Course Outline

FINANCIALEDGE

Identify the **key principles and methods** used in insurance accounting

Understand the accounting for insurance premiums and reserves for **P&C insurance**

Understand the accounting for **reinsurance** within assets and reserves

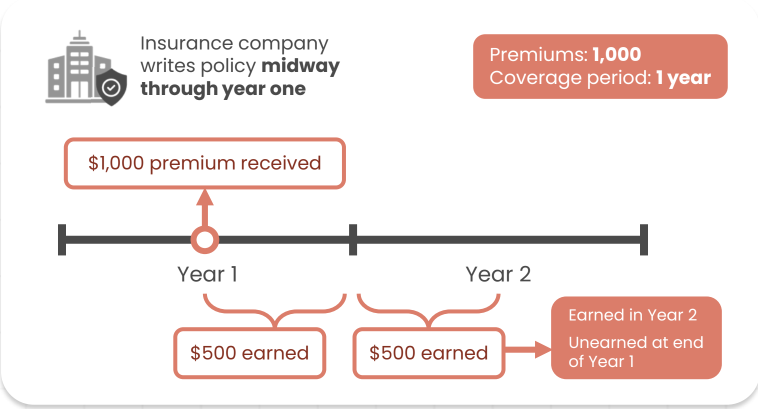
Understand the accounting for insurance premiums and reserves for **life insurance**

Identify the key components of an insurance company's **income statement** and **balance sheet**

Earned and Unearned Premiums

Premiums are a **key form of revenue** for an insurance company

PRINCIPLE: Companies **recognize premiums as they are 'earned'** over the coverage period



YEAR 1

Written premiums	1,000
Unearned premiums	(500)
Net earned premiums	**500**

(Recorded as a liability)
Unearned premium reserve

B	Beginning of year 1	0
A	Add: Premiums written	1,000
S	Subtract: Premiums earned	(500)
E	Ending of year 1	500

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P&C Claims and Reserves

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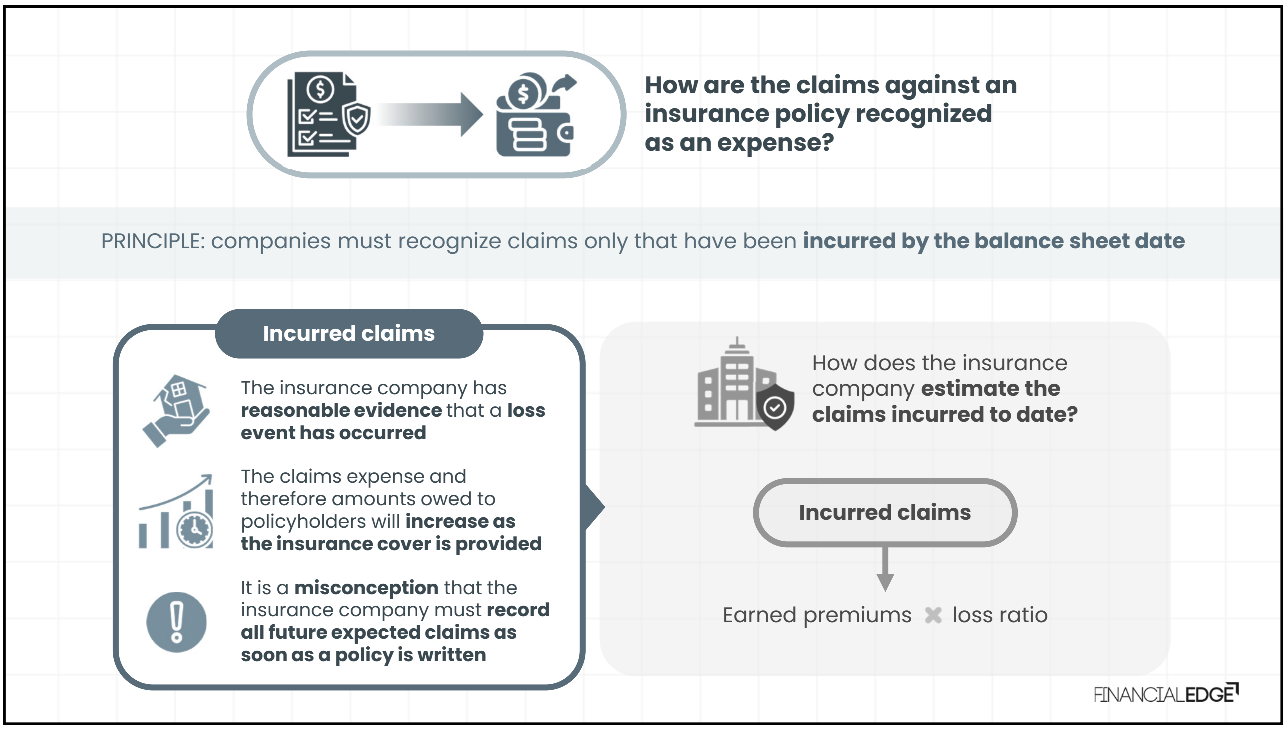
How are the claims against an insurance policy recognized as an expense?
PRINCIPLE: companies must recognize claims only that have been **incurred by the balance sheet date**
Incurred claims
The insurance company has **reasonable evidence** that a **loss event has occurred**
The claims expense and therefore amounts owed to policyholders will **increase as the insurance cover is provided**
It is a **misconception** that the insurance company must **record all future expected claims as soon as a policy is written**
How does the insurance company **estimate the claims incurred to date?**
Incurred claims
Earned premiums × loss ratio
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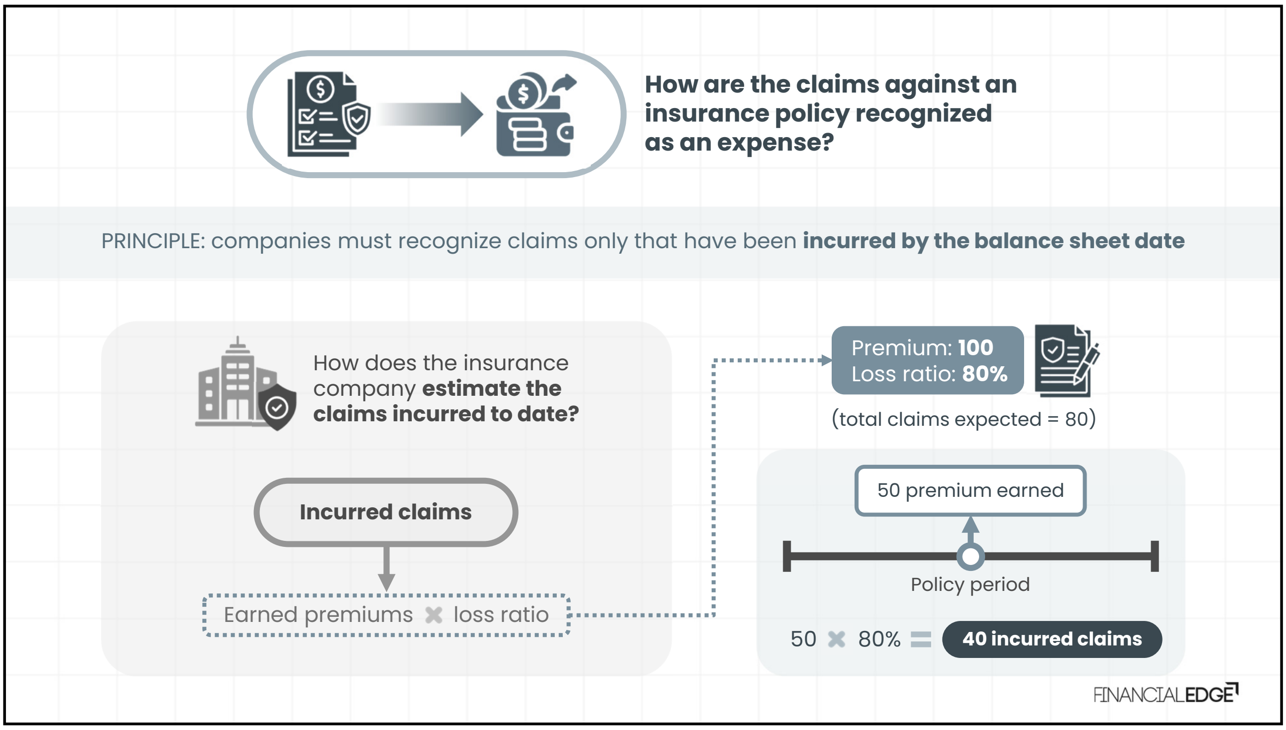
How are the claims against an insurance policy recognized as an expense?
PRINCIPLE: companies must recognize claims only that have been **incurred by the balance sheet date**
How does the insurance company **estimate the claims incurred to date?**
Incurred claims
Earned premiums × loss ratio
Premium: **100**
Loss ratio: **80%**
(total claims expected = 80)
50 premium earned
Policy period
50 × 80% = **40 incurred claims**
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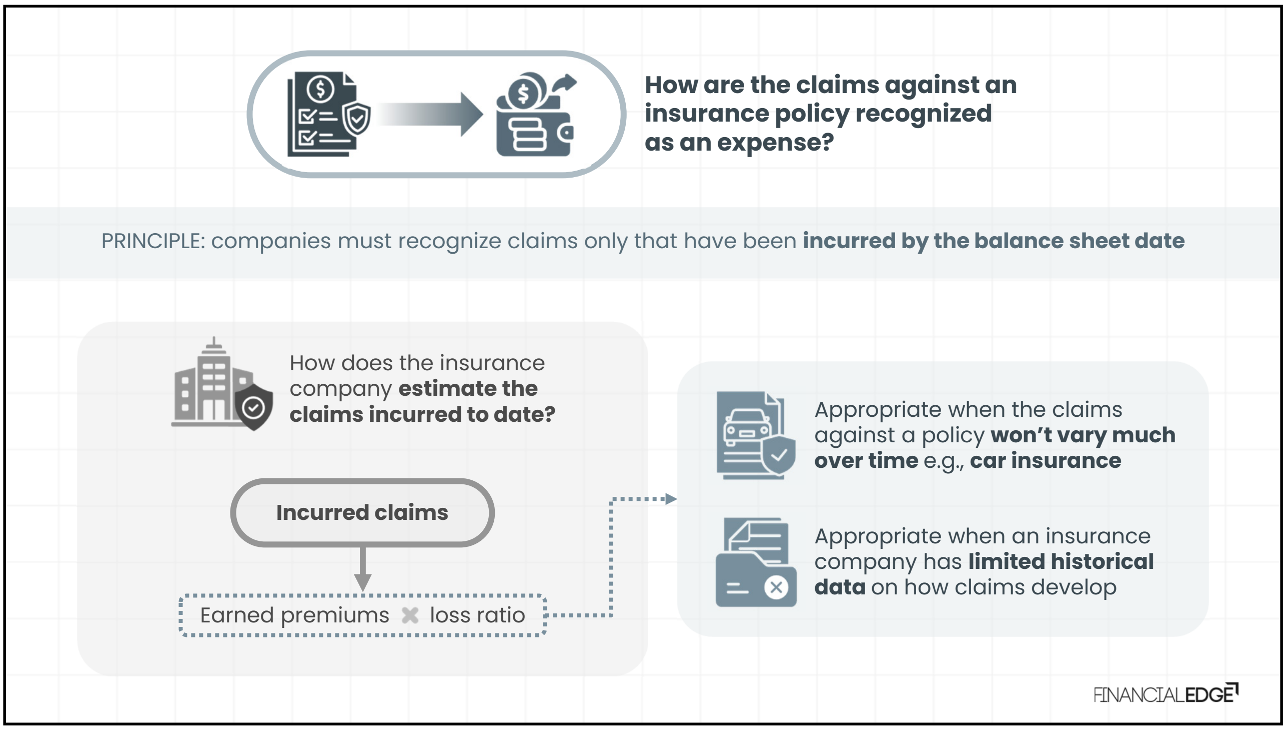
How are the claims against an insurance policy recognized as an expense?
PRINCIPLE: companies must recognize claims only that have been incurred by the balance sheet date
How does the insurance company estimate the claims incurred to date?
Incurred claims
Earned premiums ✖ loss ratio
Appropriate when the claims against a policy won't vary much over time e.g., car insurance
Appropriate when an insurance company has limited historical data on how claims develop
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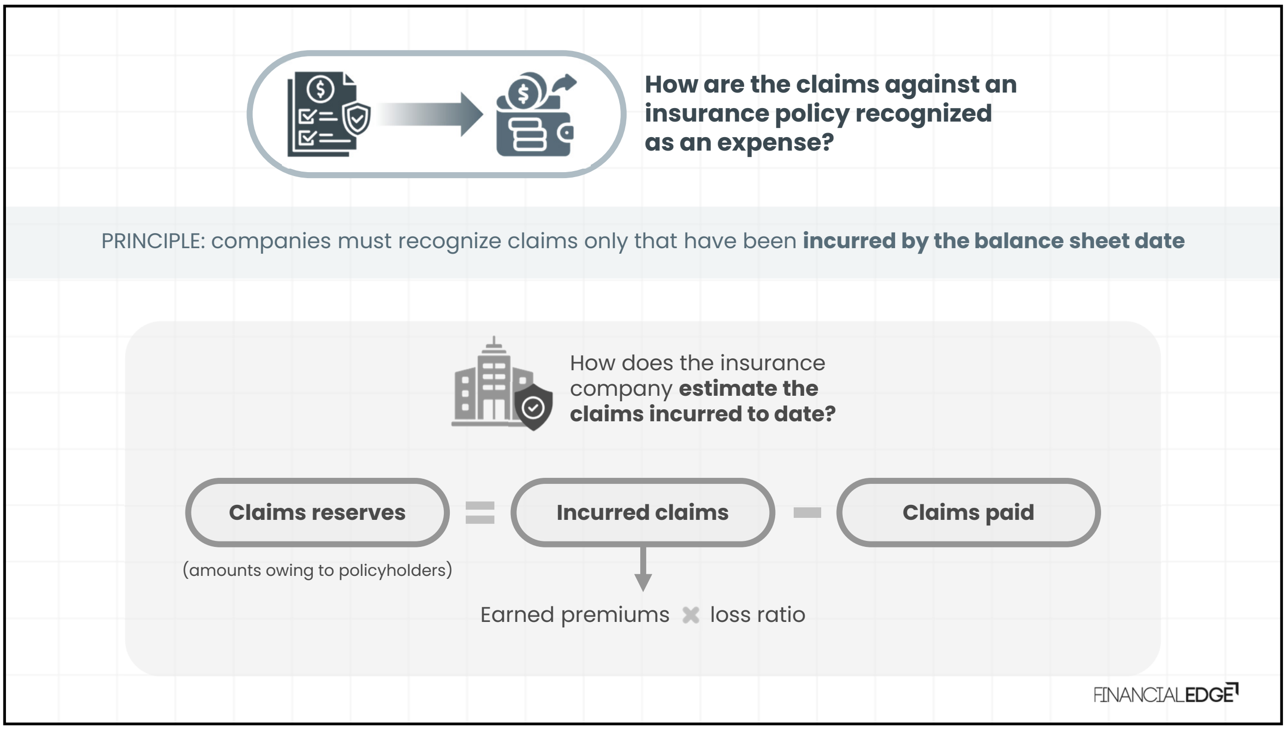
How are the claims against an insurance policy recognized as an expense?
PRINCIPLE: companies must recognize claims only that have been incurred by the balance sheet date
How does the insurance company estimate the claims incurred to date?
Claims reserves
(amounts owing to policyholders)
=
Incurred claims
−
Claims paid
Earned premiums ✖ loss ratio
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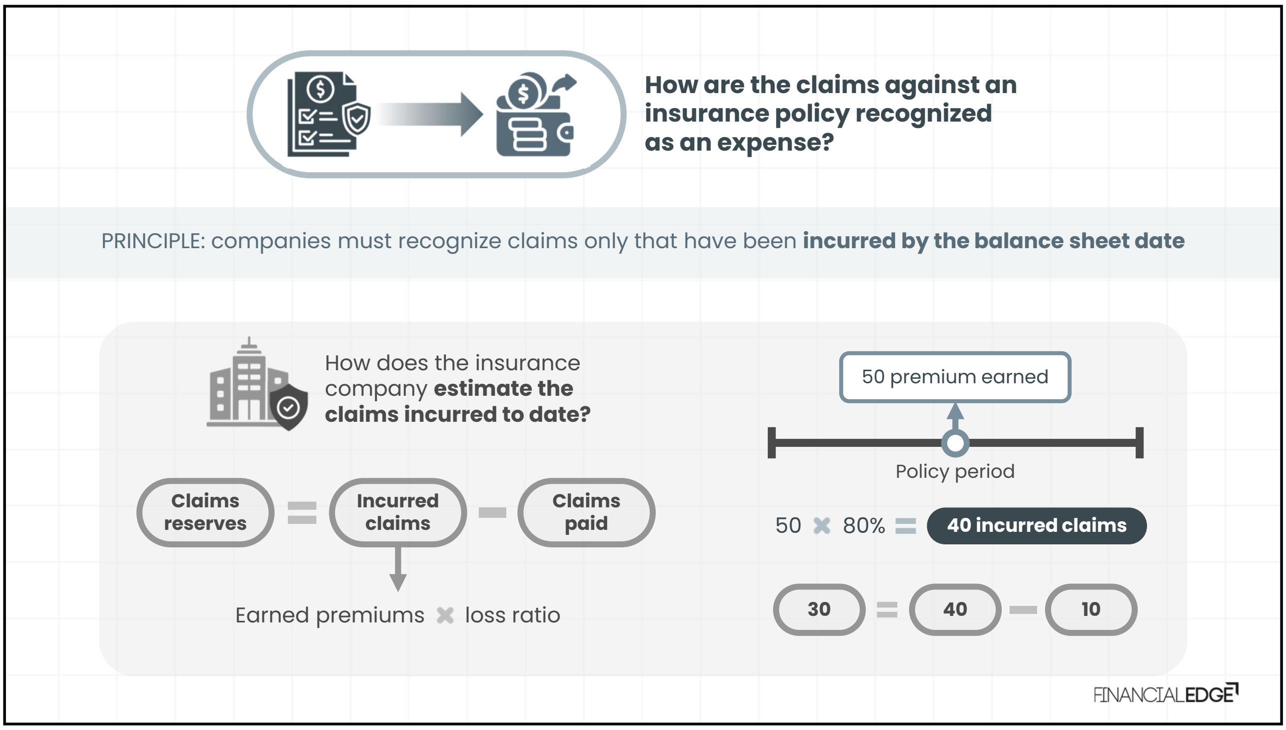
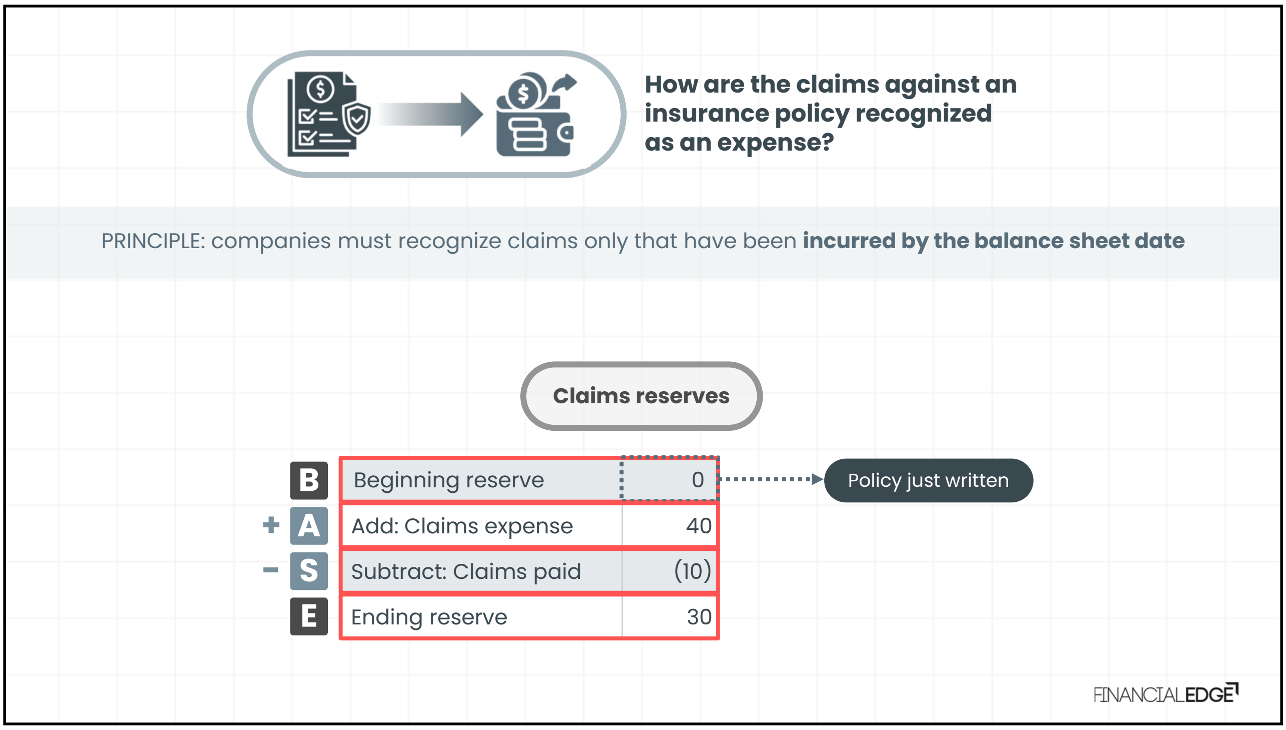
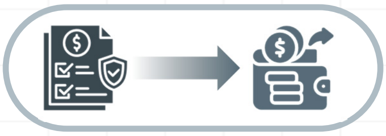

