Tuesday 24 September 2013
The Grange City Hotel (London)

Meeting documentation

World Standard-setters Meeting

Smaller group discussions: Insurance contracts

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Monday 23 and Tuesday 24 September 2013
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smaller group discussion
Insurance contracts

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International Financial Reporting Standards

Accounting proposals for insurance contracts

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

IFRS

Agenda

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

IFRS

No comprehensive IFRS today

IFRS 4 *Insurance Contracts* is an interim Standard
- Permits continuation of a wide variety of accounting models
- Requires disclosures to enhance comparability and to understand reported amounts
- Does not facilitate transparency

We have listened and responded to your concerns
- Improves representation of some aspects
- Introduces practical accommodations to conceptual approaches
- Provides additional clarification and guidance

Revised Exposure Draft (ED) next step toward final Standard
- Builds on previous consultations
- Seeks feedback on changes to previous proposals
- Focuses on operational and reporting complexity of revised proposals

IFRS

We propose current, market-consistent measurement of insurance contracts

Measurement of insurance contract has two components:

Net contract asset or liability*

Contractual service margin:
Expected contract profit

Fulfilment cash flows

Future cash flows: Expected cash flows from premiums and claims and benefits

Risk adjustment: An assessment of the uncertainty about the amount of future cash flows

Discounting: An adjustment that converts future cash flows into current amounts

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

* Depending on the timing of payments relative to coverage provided

IFRS

We propose up-to-date information about performance

Net contract asset or liability

Contractual service margin
(Expected contract profit)

Fulfilment cash flows

Future cash flows: Expected cash flows from premiums and claims and benefits

Risk adjustment: An assessment of the uncertainty about the amount of future cash flows

Discounting: An adjustment that converts future cash flows into current amounts

Statement of Comprehensive Income

	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

1. Changes in estimates relating to future services
2. All other expected cash flow changes
3. Based on a cost view
4. Based on a current view

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We propose disclosure that explain …

Amounts
- Expected present value of future payments & receipts
- Changes in risk during the period
- Changes in expected contract profit
- Effects of new contracts written in the period

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

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We seek feedback on targeted aspects

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Measurement proposals
- Changes in estimates relating to expected contract profit for providing coverage recognised 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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Illustrative example

What information you will see?

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Fact pattern – initial assumptions

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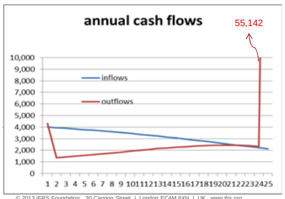
Operating activity:
- Portfolio of life contracts covered for 25 years with annual premium.
- Insurer pays benefit on death and accumulated guaranteed investment upon lapse or at maturity of the contract.
- Contracts priced to be profitable.



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).

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Initial expectations in numbers

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	Year 1*
Expected inflows	82,663
Time value of money	(35,375)
Total present value of expected inflows	47,288
Expected cash outflows (excluding acquisition costs)	103,594
Expected acquisition costs	3,000
Time value of money	(63,130)
Risk adjustment	922
Contractual service margin	2,902
Total obligation	47,288

Highlights:

Information available in the notes.

Expected benefits

Expected obligation and expected profit

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

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Fact pattern – changes

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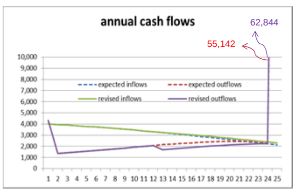
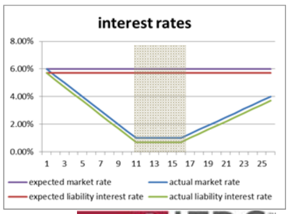
Operating activity:
- in year 13 - lower claims for the year than expected of *306*,consequently:
- entity revises expectations about future – less claims before year 25 but more payments on maturity – in total higher expected pay-outs (NPV of 2,285).



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



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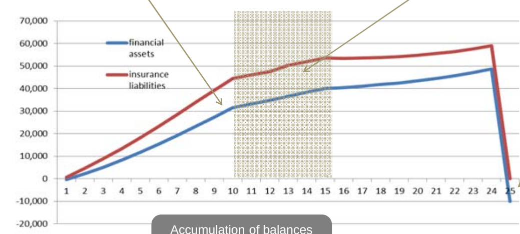
Information in the balance sheet – enough assets to cover obligation?

