes in assumptions were introduced reflecting an increase in mortality by 10% and changes to the expected lapse rates. Example 2C from the ACLI October 26, 2010 letter serves as the basis for the year 5 changes. Interest rate change was introduced at the end of year 5 returning to the original rates of 6% for investment portfolio and 4.5% was applied to the insurance contract assets/liabilities.

### **Year 6**

In the sixth year, changes in assumptions were introduced reflecting a return to the original projection in mortality and improvement to the expected lapse rates. Interest rate change was introduced at the end of year 6 resulting in a fair value rate of 5.8%.

## Example 2

		<u>Statement of Net Income</u>					
(Dr) Cr		<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	<u>Year 6</u>
Row	#						
1	Premiums	415.0	377.5	343.2	315.5	289.9	246.0
2	Benefits	(96.0)	(122.2)	(138.9)	(153.3)	(185.7)	(170.8)
3	Expenses	(773.3)	(46.2)	(42.0)	(38.6)	(35.5)	(30.1)
4	Change in insurance obligations	454.2	(209.1)	(162.3)	(123.7)	(85.7)	(28.1)
5	Insurance experience adjustments:						
6	Difference in expected and actual cash flows	-	-	-	-	16.9	(17.1)
7	Change due to changes in assumptions	-	-	-	-	(109.1)	94.2
8	Release of margins	7.9	7.8	7.5	7.3	7.5	7.1
9	Net investment income	4.3	30.2	35.6	39.2	40.9	42.6
10	Interest on insurance contract liabilities	<u>19.4</u>	<u>9.7</u>	<u>2.1</u>	<u>(4.0)</u>	<u>(8.7)</u>	<u>(16.2)</u>
11	Pre-tax Net Income (Loss)	31.6	47.8	45.2	42.4	(69.3)	127.7
12	Federal Income Taxes	<u>(11.0)</u>	<u>(16.7)</u>	<u>(15.8)</u>	<u>(14.8)</u>	<u>24.3</u>	<u>(44.7)</u>
13	<b>Net Income (Loss)</b>	<u><u>20.5</u></u>	<u><u>31.0</u></u>	<u><u>29.4</u></u>	<u><u>27.6</u></u>	<u><u>(45.1)</u></u>	<u><u>83.0</u></u>

		<u>Statement of Comprehensive Income</u>					
(Dr) Cr		<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	<u>Year 6</u>
14							
15	<b>Net Income (Loss)</b>	<u><u>20.5</u></u>	<u><u>31.0</u></u>	<u><u>29.4</u></u>	<u><u>27.6</u></u>	<u><u>(45.1)</u></u>	<u><u>83.0</u></u>
16							
17	<b>Other Comprehensive Income</b>						
18	Change in Fair Value of Assets	-	-	10.7	(15.9)	5.2	3.4
19	Insurance experience adj. - change in disc rate	<u>-</u>	<u>-</u>	<u>(7.4)</u>	<u>8.8</u>	<u>(1.4)</u>	<u>-</u>
20	<b>Net Other Comprehensive Income</b>	<u>-</u>	<u>-</u>	<u>3.3</u>	<u>(7.1)</u>	<u>3.8</u>	<u>3.4</u>
21							
22	<b>Total Comprehensive Income</b>	<u><u>20.5</u></u>	<u><u>31.0</u></u>	<u><u>32.7</u></u>	<u><u>20.5</u></u>	<u><u>(41.3)</u></u>	<u><u>86.4</u></u>