How are the claims against an insurance policy recognized as an expense?
PRINCIPLE: companies must recognize claims only that have been **incurred by the balance sheet date**
How does the insurance company **estimate the claims incurred to date?**
Claims reserves = Incurred claims − Claims paid
Earned premiums × loss ratio
50 premium earned
Policy period
50 × 80% = 40 incurred claims
30 = 40 − 10


How are the claims against an insurance policy recognized as an expense?
PRINCIPLE: companies must recognize claims only that have been **incurred by the balance sheet date**
Claims reserves
B Beginning reserve 0
+ A Add: Claims expense 40
− S Subtract: Claims paid (10)
E Ending reserve 30
Policy just written



How are the claims against an insurance policy recognized as an expense?

PRINCIPLE: companies must recognize claims only that have been **incurred by the balance sheet date**

Claims reserves

B	Beginning reserve	0
+ A	Add: Claims expense	40
– S	Subtract: Claims paid	(10)
E	Ending reserve	30

Claims expense = increase in reserves + claims paid

1. Incurred claims are calculated on a cumulative basis

3 months 6 months 9 months

2. Claims paid over this time to policyholders are known

3. Use reserve movements to calculate claims expense

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IBNR Reserves

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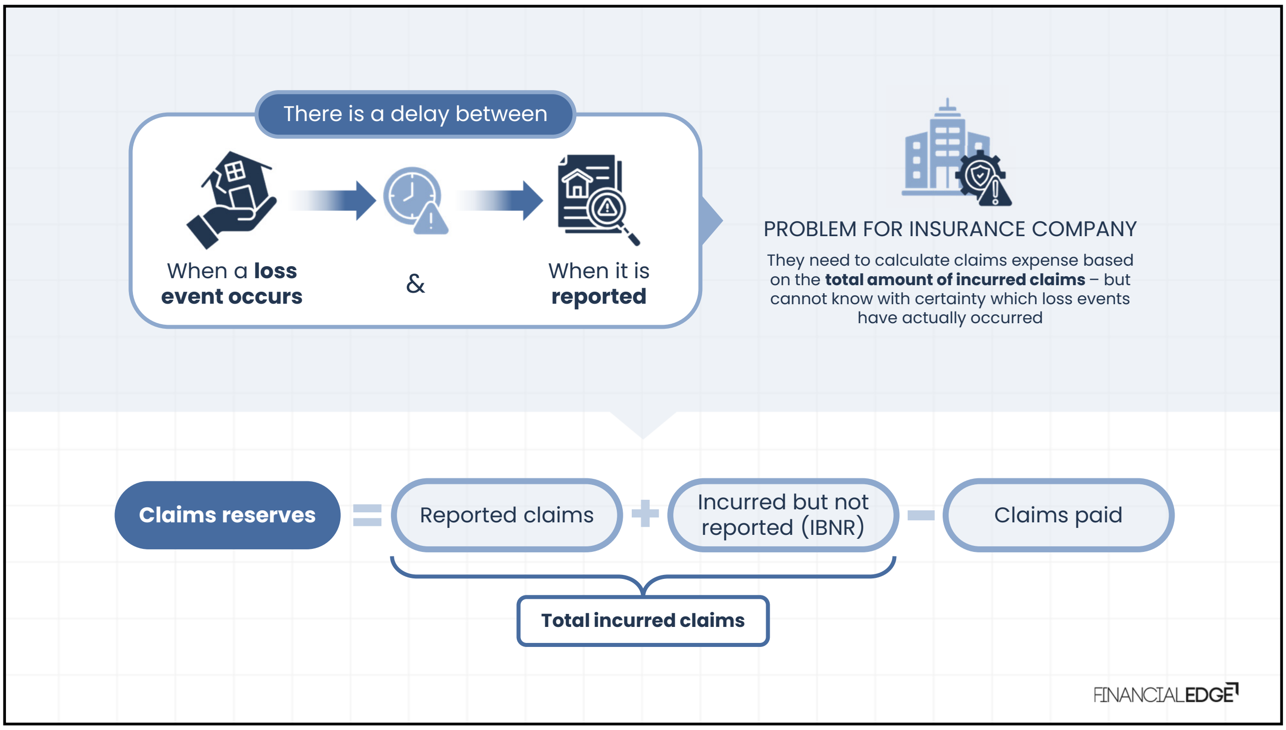
There is a delay between
When a **loss event occurs**
&
When it is **reported**
PROBLEM FOR INSURANCE COMPANY
They need to calculate claims expense based on the **total amount of incurred claims** – but cannot know with certainty which loss events have actually occurred
Claims reserves
=
Reported claims
+
Incurred but not reported (IBNR)
-
Claims paid
Total incurred claims
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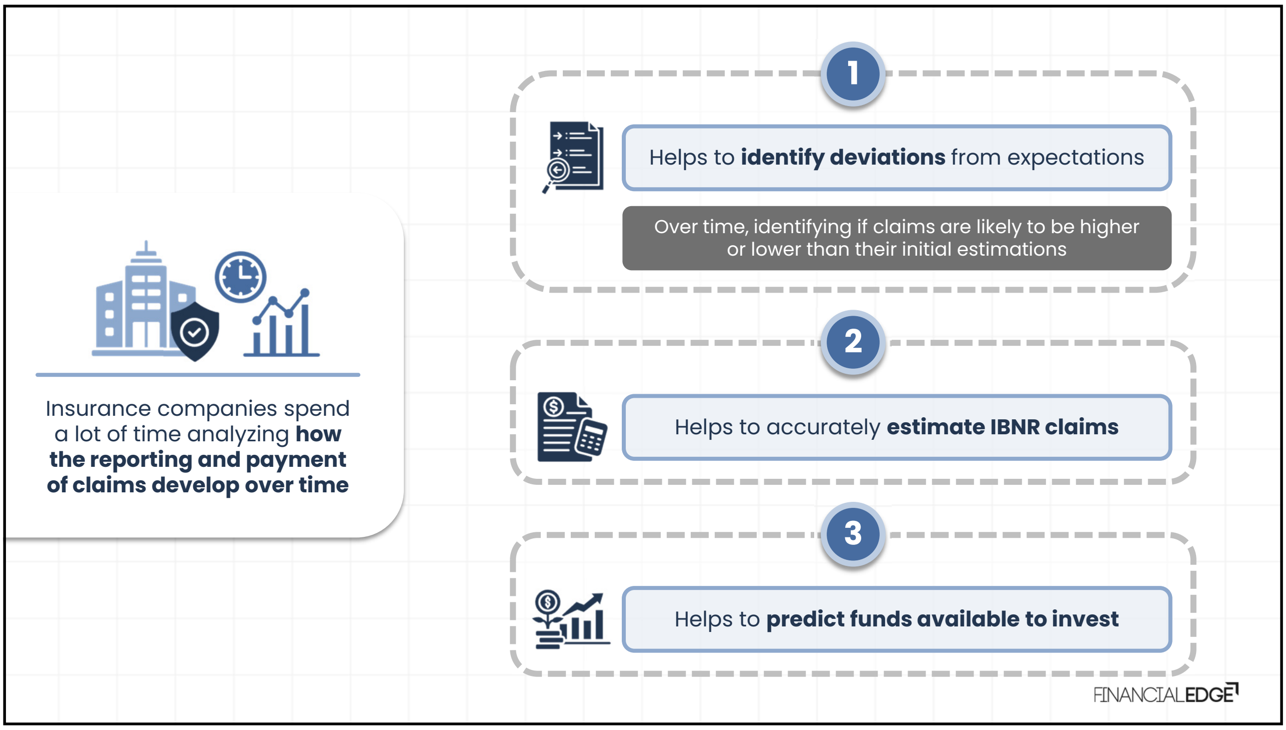
Insurance companies spend a lot of time analyzing **how the reporting and payment of claims develop over time**
1
Helps to **identify deviations** from expectations
Over time, identifying if claims are likely to be higher or lower than their initial estimations
2
Helps to accurately **estimate IBNR claims**
3
Helps to **predict funds available to invest**
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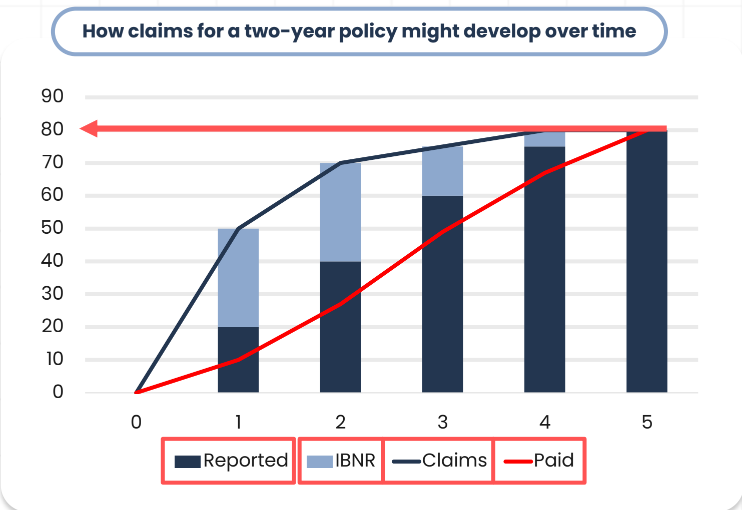

Data given on a **cumulative basis**

Premium = 100

Loss ratio = 80%

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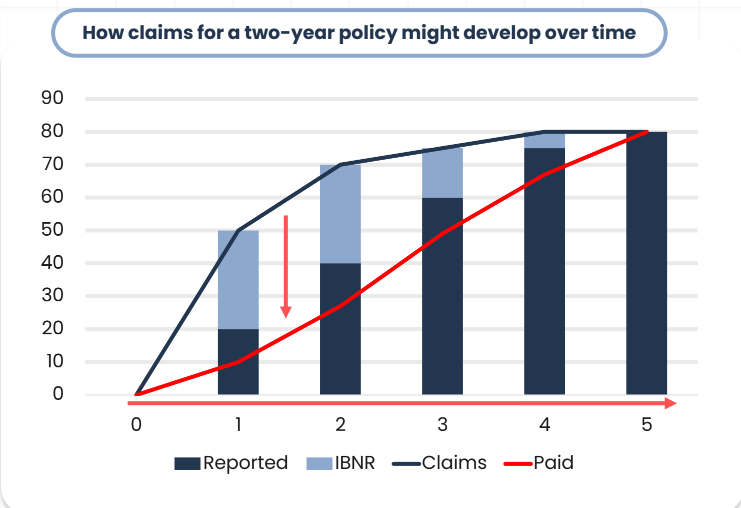

DURING THE COVERAGE PERIOD

IBNR claims make up a large portion of the total incurred claims

AFTER THE COVERAGE PERIOD

IBNR claims portion reduces rapidly as claims begin to be reported

REPORT-PAYMENT LAG

There is a lag between claims being reported and when they are paid

- It takes time for losses to be agreed and settled
- Lag is longer for commercial insurance (many months)
- Lag is shorter for auto insurance (days or weeks)