12

Expected gap - assets are expected to be not enough to cover liabilities

Change in gap follows changes in interest rate



Final gap: (10,080)

Accumulation of balances because of annual payments from policyholders

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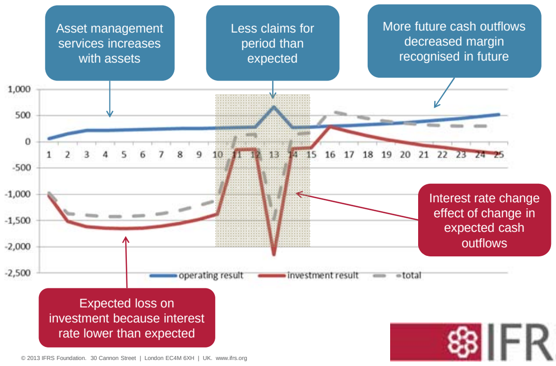
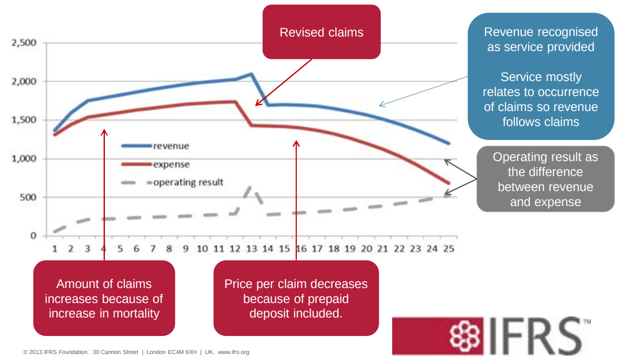
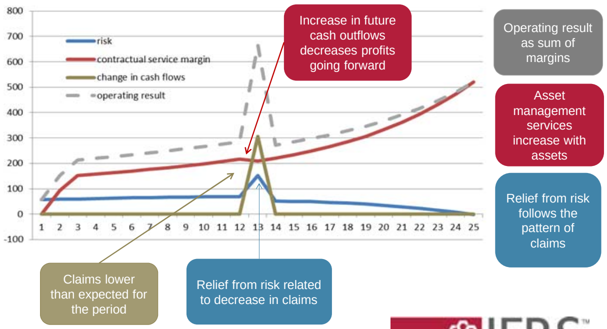
Information in the statement of comprehensive income – sources of profit



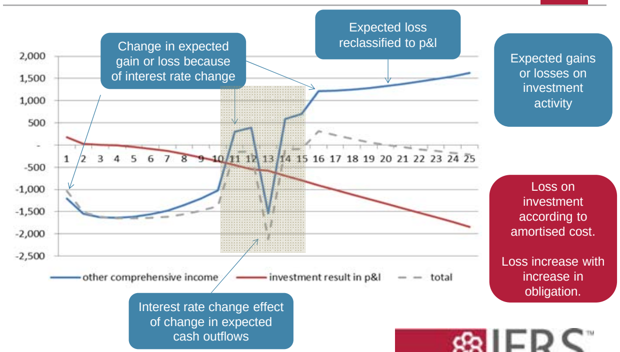
Operating result represented by volume information (comparability with others)



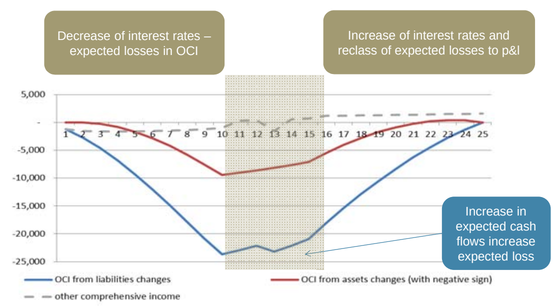
Operating result represented by margins (available in the notes)



Investment result – cost and current value information available

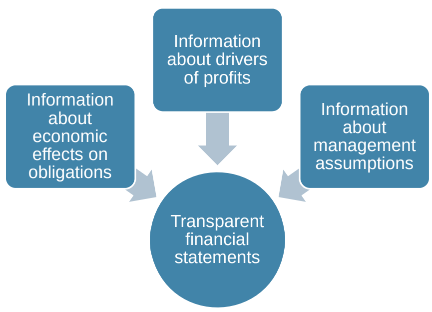


Investment result reported in other comprehensive income (OCI)