10 Year term contract – Reconciliation between years

Row #	Dr (Cr)	Premiums	Benefits	Expenses	Margins	Net Insurance Asset/ (Liability)	Change In Liability to P/L	Change In Liability to OCI
<b>23</b>	<b>Year 1:</b>							
<b>24</b>	<b>Beginning of period</b>	-	-	-	-	-		
25	New business	2,484.3	(1,384.3)	(1,026.3)	(73.7)	(0.0)		
26	Interest on insurance contract liabilities	93.1	(62.3)	(11.4)		19.4		
27	Amount released into P&L							
28	Expected cash flows	(415.0)	96.0	773.3		454.3	(454.3)	
29	Difference between expected and actual	-	-	-		-		
30	Actual cash flows	(415.0)	96.0	773.3		454.3		
31								
32	Release of margin				7.9	7.9		
33	Change due to change in assumptions	-	-	-		-		
34	Change due to change in discount rates	-	-	-	-	-		-
<b>35</b>	<b>End of period</b>	<b>2,162.4</b>	<b>1,350.6</b>	<b>(264.4)</b>	<b>(65.8)</b>	<b>481.6</b>		
<b>37</b>	<b>Year 2:</b>							
<b>38</b>	<b>Beginning of period</b>	2,162.4	(1,350.6)	(264.4)	(65.8)	481.6		
39	New business	-	-	-	-	-		
40	Interest on insurance contract liabilities	80.3	(60.8)	(9.8)		9.7		
41	Amount released into P&L							
42	Expected cash flows	(377.5)	122.2	46.2		(209.1)	209.1	
43	Difference between expected and actual	-	-	-		-		
44	Actual cash flows	(377.5)	122.2	46.2		(209.1)		
45								
46	Release of margin				7.8	7.8		
47	Change due to change in assumptions	-	-	-	-	-		
48	Change due to change in discount rates	-	-	-	-	-		-
<b>49</b>	<b>End of period</b>	<b>1,865.3</b>	<b>(1,289.1)</b>	<b>(228.0)</b>	<b>(58.0)</b>	<b>290.1</b>		
<b>51</b>	<b>Year 3:</b>							
<b>52</b>	<b>Beginning of period</b>	1,865.3	(1,289.1)	(228.0)	(58.0)	290.1		
53	New business	-	-	-	-	-		
54	Interest on insurance contract liabilities	68.5	(58.0)	(8.4)		2.1		
55	Amount released into P&L							
56	Expected cash flows	(343.2)	138.9	42.0		(162.3)	162.3	
57	Difference between expected and actual	-	-	-		-		
58	Actual cash flows	(343.2)	138.9	42.0		(162.3)		
59								
60	Release of margin				7.5	7.5		
61	Change due to change in assumptions	-	-	-	-	-		
62	Change due to change in discount rates	19.7	(24.7)	(2.4)	-	(7.4)		7.4
<b>63</b>	<b>End of period</b>	<b>1,610.2</b>	<b>(1,232.8)</b>	<b>(196.9)</b>	<b>(50.5)</b>	<b>130.0</b>		

10 Year term contract – Reconciliation between years

Row #	Dr (Cr)	Premiums	Benefits	Expenses	Margins	Net Insurance Asset/ (Liability)	Change In Liability to P/L	Change In Liability to OCI
<b>64</b>	<b>Year 4:</b>							
<b>65</b>	<b>Beginning of period</b>	1,610.2	(1,232.8)	(196.9)	(50.5)	130.0		
66	New business	-	-	-	-	-		
67	Interest on insurance contract liabilities	57.4	(54.4)	(7.0)		(4.0)		
68	Amount released into P&L							
69	Expected cash flows	(315.5)	153.3	38.6		(123.6)	123.6	
70	Difference between expected and actual	-	-	-		-		
71	Actual cash flows	(315.5)	153.3	38.6		(123.6)		
72								
73	Release of margin				7.3	7.3		
74	Change due to change in assumptions	-	-	-		-		
75	Change due to change in discount rates	(22.5)	28.5	2.7	-	8.7		(8.7)
<b>76</b>	<b>End of period</b>	<b>1,329.6</b>	<b>(1,105.4)</b>	<b>(162.6)</b>	<b>(43.2)</b>	<b>18.4</b>		
<b>78</b>	<b>Year 5:</b>							
<b>79</b>	<b>Beginning of period</b>	1,329.6	(1,105.4)	(162.6)	(43.2)	18.4		
80	New business	-	-	-	-	-		
81	Interest on insurance contract liabilities	46.9	(49.9)	(5.7)		(8.7)		
82	Amount released into P&L							
83	Expected cash flows	(289.9)	168.8	35.5		(85.7)	85.7	
84	Difference between expected and actual	-	16.9	-		16.9		
85	Actual cash flows	(289.9)	185.7	35.5		(68.8)		
86								
87	Release of margin				7.5	7.5		
88	Change due to change in assumptions	(67.1)	(50.2)	8.2		(109.1)		
89	Change due to change in discount rates	2.8	(3.9)	(0.3)	-	(1.4)		1.4
<b>90</b>	<b>End of period</b>	<b>1,022.3</b>	<b>(1,023.7)</b>	<b>(125.0)</b>	<b>(35.7)</b>	<b>(162.1)</b>		
<b>92</b>	<b>Year 6:</b>							
<b>93</b>	<b>Beginning of period</b>	1,022.3	(1,023.7)	(125.0)	(35.7)	(162.1)		
94	New business	-	-	-	-	-		
95	Interest on insurance contract liabilities	34.0	(46.1)	(4.2)		(16.2)		
96	Amount released into P&L							
97	Expected cash flows	(246.0)	187.8	30.1		(28.1)	28.1	
98	Difference between expected and actual	-	(17.1)	-		(17.1)		
99	Actual cash flows	(246.0)	170.8	30.1		(45.2)		
100								
101	Release of margin				7.1	7.1		
102	Change due to change in assumptions	21.8	75.0	(2.7)		94.2		
103	Change due to change in discount rates	-	-	-	-	-		-
<b>104</b>	<b>End of period</b>	<b>832.1</b>	<b>(824.0)</b>	<b>(101.8)</b>	<b>(28.6)</b>	<b>(122.3)</b>		