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Reserves and Profit Link

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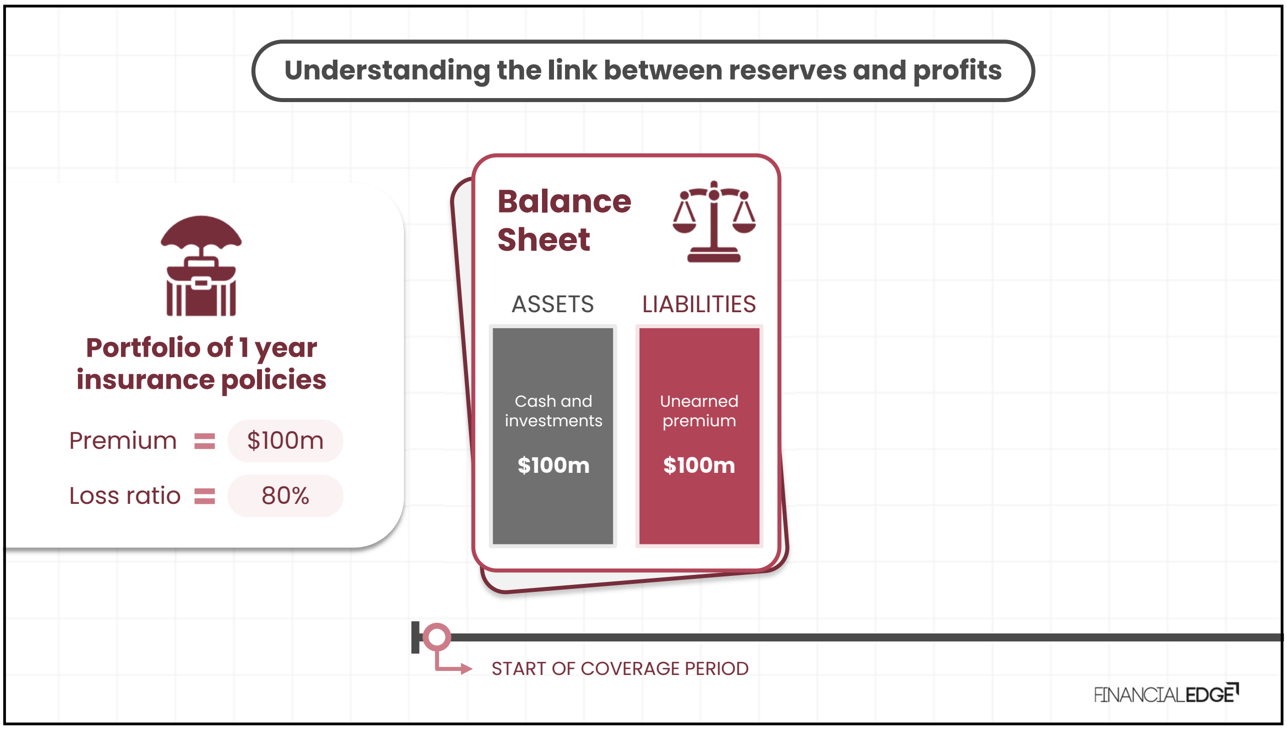
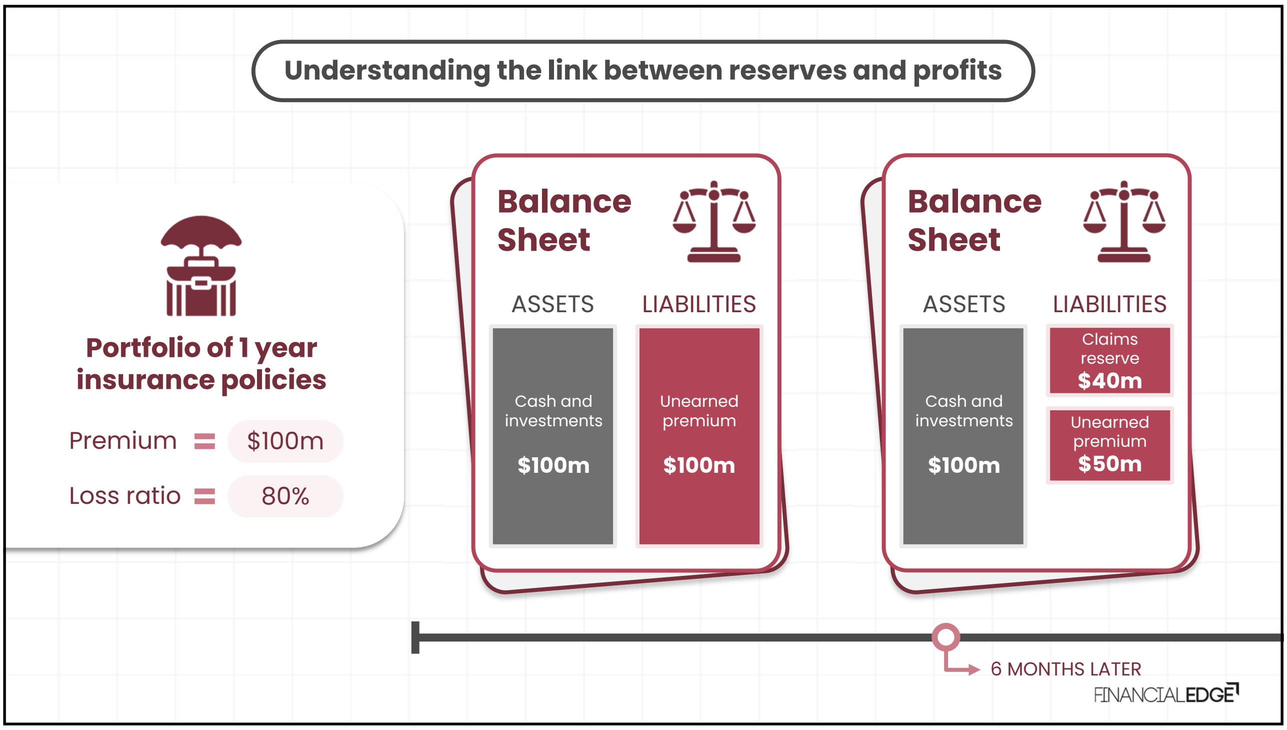
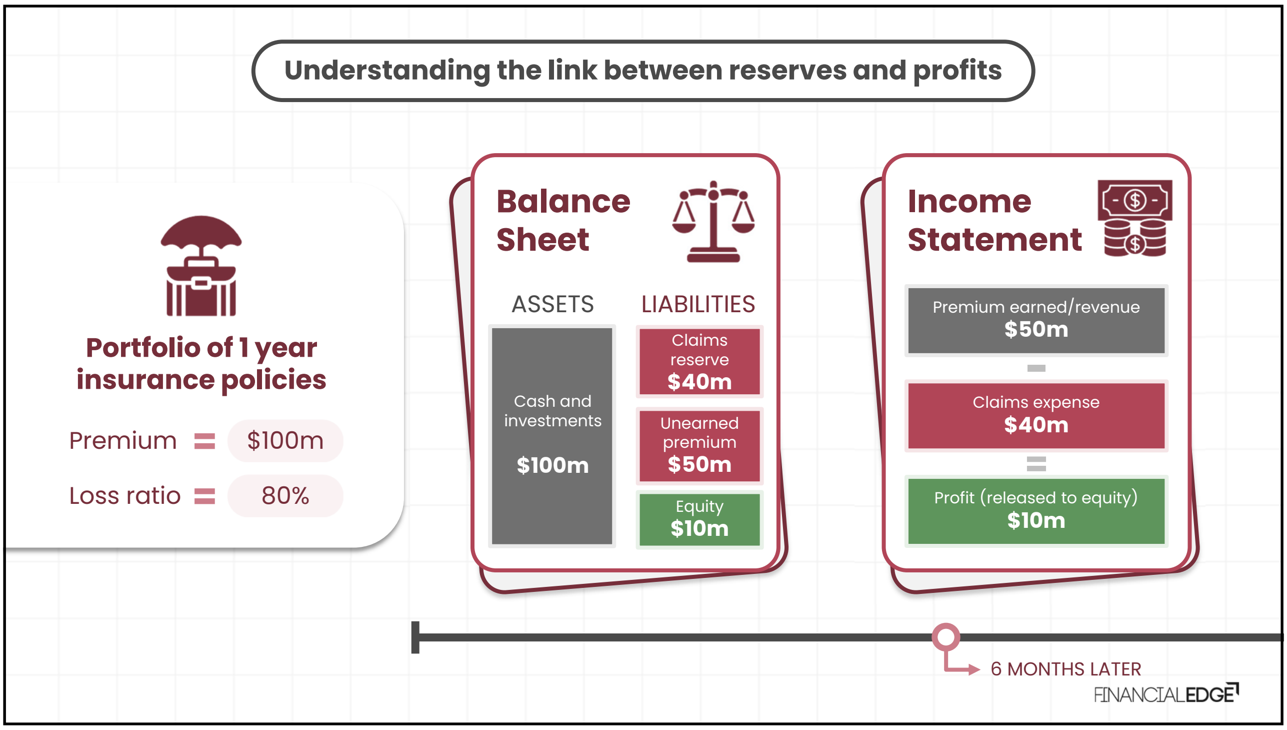
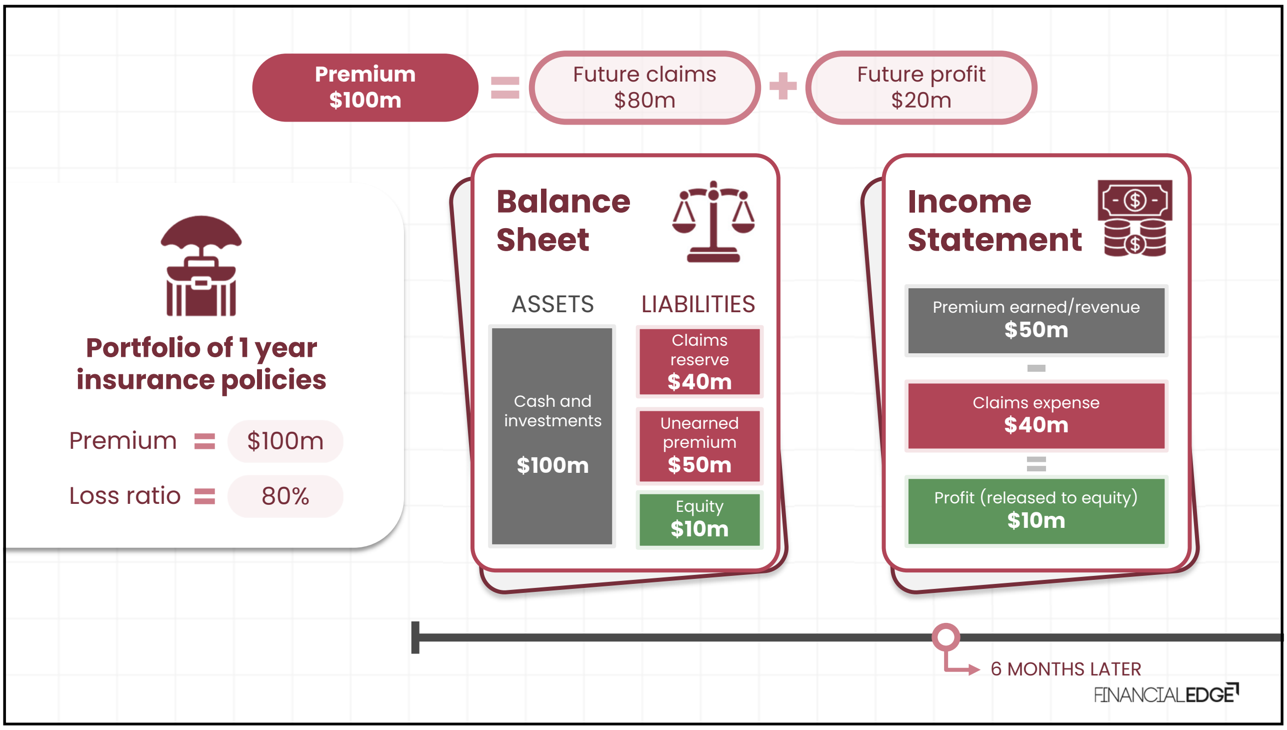
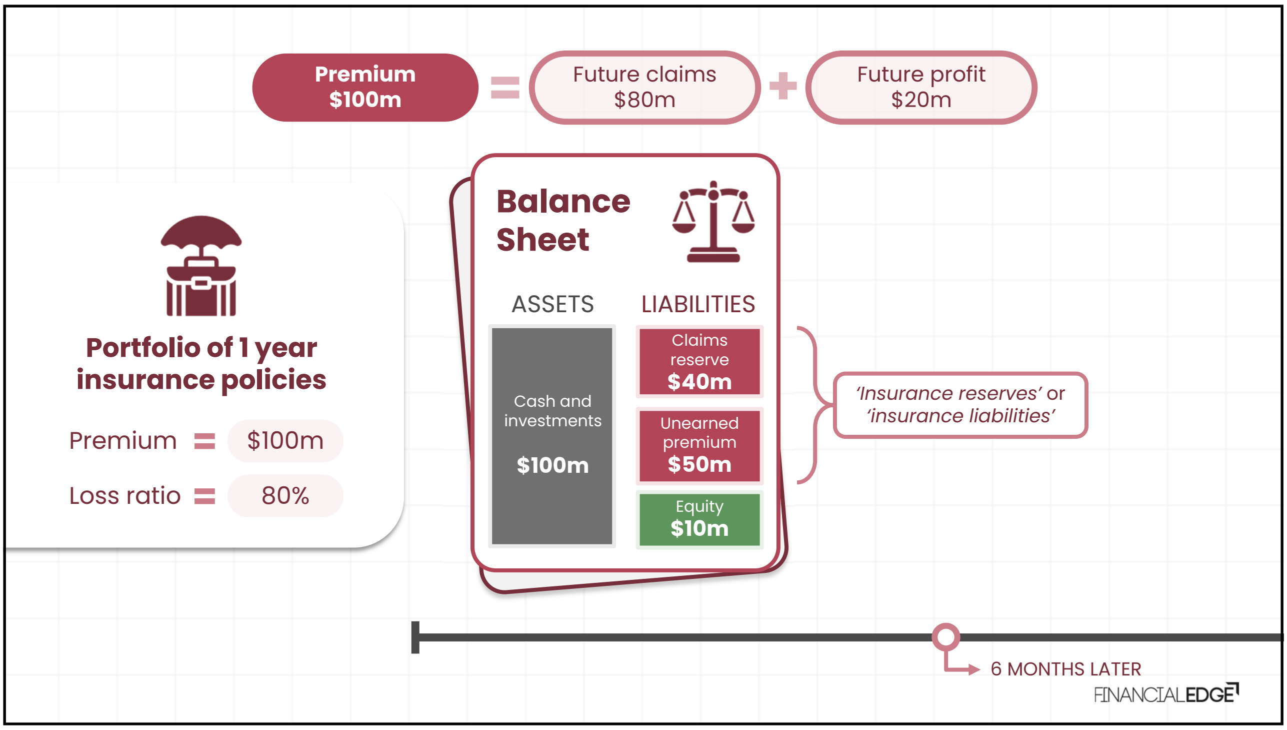



Understanding the link between reserves and profits
Portfolio of 1 year insurance policies
Premium = $100m
Loss ratio = 80%
Balance Sheet
ASSETS
LIABILITIES
Cash and investments $100m
Unearned premium $100m
Balance Sheet
ASSETS
LIABILITIES
Cash and investments $100m
Claims reserve $40m
Unearned premium $50m
6 MONTHS LATER
FINANCIALEDGE


Understanding the link between reserves and profits
Portfolio of 1 year insurance policies
Premium = $100m
Loss ratio = 80%
Balance Sheet
ASSETS
LIABILITIES
Cash and investments $100m
Claims reserve $40m
Unearned premium $50m
Equity $10m
Income Statement
Premium earned/revenue $50m
-
Claims expense $40m
=
Profit (released to equity) $10m
6 MONTHS LATER
FINANCIALEDGE



Premium
$100m
Future claims
$80m
Future profit
$20m
Portfolio of 1 year insurance policies
Premium $100m
Loss ratio 80%
Balance Sheet
ASSETS
LIABILITIES
Cash and investments
$100m
Claims reserve
$40m
Unearned premium
$50m
Equity
$10m
Income Statement
Premium earned/revenue
$50m
Claims expense
$40m
Profit (released to equity)
$10m
6 MONTHS LATER
FINANCIALEDGE



Premium
$100m
Future claims
$80m
Future profit
$20m
Portfolio of 1 year insurance policies
Premium $100m
Loss ratio 80%
Balance Sheet
ASSETS
LIABILITIES
Cash and investments
$100m
Claims reserve
$40m
Unearned premium
$50m
Equity
$10m
'Insurance reserves' or 'insurance liabilities'
6 MONTHS LATER
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Deferred Acquisition Costs (DAC)