OCI includes difference between fair value (current value) and cost value

Key takeaways: information provided by our proposals



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Appendix:

additional information for illustrative example

Financial statement for a current period (year 13) and comparative information

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Information in the balance sheet

Balance sheet	13	12	change
Financial assets	36,608	34,709	+1,900
Total assets	36,608	34,709	+1,900
Insurance contract liabilities	50,817	47,443	+3,374
Equity	**(14,208)**	**(12,734)**	**-1,474**
Total equity and liabilities	36,608	34,709	+1,900

Highlights:

- Current insurance obligation measures expected obligation + expected profit on insurance
- Separate measurement from assets reveal investment risks

Assets are expected to be not enough to fund obligation due to lower than expected interest rate

Equity further decreases mainly due to increase of obligation as assumption changes.

See also next slide.

Information in statement of comprehensive income (SCI)

Statement of Comprehensive Income	13	12	See also slide
Operating result	667	285	9
Net investment result	(603)	(539)	10
Profit or loss	64	(254)	
Other comprehensive income (OCI)	(1,538)	395	10
Total comprehensive income	(1,474)	140	

Highlights:

- Separate operating from investment result
- For investment result: separate amortised cost in p&l from other changes in OCI

- Profit on operating activity as priced at inception. In year 13 additional gain as claims lower than expected for a year.
- Loss on investment activity in p&l result from interest rate lower than expected.

OCI reflect schanges in fair value (current value) not included in p&l ie it reflects changes in expected losses:

- year 12 - reversal of losses to p&l,
- year 13 – mainly effect of interest rate change of assumptions changes.

Operating result represented by volume information

	13	12
Revenue	2,095	2,025
Incurred claims and other expenses	(1,428)	(1,740)
Expected future losses	-	-
Operating result	667	285

Highlights:

Comparable revenue and expenses across all insurance and other industries:

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

Similar revenue comparing to PY because similar service was expected to be provided for the period

Less claims because:
1. mortality lower than expected,
2. lower cost per claim because more pre-funded deposit in the pay-out

No expected losses on insurance activity – negative change in expected cash outflows decrease expected future profits

Investment result with separated market-related changes

	13	12
Interest income	816	775
Interest expense	(1,420)	(1,314)
Investment result	(603)	(539)
Changes from financial assets at FVOCI	(469)	(444)
Changes from insurance liability	(1,068)	838
Other comprehensive income (OCI)	(1,538)	395
Total	(2,141)	(144)

Highlights:

Separate expected gain or loss in OCI from gain or loss according to amortised cost in p&l

Change in expected loss on investment activity:
2012 - reclass to profit or loss part of expected loss accumulated in OCI
2013 – increase of expected loss due to increase in expected claims

Loss in p&l because the entity earns less interest from investment than expected when pricing the contract.
Increase of loss because obligation increases.

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

	Insurance contract liability	Financial assets
Opening balance	47,433	34,709
Net changes recognised in SCI	**1,821**	**354**
Operating result: change in risk/ service margin/cash flows	(667)	N/A
Investment result in p&l: Interest according to amortised cost	1,420	816
Other comprehensive income Discount rate (and other) changes	1,068	(469)
Cash flows	**1,553**	**1,553**
Net cash inflows / purchase of assets	1,553	1,553
Closing balance	50,817	36,608

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

Disclosure: Reconciliation of insurance balance to margin information*

	Total insurance contract liability	Present value of cash flows	Risk adjustment	Contractual service margin
Opening balance (year 12)	47,443	43,853	559	3,032
Net changes recognised in SCI	**1,821**	**2,286**	**(179)**	**(286)**
Operating result: Change in risk/service margin	(361)	-	(151)	(210)
Operating result: Change in cash flows	(306)	(74)	-	(232)
Interest expense recognised in p&l	1,420	1,241	19	160
Discount rate (and other) changes recognised in OCI	1,068	1,115	(47)	-
Cash flows	**1,553**	**1,553**	**-**	**-**
Cash inflows	3,248	3,248	-	-
Cash outflows	(1,695)	(1,695)	-	-
Closing balance (year 13)	50,817	47,691	380	2,750

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

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NOTES