Meeting documentation

World Standard-setters Meeting

Smaller group discussions: Insurance contracts

Tuesday 24 September 2013
The Grange City Hotel (London)
World Standard-setters Meeting
Monday 23 and Tuesday 24 September 2013
The Grange City Hotel (London)

smaller group discussion
Insurance contracts

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IASB

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International Financial Reporting Standards

Accounting proposals for insurance contracts

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Agenda

• Background information
• Numerical example illustrating the outcome of proposed model
• Appendix: additional information for the numerical example

No comprehensive IFRS today

IFRS 4 Insurance Contracts is an interim Standard

We have listened and responded to your concerns

Revised Exposure Draft (ED) next step toward final Standard

We propose current, market-consistent measurement of insurance contracts

Measurement of insurance contract has two components:

Contractual service margin represents expected contract profit

Fulfilment cash flows represent a current, updated estimate of amounts the company expects to collect from premiums and pay out for claims, benefits and expenses, adjusted for risk and time value of money

We propose up-to-date information about performance

Net contract asset or liability

Statement of Comprehensive Income

<table>
<thead>
<tr>
<th>20XX</th>
<th>Insurance contracts revenue</th>
<th>(X)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Interest on insurance liability</td>
<td>(X)</td>
</tr>
<tr>
<td></td>
<td>Total comprehensive income</td>
<td>XX</td>
</tr>
</tbody>
</table>

We propose disclosure that explain ...

Amounts

Expected present value of future payments & receipts

Judgements

Processes for estimating inputs and methods used

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
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We seek feedback on targeted aspects

**Measurement proposals**
- Changes in estimates relating to expected contract profit
- Providing coverage over remaining period
- Measurement and presentation exception when no economic mismatch is possible

**Presentation proposals**
- Align to presentation of revenue required for other types of contracts with customers
- Interest expense is amortised cost-based in profit or loss, current value-based on balance sheet

**Approach to transition**
- Apply Standard retrospectively if practicable, or with specified simplifications if not practicable

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**Fact pattern – initial assumptions**

**Operating activity:**
- Portfolio of life contracts covered for 25 years with annual premium
- Insurer pays benefit on death and accumulated guaranteed investment upon lapse or at maturity of the contract
- Contracts priced to be profitable

**Investment activity:**
- Net cash inflows each year are invested in bonds with duration matched with expected net cash outflows (for expected cash flows see graph)
- Current and expected market interest rate (flat yield curve) equals 6%
- Interest rate for the liability is assumed to be 0.5 p.p. lower (no credit risk)

<table>
<thead>
<tr>
<th>Year</th>
<th>Expected inflows</th>
<th>Time value of money</th>
<th>Total present value of expected inflows</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>82,663</td>
<td>35,375</td>
<td>47,288</td>
</tr>
</tbody>
</table>

- We offset benefits and obligation + expected profit, therefore at inception it equals zero.

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**Fact pattern – changes**

**Operating activity:**
- In year 13 - lower claims for the year than expected or consequently entity revises expectations about future – less claims before year 25 but more payments on maturity – in total higher expected pay-outs (NPV of 2,285)

**Investment activity:**
- The fact pattern - throughout the life of the contract marked interest rate lower than expected (changes as presented below)

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**Information in the balance sheet – enough assets to cover obligation?**

<table>
<thead>
<tr>
<th>Year</th>
<th>Expected benefits</th>
<th>Expected obligations and expected profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>62,663</td>
<td>47,288</td>
</tr>
</tbody>
</table>

- The expected assets are expected to be not enough to cover liabilities
- Change in gap follows changes in interest rate
- Final gap: $(10,080)
Information in the statement of comprehensive income – sources of profit

- Asset management services increase with assets
- Less claims for period than expected
- More future cash outflows decrease margins recognized in future

Expected loss on investment because interest rate lower than expected

Interest rate change effect of change in expected cash outflows

Operating result represented by volume information (comparability with others)

- Revised claims
- Revenue recognized as service provided
- Service mortality relates to occurrence of claims in revenue follows claims
- Operating result as the difference between revenue and expense

- Amount of claims increases because of increase in mortality
- Price per claim decreases because of prepaid deposit included

Operating result represented by margins (available in the notes)

- Increase in future cash outflows decreases profits going forward
- Operating result as sum of margins
- Asset management services increase with assets
- Relief from risk follows the pattern of claims

- Claims lower than expected for the period
- Relief from risk related to decrease in claims

Investment result – cost and current value information available

- Expected gains on investment activity
- Expected loss on investment according to amortized cost
- Loss increase with increase in obligation

- Change in expected gain or loss because of interest rate change
- Expected loss reclassified to p&l
- Interest rate change effect of change in expected cash outflows

Investment result reported in other comprehensive income (OCI)

- Decrease of interest rates – expected losses in OCI
- Increase of interest rates and losses of expected losses to p&l

- Increase in expected cash flows increase expected losses

Key takeaways: information provided by our proposals

- Information about economic effects on obligations
- Information about management assumptions
- Information about drivers of profits
- Transparent financial statements
Information in statement of comprehensive income (SCI)

<table>
<thead>
<tr>
<th>Statement of Comprehensive Income</th>
<th>13</th>
<th>12</th>
<th>See also slide</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating result</td>
<td>667</td>
<td>285</td>
<td>9</td>
</tr>
<tr>
<td>Net investment result</td>
<td>(833)</td>
<td>(335)</td>
<td>10</td>
</tr>
<tr>
<td>Profit or loss</td>
<td>64</td>
<td>(254)</td>
<td></td>
</tr>
<tr>
<td>Other comprehensive income (OCI)</td>
<td>(1,533)</td>
<td>395</td>
<td></td>
</tr>
<tr>
<td>Total comprehensive income</td>
<td>(1,474)</td>
<td>140</td>
<td></td>
</tr>
</tbody>
</table>

OCIL effects outside of the year (current item) not included in p&l as it reflects changes in expected losses:
- year 13: net of loss in OCI
- year 13: mainly effect of interest rate change of assumptions changes.