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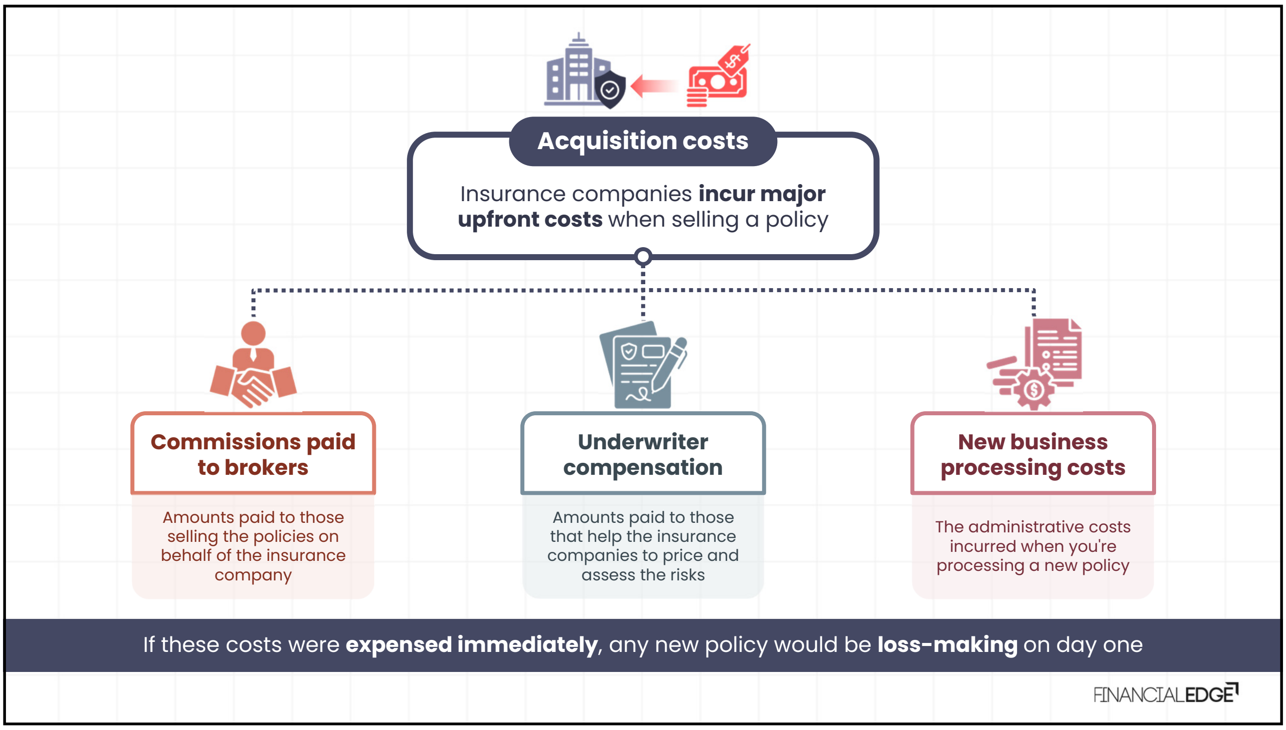

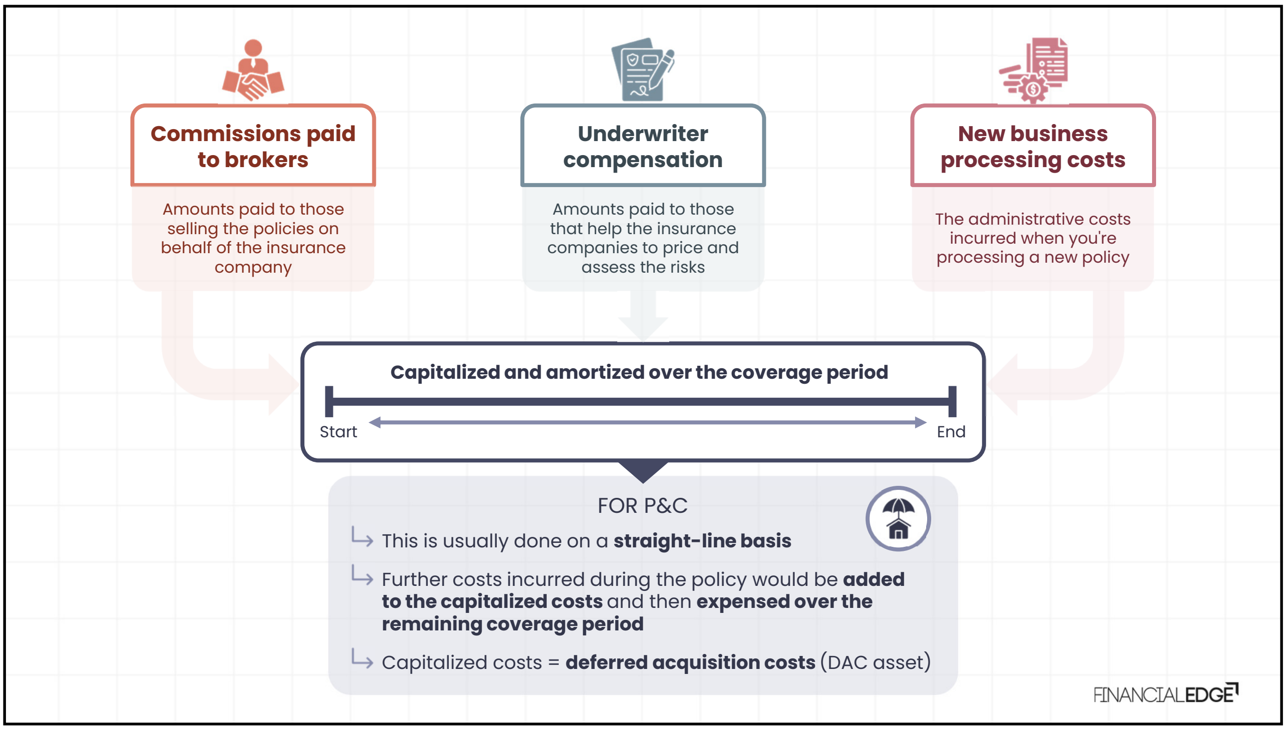
Commissions paid to brokers
Amounts paid to those selling the policies on behalf of the insurance company
Underwriter compensation
Amounts paid to those that help the insurance companies to price and assess the risks
New business processing costs
The administrative costs incurred when you're processing a new policy
Capitalized and amortized over the coverage period
Start
End
FOR P&C
This is usually done on a **straight-line basis**
Further costs incurred during the policy would be **added to the capitalized costs** and then **expensed over the remaining coverage period**
Capitalized costs = **deferred acquisition costs** (DAC asset)
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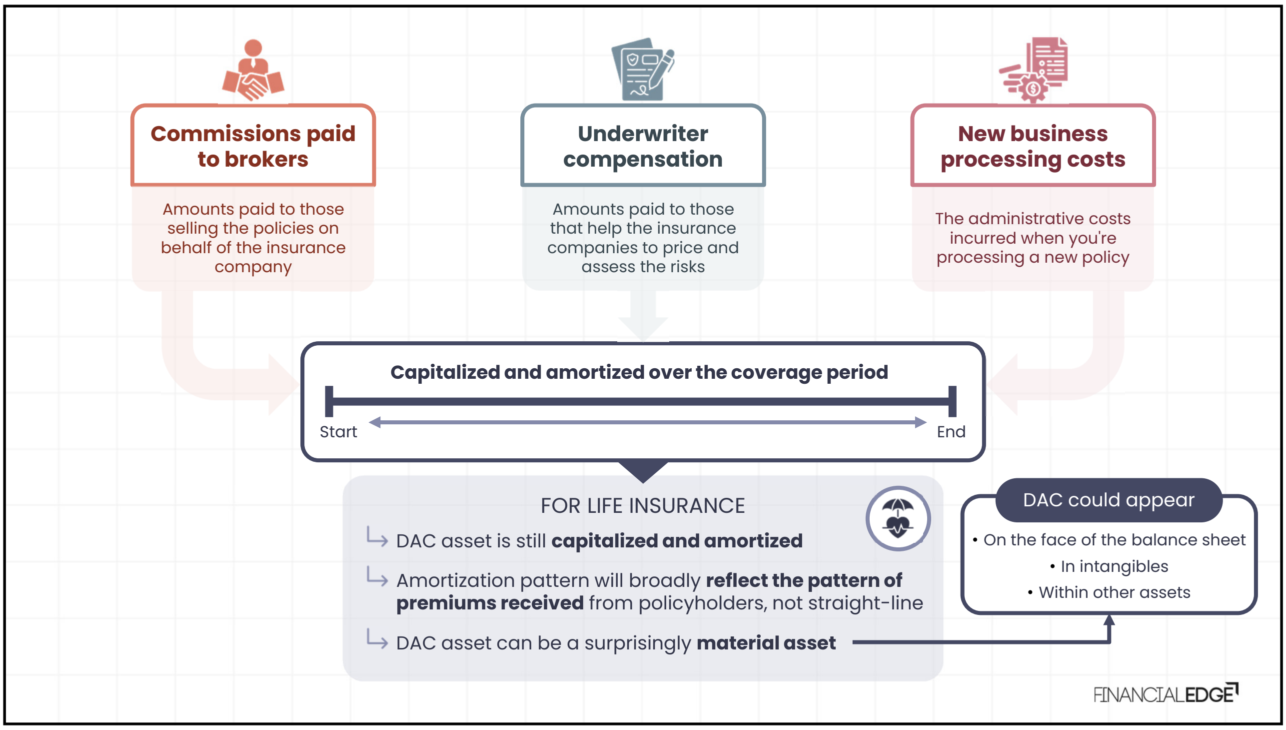
Commissions paid to brokers
Amounts paid to those selling the policies on behalf of the insurance company
Underwriter compensation
Amounts paid to those that help the insurance companies to price and assess the risks
New business processing costs
The administrative costs incurred when you're processing a new policy
Capitalized and amortized over the coverage period
Start
End
FOR LIFE INSURANCE
DAC asset is still **capitalized and amortized**
Amortization pattern will broadly **reflect the pattern of premiums received** from policyholders, not straight-line
DAC asset can be a surprisingly **material asset**
DAC could appear
• On the face of the balance sheet
• In intangibles
• Within other assets
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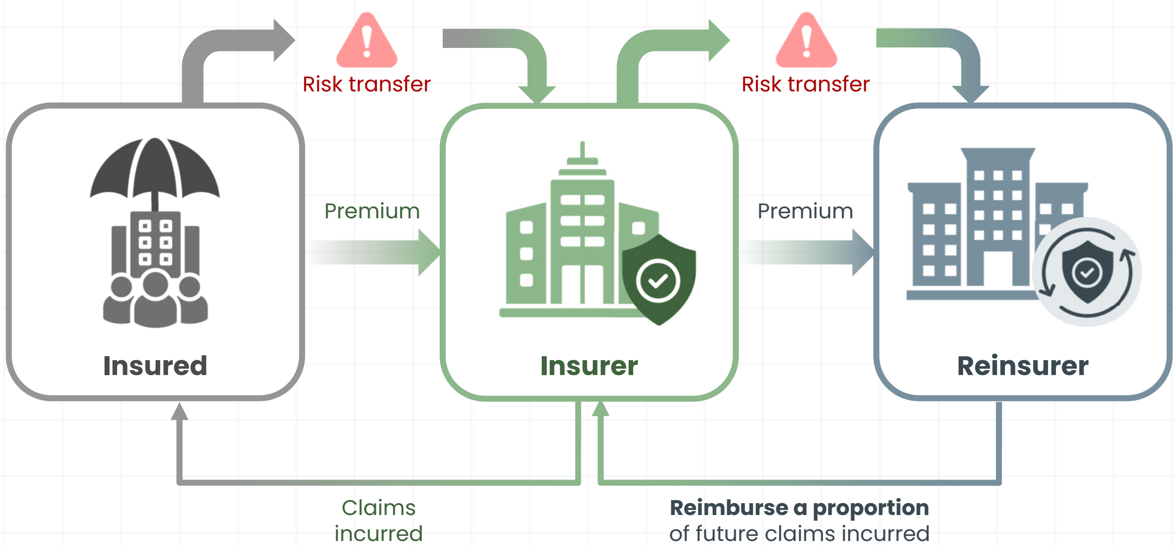
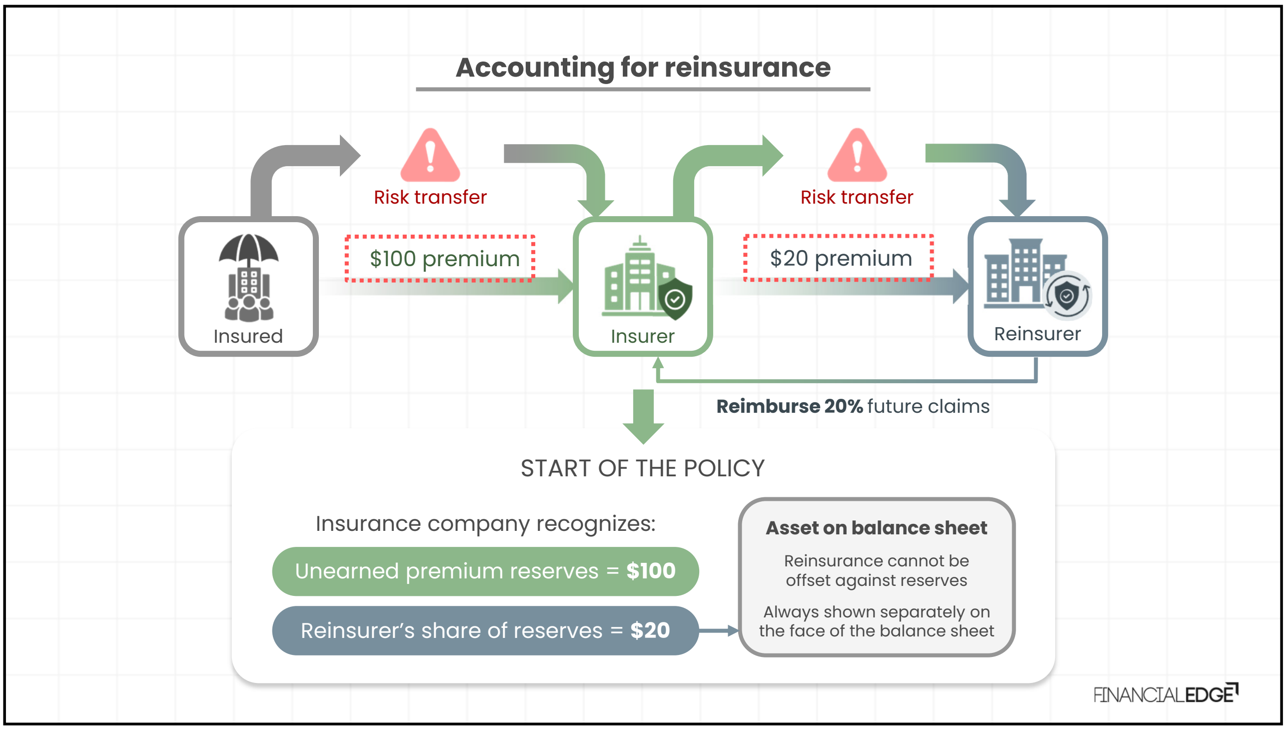
Reinsurance Accounting




Accounting for reinsurance
Risk transfer
Risk transfer
$100 premium
$20 premium
Insured
Insurer
Reinsurer
Reimburse 20% future claims
START OF THE POLICY
Insurance company recognizes:
Unearned premium reserves = $100
Reinsurer's share of reserves = $20
Asset on balance sheet
Reinsurance cannot be offset against reserves
Always shown separately on the face of the balance sheet
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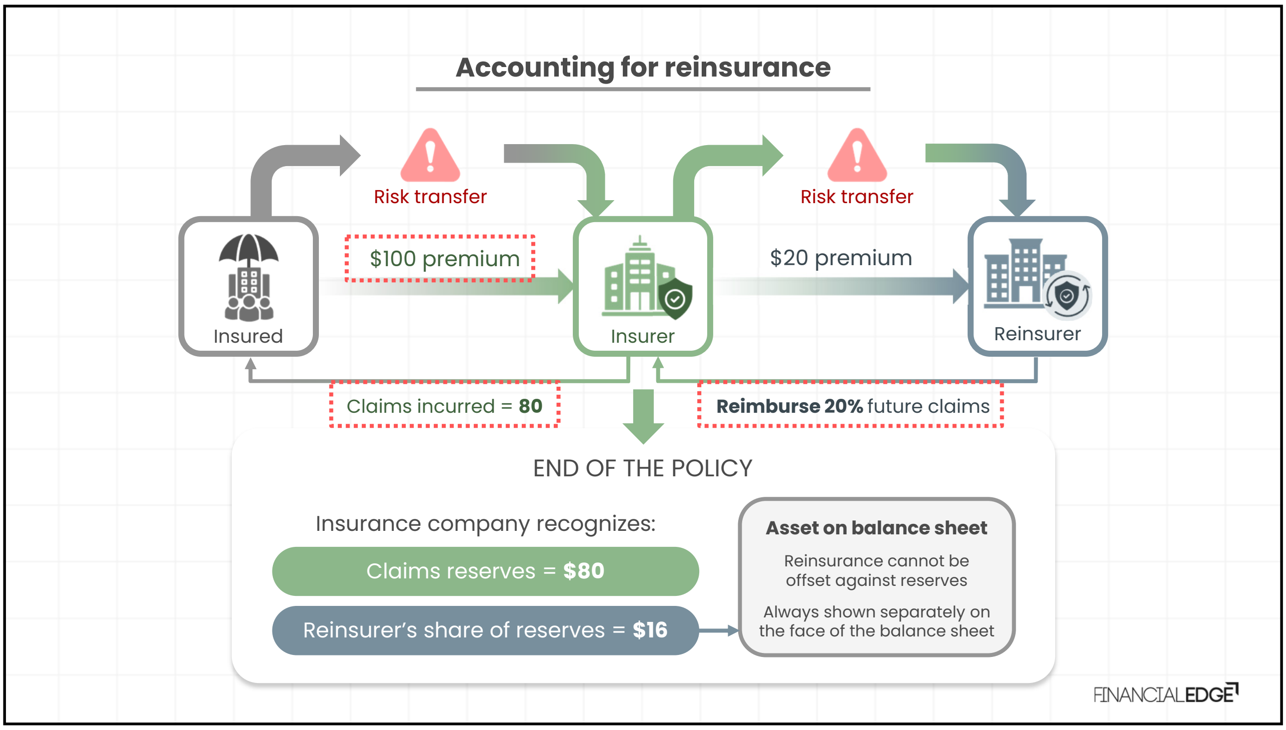
Accounting for reinsurance
Risk transfer
Risk transfer
$100 premium
$20 premium
Insured
Insurer
Reinsurer
Claims incurred = 80
Reimburse 20% future claims
END OF THE POLICY
Insurance company recognizes:
Claims reserves = $80
Reinsurer's share of reserves = $16
Asset on balance sheet
Reinsurance cannot be offset against reserves
Always shown separately on the face of the balance sheet
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US GAAP P&C Financial Statements

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US GAAP Income Statement

Reflect premiums after **deducting** the **amount ceded to reinsurance**

Net premiums earned	72,000
Investment income	3,000
Total revenue	**75,000**
Net claims expense	(49,000)
Policy acquisition costs	(5,000)
Operating costs	(10,000)
Finance costs	(500)
Total expenses	**(64,500)**
Tax expense	(2,500)
Net income	**8,000**

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US GAAP Income Statement

Generated from **investments** in the **balance sheet**

Net premiums earned	72,000
Investment income	3,000
Total revenue	**75,000**
Net claims expense	(49,000)
Policy acquisition costs	(5,000)
Operating costs	(10,000)
Finance costs	(500)
Total expenses	**(64,500)**
Tax expense	(2,500)
Net income	**8,000**

Income items
Included together at the top of the US GAAP income statement

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US GAAP Income Statement

Net premiums earned
+ Investment income
= **Total revenue**

Some P&C insurers may include **fee income** from additional services

Net premiums earned	72,000
Investment income	3,000
Total revenue	**75,000**
Net claims expense	(49,000)
Policy acquisition costs	(5,000)
Operating costs	(10,000)
Finance costs	(500)
Total expenses	**(64,500)**
Tax expense	(2,500)
Net income	**8,000**

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US GAAP Income Statement

Includes:

- All **claims incurred** during the period
- **Costs associated** with assessing those losses

After **subtracting** any **claims recovered** from **reinsurers**

Net premiums earned	72,000
Investment income	3,000
Total revenue	**75,000**
Net claims expense	(49,000)
Policy acquisition costs	(5,000)
Operating costs	(10,000)
Finance costs	(500)
Total expenses	**(64,500)**
Tax expense	(2,500)
Net income	**8,000**

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US GAAP Income Statement

Deferred Acquisition Costs:

- Paid to **brokers**
- Paid for **processing new policies**

Amortized through expenses over the period of cover

Net premiums earned	72,000
Investment income	3,000
Total revenue	**75,000**
Net claims expense	(49,000)
Policy acquisition costs	(5,000)
Operating costs	(10,000)
Finance costs	(500)
Total expenses	**(64,500)**
Tax expense	(2,500)
Net income	**8,000**

Net premiums earned
− Net claims expense
− Policy acquisition costs
= **Underwriting profit**

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US GAAP Income Statement

Includes overheads of the business:

- **Staff** costs
- **IT** costs
- **Head office** costs

Net premiums earned	72,000
Investment income	3,000
Total revenue	**75,000**
Net claims expense	(49,000)
Policy acquisition costs	(5,000)
Operating costs	(10,000)
Finance costs	(500)
Total expenses	**(64,500)**
Tax expense	(2,500)
Net income	**8,000**

US GAAP Income Statement

Interest expense on borrowings

Net premiums earned	72,000
Investment income	3,000
Total revenue	**75,000**
Net claims expense	(49,000)
Policy acquisition costs	(5,000)
Operating costs	(10,000)
Finance costs	(500)
Total expenses	**(64,500)**
Tax expense	(2,500)
Net income	**8,000**

US GAAP Income Statement

Net premiums earned	72,000
Investment income	3,000
Total revenue	**75,000**
Net claims expense	(49,000)
Policy acquisition costs	(5,000)
Operating costs	(10,000)
Finance costs	(500)
Total expenses	**(64,500)**
Tax expense	(2,500)
Net income	**8,000**

Net claims expense
+ Policy acquisition costs
+ Operating costs
+ Finance costs
= **Total expenses**

US GAAP Income Statement

Net premiums earned	72,000
Investment income	3,000
Total revenue	**75,000**
Net claims expense	(49,000)
Policy acquisition costs	(5,000)
Operating costs	(10,000)
Finance costs	(500)
Total expenses	**(64,500)**
Tax expense	(2,500)
Net income	**8,000**

Insurance companies have lower tax rates as:

- Some investment income and dividends are **tax deductible** or taxed at a **preferential rate**

US GAAP Balance Sheet

Largest item in assets

Typically **fixed income** instruments e.g. **government** and **corporate debt**

- Relatively liquid
- Minimize downside risk

Investments	80,000
Premiums receivable	9,000
Reinsurance recoverables	4,500
Prepaid reinsurance premium	500
Deferred acquisition costs	2,000
Total assets	**96,000**
Unearned premiums	24,000
Loss / claims reserves	39,000
Debt	7,000
Equity	26,000
Total liabilities and equity	**96,000**

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US GAAP Balance Sheet

Premiums written that the policyholder has **not yet paid**

Investments	80,000
Premiums receivable	9,000
Reinsurance recoverables	4,500
Prepaid reinsurance premium	500
Deferred acquisition costs	2,000
Total assets	**96,000**
Unearned premiums	24,000
Loss / claims reserves	39,000
Debt	7,000
Equity	26,000
Total liabilities and equity	**96,000**

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US GAAP Balance Sheet

Claims recoverable from **reinsurers**

It is presented on the balance sheet as **gross** (a separate asset item)

Investments	80,000
Premiums receivable	9,000
Reinsurance recoverables	4,500
Prepaid reinsurance premium	500
Deferred acquisition costs	2,000
Total assets	**96,000**
Unearned premiums	24,000
Loss / claims reserves	39,000
Debt	7,000
Equity	26,000
Total liabilities and equity	**96,000**

US GAAP Balance Sheet

Premiums paid upfront to reinsurers where **cover has not been provided yet**

Investments	80,000
Premiums receivable	9,000
Reinsurance recoverables	4,500
Prepaid reinsurance premium	500
Deferred acquisition costs	2,000
Total assets	**96,000**
Unearned premiums	24,000
Loss / claims reserves	39,000
Debt	7,000
Equity	26,000
Total liabilities and equity	**96,000**

US GAAP Balance Sheet

Investments	80,000
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Unearned premiums	24,000
Loss / claims reserves	39,000
Debt	7,000
Equity	26,000
Total liabilities and equity	**96,000**

Amounts paid during the **acquisition of new policies**

US GAAP Balance Sheet

Investments	80,000
Premiums receivable	9,000
Reinsurance recoverables	4,500
Prepaid reinsurance premium	500
Deferred acquisition costs	2,000
Total assets	**96,000**
Unearned premiums	24,000
Loss / claims reserves	39,000
Debt	7,000
Equity	26,000
Total liabilities and equity	**96,000**

Premiums written which have **not been earned yet**

US GAAP Balance Sheet

Investments	80,000
Premiums receivable	9,000
Reinsurance recoverables	4,500
Prepaid reinsurance premium	500
Deferred acquisition costs	2,000
Total assets	**96,000**
Unearned premiums	24,000
Loss / claims reserves	39,000
Debt	7,000
Equity	26,000
Total liabilities and equity	**96,000**

Claims incurred which have **not yet been settled with policyholders**

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US GAAP Balance Sheet

Investments	80,000
Premiums receivable	9,000
Reinsurance recoverables	4,500
Prepaid reinsurance premium	500
Deferred acquisition costs	2,000
Total assets	**96,000**
Unearned premiums	24,000
Loss / claims reserves	39,000
Debt	7,000
Equity	26,000
Total liabilities and equity	**96,000**

Insurance reserves
(total liability to policyholders)

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US GAAP Balance Sheet

Investments	80,000
Premiums receivable	9,000
Reinsurance recoverables	4,500
Prepaid reinsurance premium	500
Deferred acquisition costs	2,000
Total assets	**96,000**
Unearned premiums	24,000
Loss / claims reserves	39,000
Debt	7,000
Equity	26,000
Total liabilities and equity	**96,000**

Loans and bonds used to help **finance the business**

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US GAAP Balance Sheet

Investments	80,000
Premiums receivable	9,000
Reinsurance recoverables	4,500
Prepaid reinsurance premium	500
Deferred acquisition costs	2,000
Total assets	**96,000**
Unearned premiums	24,000
Loss / claims reserves	39,000
Debt	7,000
Equity	26,000
Total liabilities and equity	**96,000**

Covered by **regulatory capital requirements**

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IFRS P&C Financial Statements

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IFRS Income Statement

1

No premiums referenced

- IFRS refers to premiums earned as **insurance revenue**
- IFRS requires insurance revenue to be **presented gross of premiums paid to reinsurers**

Insurance revenue	5,000
Insurance service expenses	(3,400)
Net expense from reinsurance	(500)
Insurance service result	**1,100**
Investment return	200
Other operating costs	(300)
Finance costs	(100)
Profit before tax	**900**
Tax expense	(200)
Net income	**700**

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IFRS Income Statement

2

No claims expense/policy acquisition costs referenced

- IFRS refers to all of these as **insurance service expenses**

Insurance revenue	5,000
Insurance service expenses	(3,400)
Net expense from reinsurance	(500)
Insurance service result	**1,100**
Investment return	200
Other operating costs	(300)
Finance costs	(100)
Profit before tax	**900**
Tax expense	(200)
Net income	**700**

IFRS Income Statement

Premiums paid to reinsurers net of claims recovered from reinsurers

Insurance revenue	5,000
Insurance service expenses	(3,400)
Net expense from reinsurance	(500)
Insurance service result	**1,100**
Investment return	200
Other operating costs	(300)
Finance costs	(100)
Profit before tax	**900**
Tax expense	(200)
Net income	**700**

IFRS Income Statement

Insurance revenue
+ Insurance expenses
+ Net expense from reinsurance
= **Insurance service result**
(underwriting profit)

Insurance revenue	5,000
Insurance service expenses	(3,400)
Net expense from reinsurance	(500)
Insurance service result	**1,100**
Investment return	200
Other operating costs	(300)
Finance costs	(100)
Profit before tax	**900**
Tax expense	(200)
Net income	**700**

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IFRS Income Statement

Insurance revenue	5,000
Insurance service expenses	(3,400)
Net expense from reinsurance	(500)
Insurance service result	**1,100**
Investment return	200
Other operating costs	(300)
Finance costs	(100)
Profit before tax	**900**
Tax expense	(200)
Net income	**700**

Required subtotal under IFRS

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IFRS Income Statement

Insurance revenue	5,000
Insurance service expenses	(3,400)
Net expense from reinsurance	(500)
Insurance service result	**1,100**
Investment return	200
Other operating costs	(300)
Finance costs	(100)
Profit before tax	**900**
Tax expense	(200)
Net income	**700**

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IFRS Income Statement

Reinsurance is included separately ← KEY DIFFERENCES → **Underwriting income** and **expenses** presented separately

Insurance revenue	5,000
Insurance service expenses	(3,400)
Net expense from reinsurance	(500)
Insurance service result	**1,100**
Investment return	200
Other operating costs	(300)
Finance costs	(100)
Profit before tax	**900**
Tax expense	(200)
Net income	**700**

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IFRS Balance Sheet

More aggregated than a US GAAP balance sheet

Investments	5,000
Premiums receivable	1,000
Reinsurance assets	1,000
Total assets	**7,000**
Insurance contract liabilities	5,000
Financial liabilities	1,000
Equity	1,000
Total liabilities and equity	**7,000**

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IFRS Balance Sheet

1

No deferred acquisition costs

- These are **deducted from insurance reserves** and **included net within liabilities**

Investments	5,000
Premiums receivable	1,000
Reinsurance assets	1,000
Total assets	**7,000**
Insurance contract liabilities	5,000
Financial liabilities	1,000
Equity	1,000
Total liabilities and equity	**7,000**

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IFRS Balance Sheet

2

Single line for **reinsurance assets**

- IFRS requires **reinsurance recoverables** and **prepaid reinsurance premiums** to be **aggregated** together

Investments	5,000
Premiums receivable	1,000
Reinsurance assets	1,000
Total assets	**7,000**
Insurance contract liabilities	5,000
Financial liabilities	1,000
Equity	1,000
Total liabilities and equity	**7,000**

IFRS Balance Sheet

3

No unearned premiums reserve or **claims reserve**

- IFRS requires these to be **aggregated** together as **insurance contract liabilities**
- Reflects the **net future revenues and expenses** associated with insurance policies

Investments	5,000
Premiums receivable	1,000
Reinsurance assets	1,000
Total assets	**7,000**
Insurance contract liabilities	5,000
Financial liabilities	1,000
Equity	1,000
Total liabilities and equity	**7,000**

Life Insurance Fundamentals

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1 2 3

Accounting fundamentals for life insurance

(long duration insurance contracts)