- Profit on operating activity for profit or operation:
  - year 13: additional gain on claim lower than expected for a year
  - year 13: expected cash outflows decrease from expected interest rate change in OCI

- Revenue:
  - 2013: no deposit in revenue
  - 2012: lower cost per claim because more pre-funded deposits in the deposit

- Incurred claims and other expenses:
  - 2013: no expected losses on insurance activity – negative change in expected cash inflows decrease expected future pro

- Revenue:
  - 2013: no deposit in revenue
  - 2012: lower cost per claim because more pre-funded deposits in the deposit

Information in the balance sheet

<table>
<thead>
<tr>
<th>Balance sheet</th>
<th>13</th>
<th>12</th>
<th>change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial assets</td>
<td>36,838</td>
<td>34,709</td>
<td>1,900</td>
</tr>
<tr>
<td>Total assets</td>
<td>36,838</td>
<td>34,709</td>
<td>1,900</td>
</tr>
<tr>
<td>Insurance contract liabilities</td>
<td>50,817</td>
<td>47,443</td>
<td>3,374</td>
</tr>
<tr>
<td>Equity</td>
<td>(14,208)</td>
<td>(12,734)</td>
<td>1,474</td>
</tr>
<tr>
<td>Total equity and liabilities</td>
<td>36,620</td>
<td>34,709</td>
<td>1,900</td>
</tr>
</tbody>
</table>

Assets are expected to be net enough to fund obligations due to lower than expected interest rate changes.

Operating result represented by volume information

<table>
<thead>
<tr>
<th>Operating result</th>
<th>13</th>
<th>12</th>
<th>change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>2,035</td>
<td>2,025</td>
<td>10</td>
</tr>
<tr>
<td>Incurred claims and other expenses</td>
<td>(1,428)</td>
<td>(1,740)</td>
<td>312</td>
</tr>
</tbody>
</table>
| Less claims because:
  - 1: mortality lower than expected, service margin/cash flows
  - 2: lower cost per claim because more pre-funded deposits in the deposit

- Revenue recognized when service provided
- Expenses incurred
- No deposit in revenue and claims

Disclosure*: Reconciliation of asset and liabilities balance for the period

<table>
<thead>
<tr>
<th>Insurance contract liabilities</th>
<th>Financial assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening balance</td>
<td>47,433</td>
</tr>
<tr>
<td>Net changes recognised in SCI</td>
<td>1,821</td>
</tr>
<tr>
<td>Operating result*</td>
<td>(967)</td>
</tr>
<tr>
<td>Investment result in p&amp;l</td>
<td>1,420</td>
</tr>
<tr>
<td>Expected future losses</td>
<td>(667)</td>
</tr>
<tr>
<td>Less claims because:</td>
<td>(1,068)</td>
</tr>
<tr>
<td>1: mortality lower than</td>
<td>(1,068)</td>
</tr>
<tr>
<td>2: lower cost per claim because</td>
<td>(1,068)</td>
</tr>
<tr>
<td>Other comprehensive income</td>
<td>(1,068)</td>
</tr>
<tr>
<td>Cash flows</td>
<td>(1,068)</td>
</tr>
<tr>
<td>Net cash inflows / purchase of assets</td>
<td>1,533</td>
</tr>
<tr>
<td>Closing balance</td>
<td>50,817</td>
</tr>
</tbody>
</table>

Disclosure not required in this form but all information is required.

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## Disclosure: Reconciliation of insurance balance to margin information

<table>
<thead>
<tr>
<th>Insurance contract liability</th>
<th>Present value of cash flows</th>
<th>Risk adjustment</th>
<th>Contractual service margin</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Opening balance (year 12)</strong></td>
<td>47,443</td>
<td>43,853</td>
<td>559</td>
</tr>
<tr>
<td>Net changes recognised in SCI</td>
<td>1,821</td>
<td>2,286</td>
<td>(179)</td>
</tr>
<tr>
<td>Change in risk/service margin</td>
<td>(361)</td>
<td>-</td>
<td>(151)</td>
</tr>
<tr>
<td>Operating result</td>
<td>(300)</td>
<td>(76)</td>
<td>-</td>
</tr>
<tr>
<td>Interest expense recognised in OCI</td>
<td>1,420</td>
<td>1,241</td>
<td>19</td>
</tr>
<tr>
<td>Discount rate (and other) changes recognised in OCI</td>
<td>1,058</td>
<td>1,115</td>
<td>(47)</td>
</tr>
<tr>
<td><strong>Cash flows</strong></td>
<td>1,553</td>
<td>1,553</td>
<td>-</td>
</tr>
<tr>
<td>Cash inflows</td>
<td>3,248</td>
<td>3,248</td>
<td>-</td>
</tr>
<tr>
<td>Cash outflows</td>
<td>(1,695)</td>
<td>(1,695)</td>
<td>-</td>
</tr>
<tr>
<td><strong>Closing balance (year 13)</strong></td>
<td>50,817</td>
<td>47,691</td>
<td>380</td>
</tr>
</tbody>
</table>

* Available for long-term business where simplified model not used.
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NOTES