These apply for both **US GAAP** and **IFRS**

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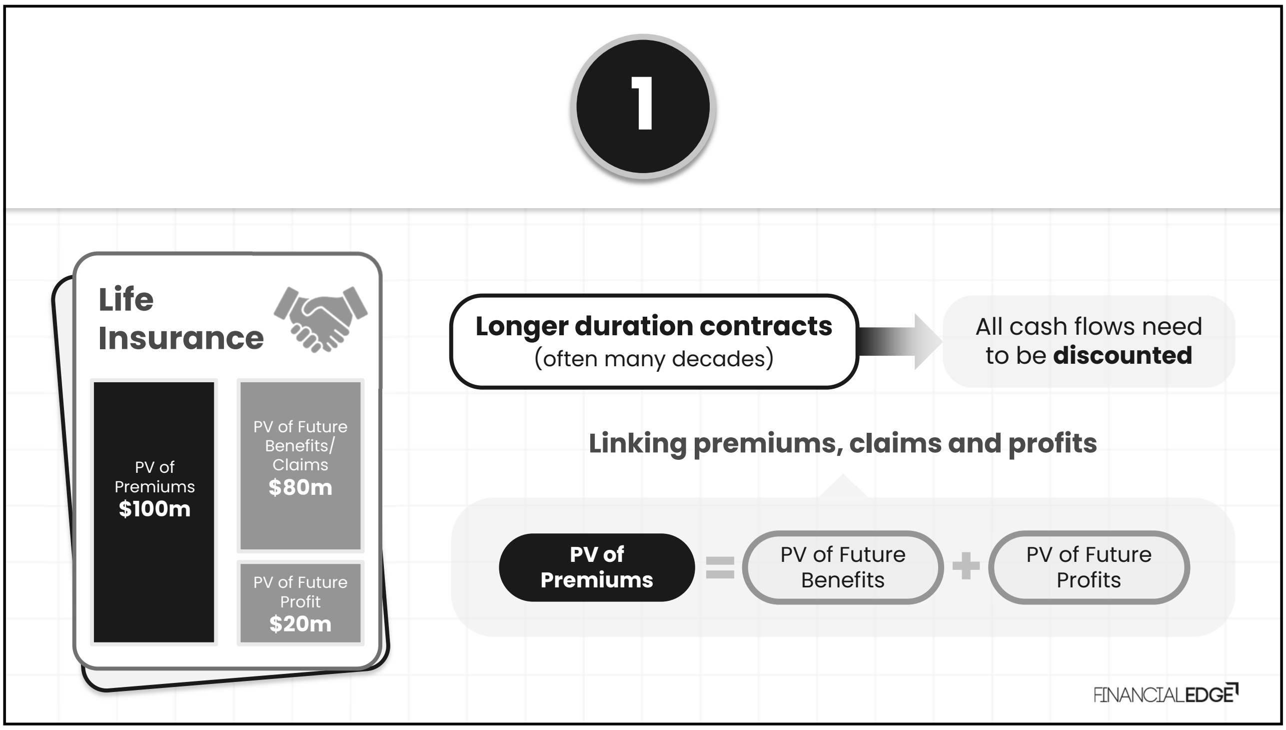
1
Life Insurance
PV of Premiums
$100m
PV of Future Benefits/ Claims
$80m
PV of Future Profit
$20m
Longer duration contracts
(often many decades)
All cash flows need to be discounted
Linking premiums, claims and profits
PV of Premiums
=
PV of Future Benefits
+
PV of Future Profits
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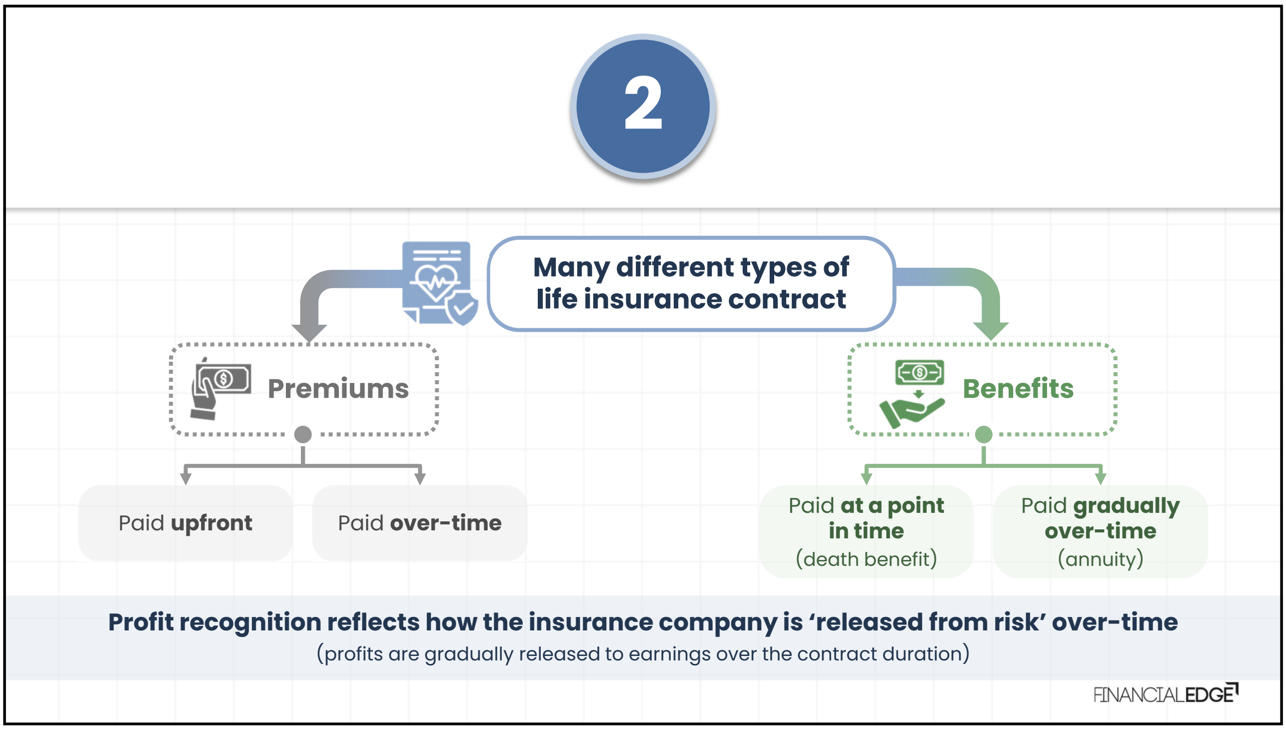
2
Many different types of life insurance contract
Premiums
Paid upfront
Paid over-time
Benefits
Paid at a point in time
(death benefit)
Paid gradually over-time
(annuity)
Profit recognition reflects how the insurance company is 'released from risk' over-time
(profits are gradually released to earnings over the contract duration)
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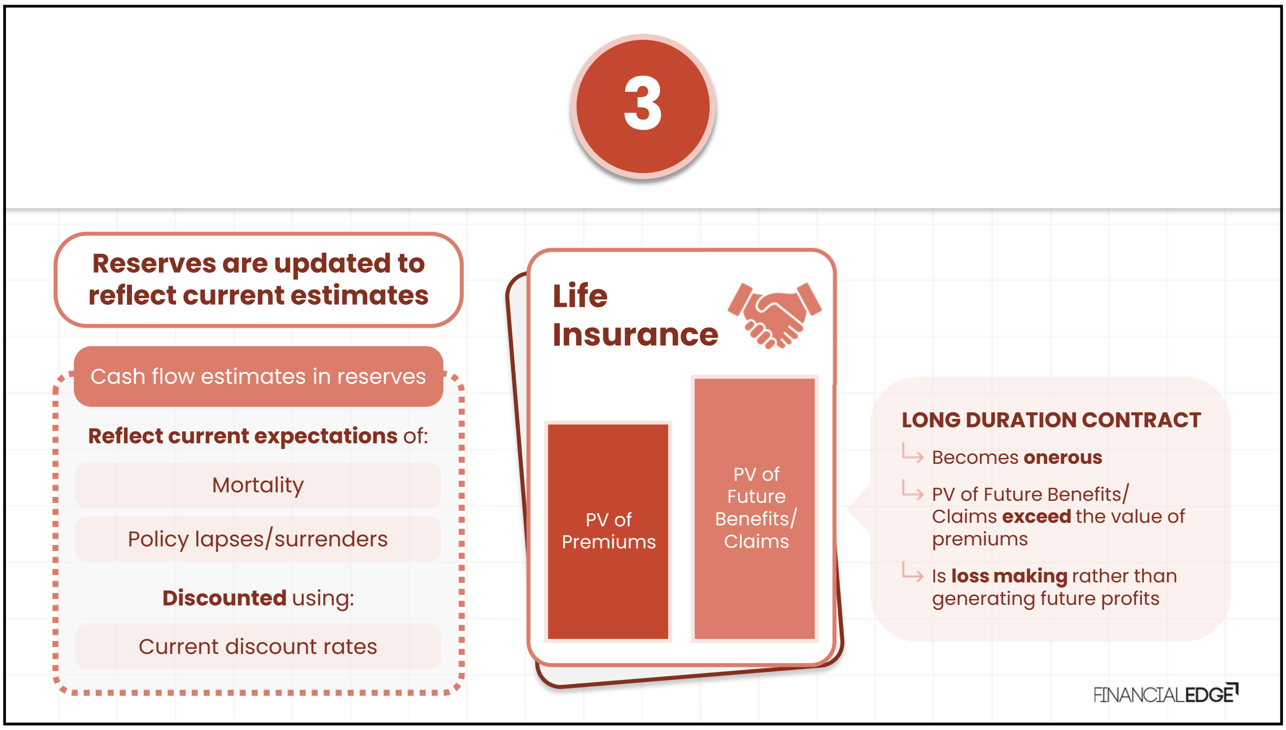

US GAAP Contract Types

US GAAP long duration contracts

Traditional Life

Significant insurance risk and **fixed premiums paid** over a similar period as the benefits are paid

E.g. term life insurance and whole life insurance

Limited-Payment

Significant insurance risk but **premium period is paid upfront or over a short duration** compared to benefits

E.g. annuities

Universal Life

Significant insurance risk but **premiums are flexible** and policy values are not guaranteed

Guaranteed interest rate may be offered

Each has modified accounting for determining **insurance reserves** and **how profits are 'earned'**

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US GAAP Traditional Life

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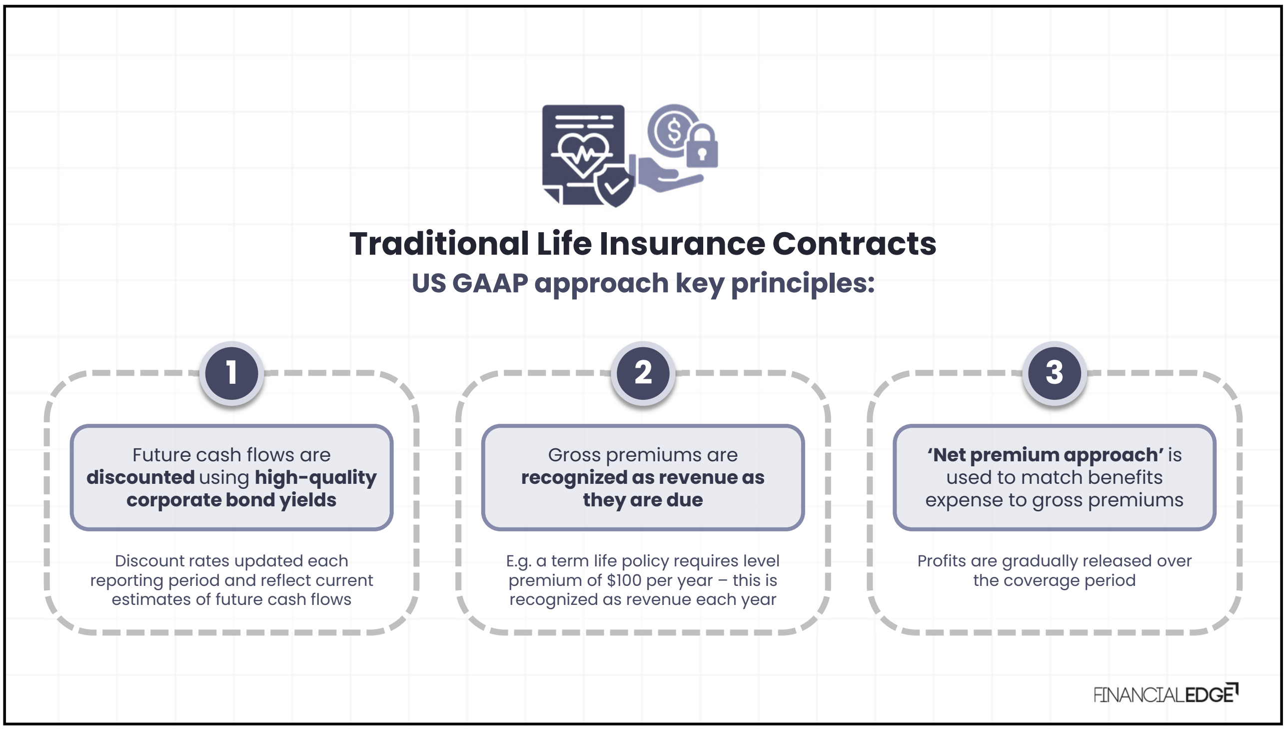
Traditional Life Insurance Contracts
US GAAP approach key principles:
1
Future cash flows are **discounted** using **high-quality corporate bond yields**
Discount rates updated each reporting period and reflect current estimates of future cash flows
2
Gross premiums are **recognized as revenue as they are due**
E.g. a term life policy requires level premium of $100 per year – this is recognized as revenue each year
3
'Net premium approach' is used to match benefits expense to gross premiums
Profits are gradually released over the coverage period
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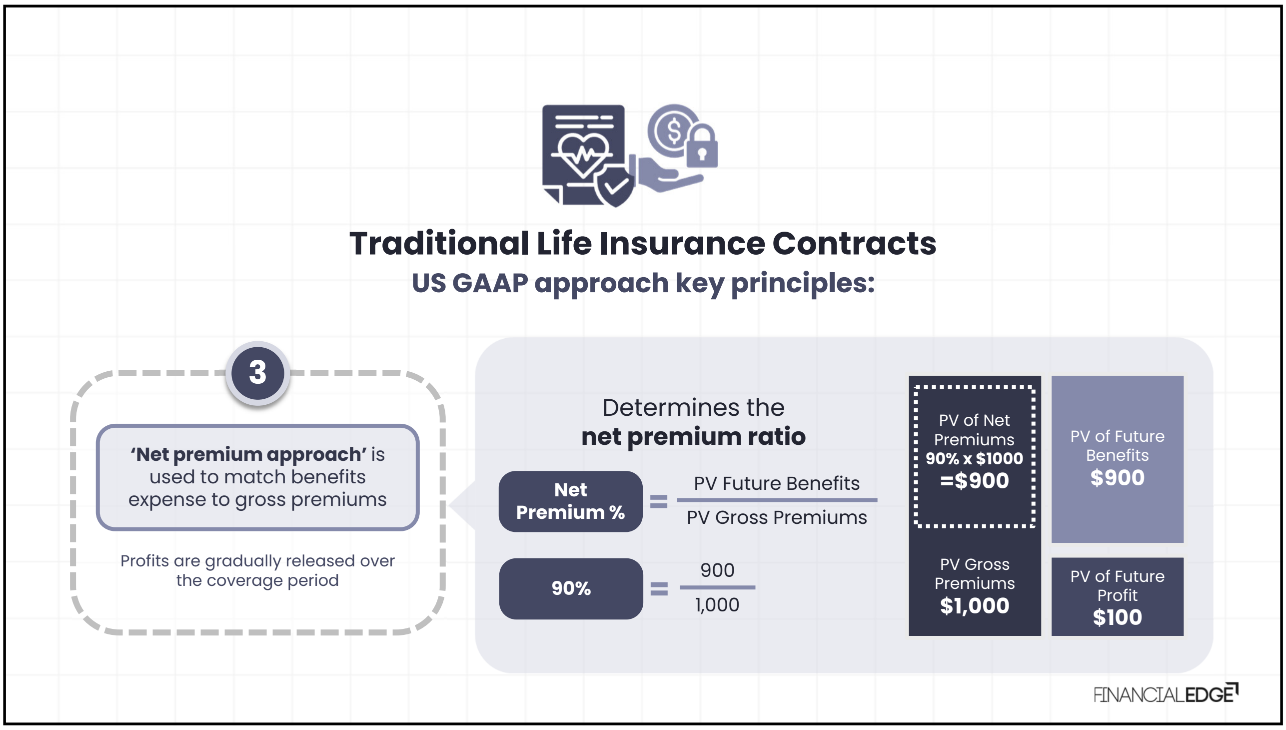
Traditional Life Insurance Contracts
US GAAP approach key principles:
3
'Net premium approach' is used to match benefits expense to gross premiums
Profits are gradually released over the coverage period
Determines the
net premium ratio
Net Premium % = PV Future Benefits / PV Gross Premiums
90% = 900 / 1,000
PV of Net Premiums 90% x $1000 =$900
PV of Future Benefits $900
PV Gross Premiums $1,000
PV of Future Profit $100
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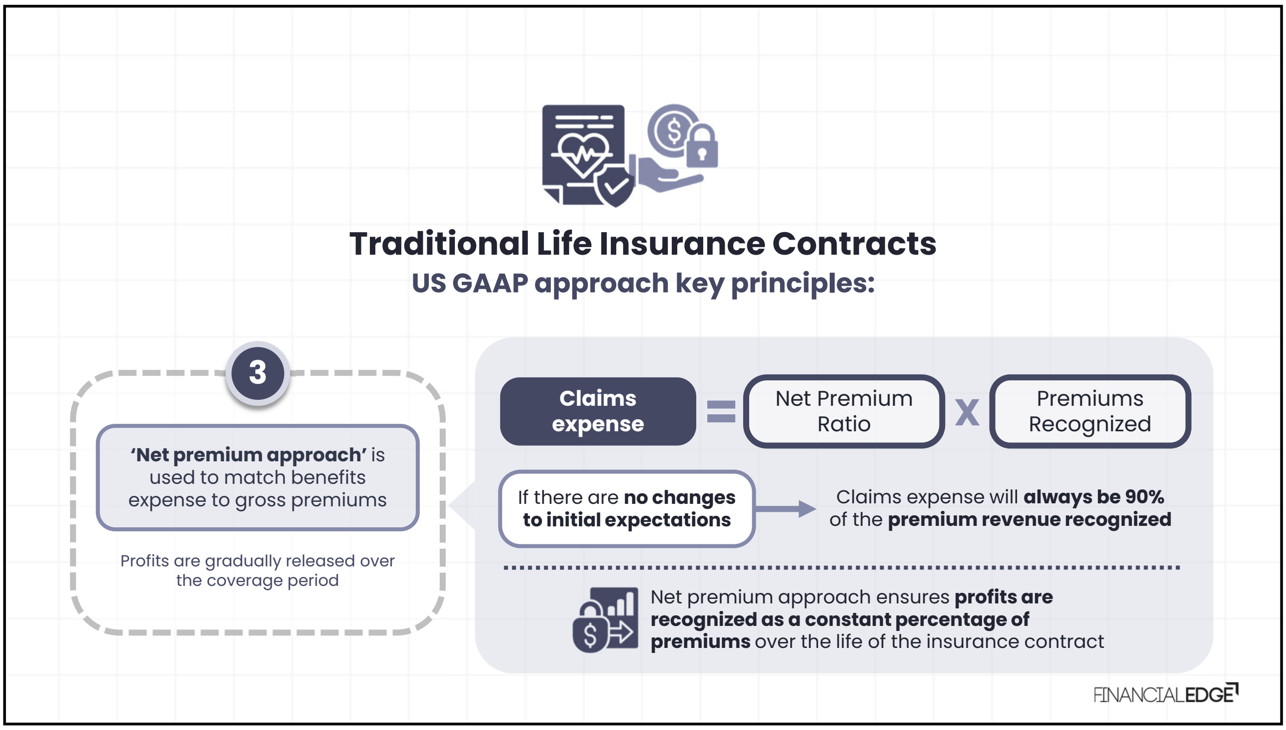
Traditional Life Insurance Contracts
US GAAP approach key principles:
3
'Net premium approach' is used to match benefits expense to gross premiums
Profits are gradually released over the coverage period
Claims expense = Net Premium Ratio x Premiums Recognized
If there are no changes to initial expectations
Claims expense will always be 90% of the premium revenue recognized
Net premium approach ensures profits are recognized as a constant percentage of premiums over the life of the insurance contract
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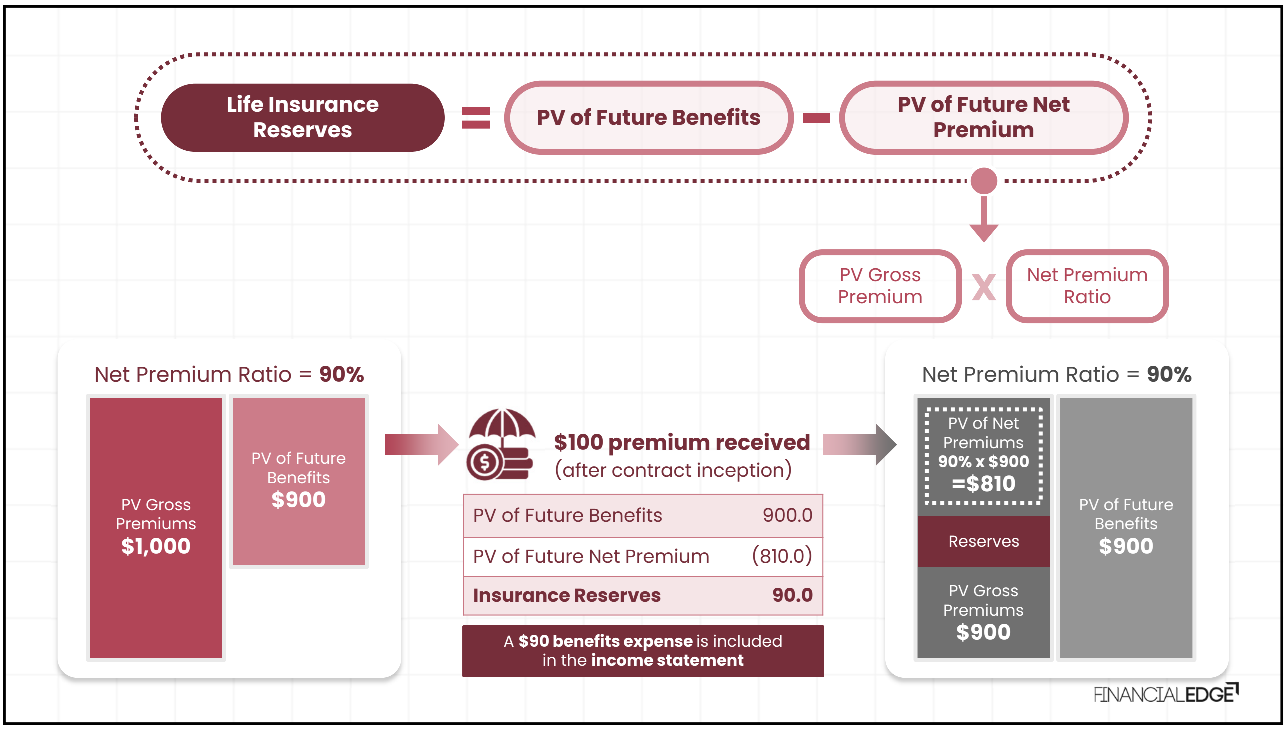
Life Insurance Reserves = PV of Future Benefits – PV of Future Net Premium
PV Gross Premium x Net Premium Ratio
Net Premium Ratio = 90%
PV Gross Premiums $1,000
PV of Future Benefits $900
$100 premium received
(after contract inception)
PV of Future Benefits 900.0
PV of Future Net Premium (810.0)
Insurance Reserves 90.0
A $90 benefits expense is included in the income statement
Net Premium Ratio = 90%
PV of Net Premiums 90% x $900 =$810
Reserves
PV Gross Premiums $900
PV of Future Benefits $900
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US GAAP Updating Assumptions

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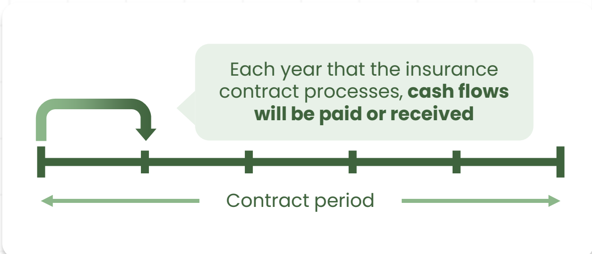
What happens if cash flow expectations change?

The net premium ratio is updated each year to reflect current cash flow expectations



Revised

$$\text{Net Premium \%} = \frac{\text{PV Actual + Future Benefits}}{\text{PV Actual + Gross Premiums}}$$

- Used in the calculation of reserves going forward
- Only cash flows are updated
- Discount rate remains the same – it is 'locked in'

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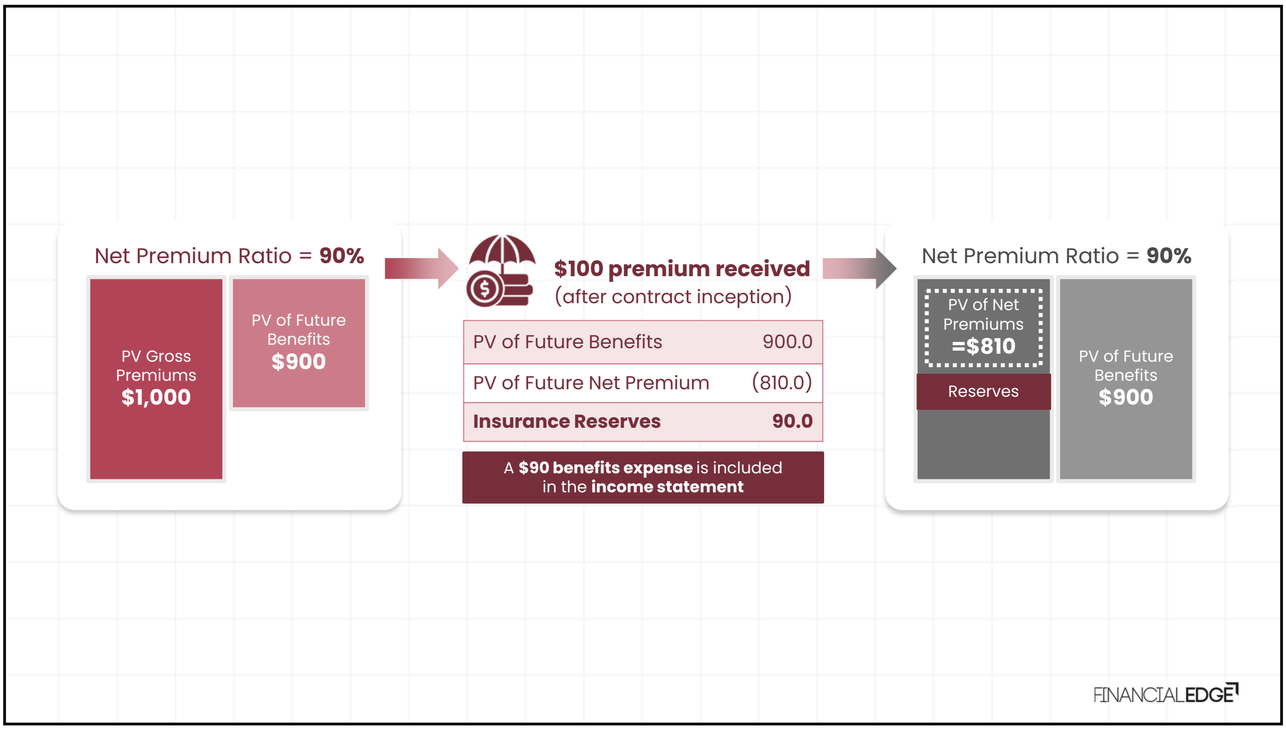
Net Premium Ratio = 90%
PV Gross Premiums $1,000
PV of Future Benefits $900
$100 premium received
(after contract inception)
PV of Future Benefits 900.0
PV of Future Net Premium (810.0)
Insurance Reserves 90.0
A $90 benefits expense is included in the income statement
Net Premium Ratio = 90%
PV of Net Premiums =$810
Reserves
PV of Future Benefits $900
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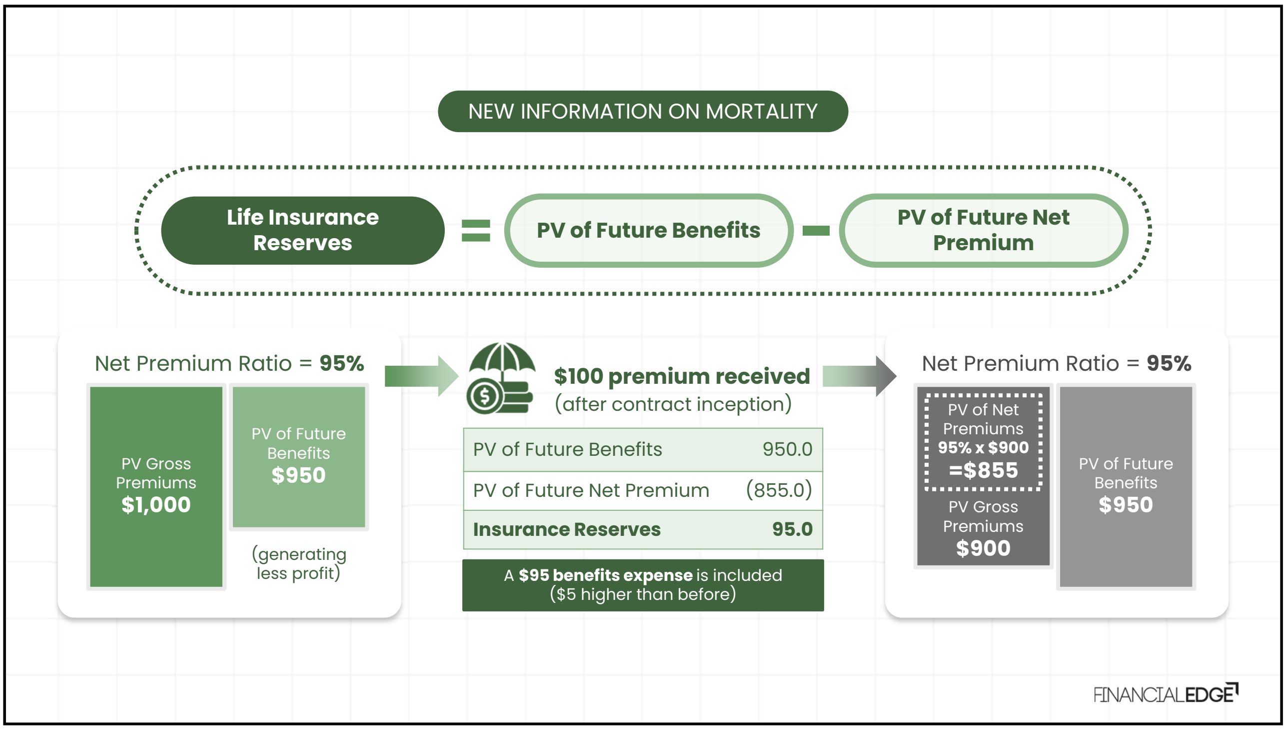
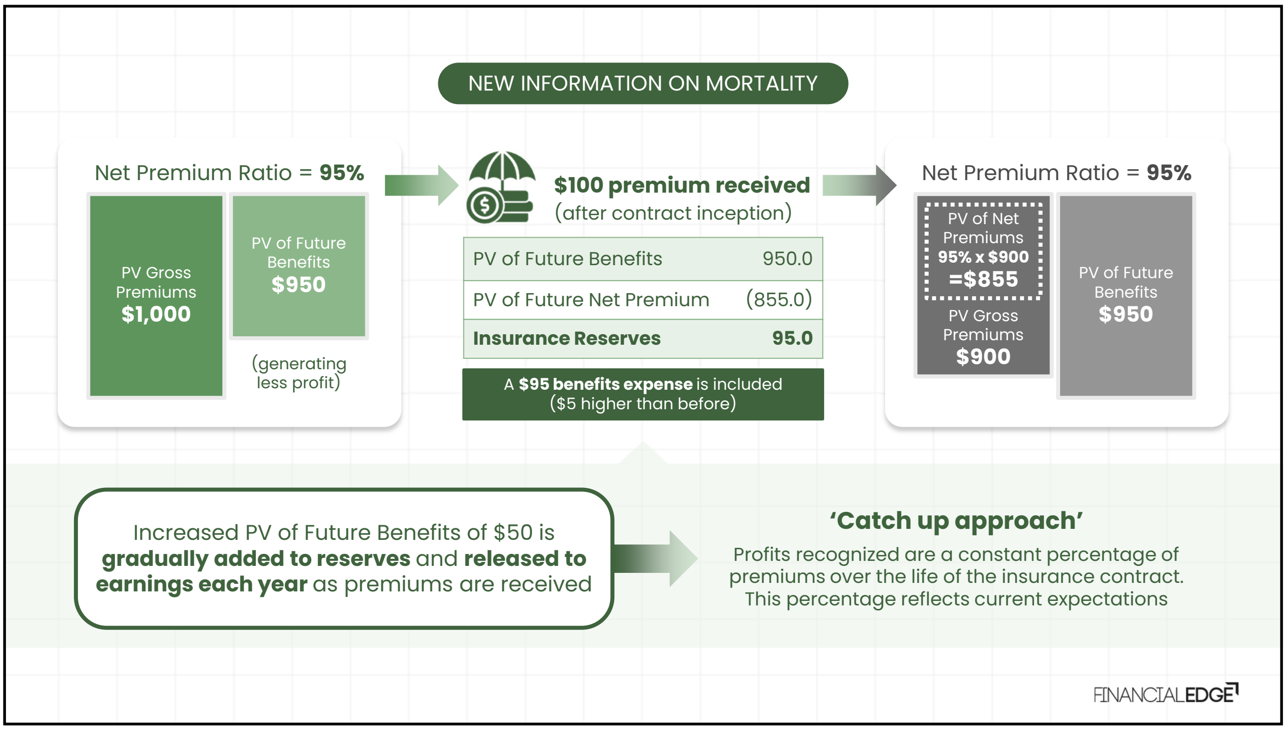

NEW INFORMATION ON MORTALITY
Life Insurance Reserves = PV of Future Benefits − PV of Future Net Premium
Net Premium Ratio = 95%
PV Gross Premiums $1,000
PV of Future Benefits $950
(generating less profit)
$100 premium received
(after contract inception)
PV of Future Benefits 950.0
PV of Future Net Premium (855.0)
Insurance Reserves 95.0
A $95 benefits expense is included ($5 higher than before)
Net Premium Ratio = 95%
PV of Net Premiums 95% x $900 =$855
PV Gross Premiums $900
PV of Future Benefits $950
FINANCIALEDGE


NEW INFORMATION ON MORTALITY
Net Premium Ratio = 95%
PV Gross Premiums $1,000
PV of Future Benefits $950
(generating less profit)
$100 premium received
(after contract inception)
PV of Future Benefits 950.0
PV of Future Net Premium (855.0)
Insurance Reserves 95.0
A $95 benefits expense is included ($5 higher than before)
Net Premium Ratio = 95%
PV of Net Premiums 95% x $900 =$855
PV Gross Premiums $900
PV of Future Benefits $950
Increased PV of Future Benefits of $50 is gradually added to reserves and released to earnings each year as premiums are received
'Catch up approach'
Profits recognized are a constant percentage of premiums over the life of the insurance contract. This percentage reflects current expectations
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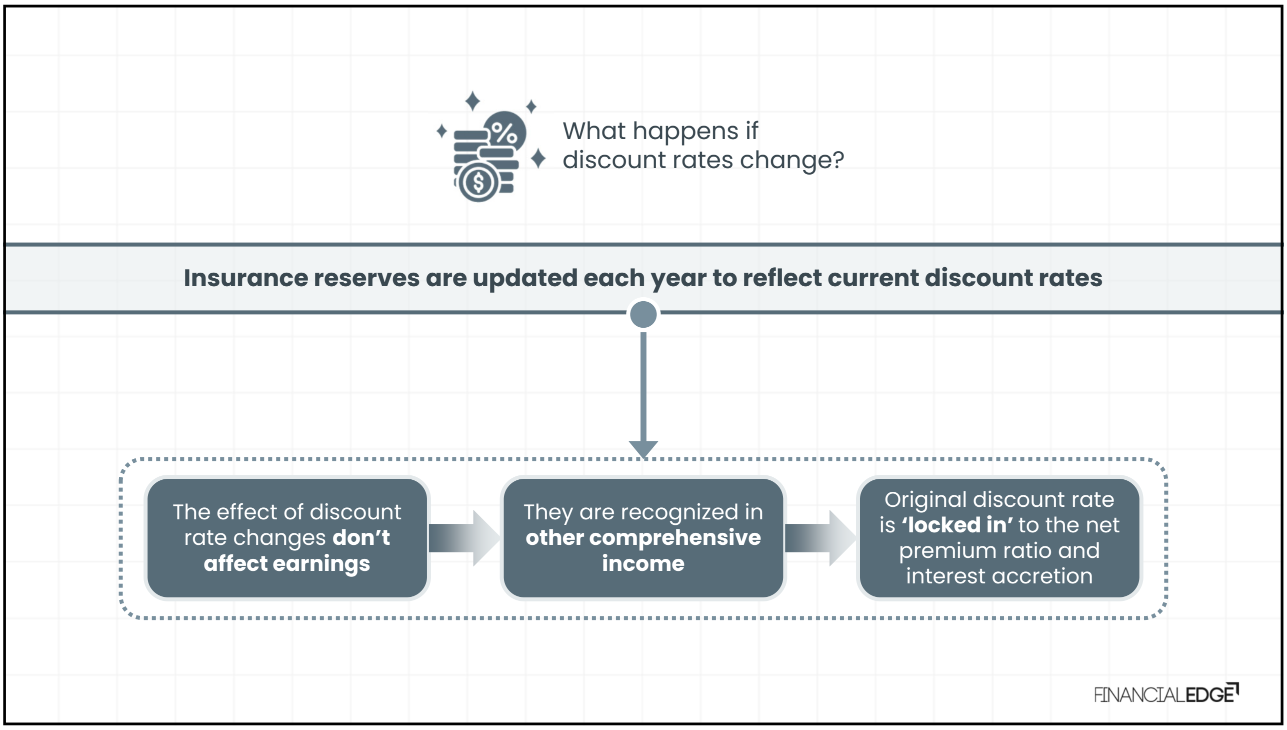
What happens if discount rates change?
Insurance reserves are updated each year to reflect current discount rates
The effect of discount rate changes don't affect earnings
They are recognized in other comprehensive income
Original discount rate is 'locked in' to the net premium ratio and interest accretion
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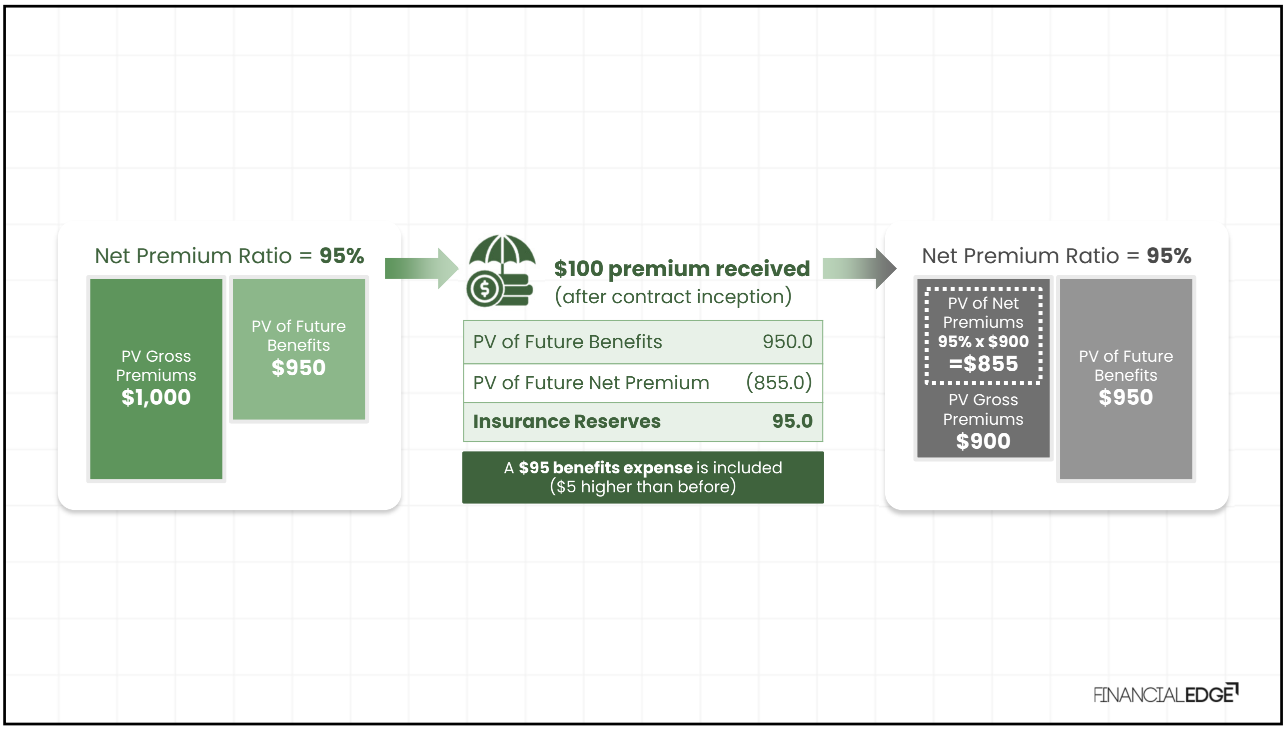
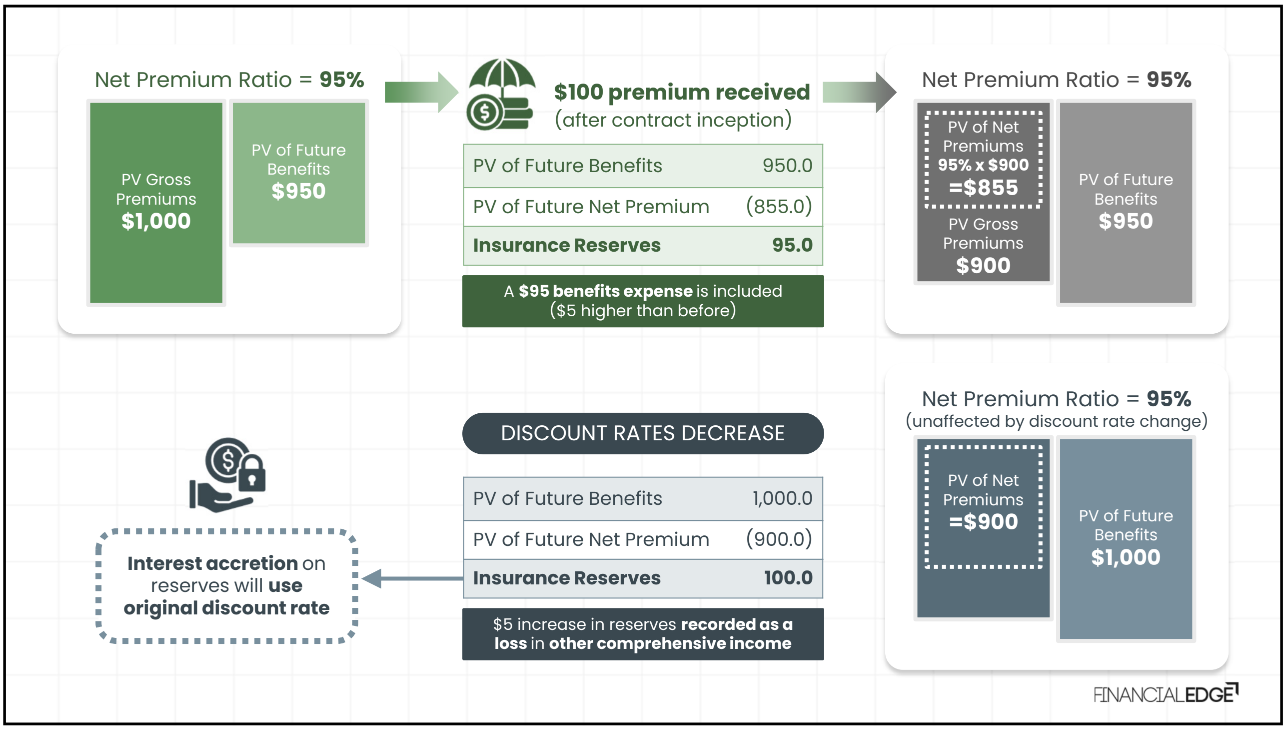


Net Premium Ratio = 95%
PV Gross Premiums $1,000
PV of Future Benefits $950
$100 premium received
(after contract inception)
PV of Future Benefits 950.0
PV of Future Net Premium (855.0)
Insurance Reserves 95.0
A $95 benefits expense is included
($5 higher than before)
Net Premium Ratio = 95%
PV of Net Premiums 95% x $900 =$855
PV Gross Premiums $900
PV of Future Benefits $950



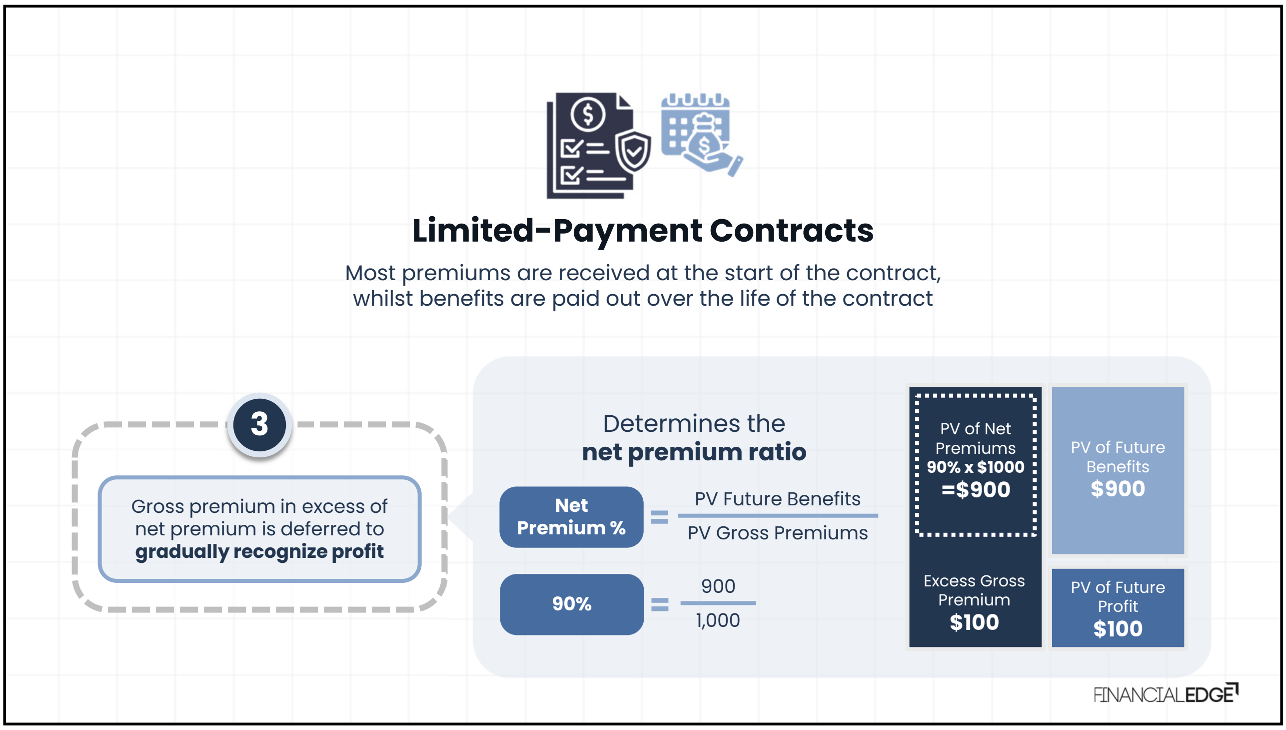
Net Premium Ratio = 95%
PV Gross Premiums $1,000
PV of Future Benefits $950
$100 premium received
(after contract inception)
PV of Future Benefits 950.0
PV of Future Net Premium (855.0)
Insurance Reserves 95.0
A $95 benefits expense is included
($5 higher than before)
Net Premium Ratio = 95%
PV of Net Premiums 95% x $900 =$855
PV Gross Premiums $900
PV of Future Benefits $950
DISCOUNT RATES DECREASE
PV of Future Benefits 1,000.0
PV of Future Net Premium (900.0)
Insurance Reserves 100.0
$5 increase in reserves recorded as a loss in other comprehensive income
Interest accretion on reserves will use original discount rate
Net Premium Ratio = 95%
(unaffected by discount rate change)
PV of Net Premiums =$900
PV of Future Benefits $1,000

US GAAP Limited Payment

Limited-Payment Contracts

Most premiums are received at the start of the contract, whilst benefits are paid out over the life of the contract

1. Future cash flows are **discounted** using **high-quality corporate bond yields**
2. **'Net premium approach'** is used to **spread the contract profit** over the contract life
3. Gross premium in excess of net premium is deferred to **gradually recognize profit**


Limited-Payment Contracts
Most premiums are received at the start of the contract, whilst benefits are paid out over the life of the contract
3
Gross premium in excess of net premium is deferred to **gradually recognize profit**
Determines the **net premium ratio**
Net Premium % = PV Future Benefits / PV Gross Premiums
90% = 900 / 1,000
PV of Net Premiums 90% x $1000 =$900
PV of Future Benefits $900
Excess Gross Premium $100
PV of Future Profit $100
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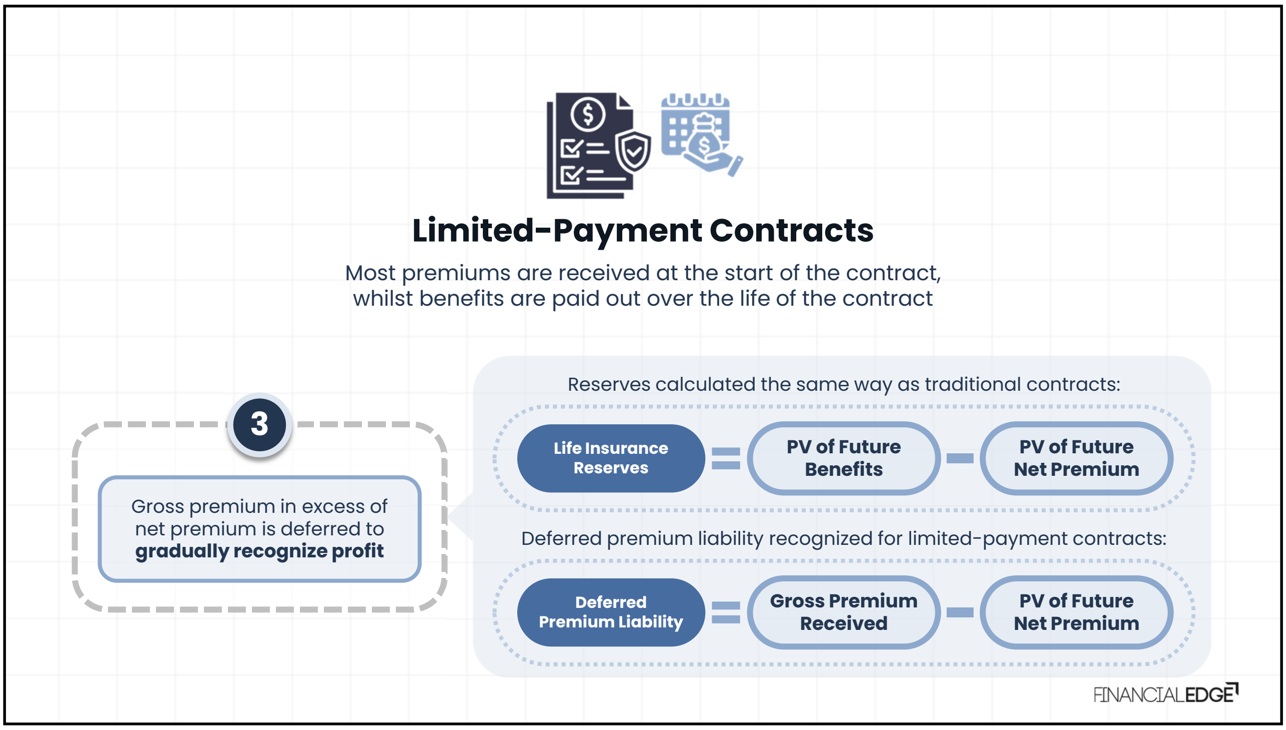
Limited-Payment Contracts
Most premiums are received at the start of the contract, whilst benefits are paid out over the life of the contract
3
Gross premium in excess of net premium is deferred to **gradually recognize profit**
Reserves calculated the same way as traditional contracts:
Life Insurance Reserves = PV of Future Benefits − PV of Future Net Premium
Deferred premium liability recognized for limited-payment contracts:
Deferred Premium Liability = Gross Premium Received − PV of Future Net Premium
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Limited-Payment Contracts

Most premiums are received at the start of the contract, whilst benefits are paid out over the life of the contract

3

Gross premium in excess of net premium is deferred to **gradually recognize profit**

$100 = $1,000 − $900

$100 deferred premium **gradually recognized in income** as benefits are paid

PV of Net Premiums **90% x $1000** **=$900**	PV of Future Benefits **$900**
Excess Gross Premium **$100**	PV of Future Profit **$100**

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US GAAP Universal Life

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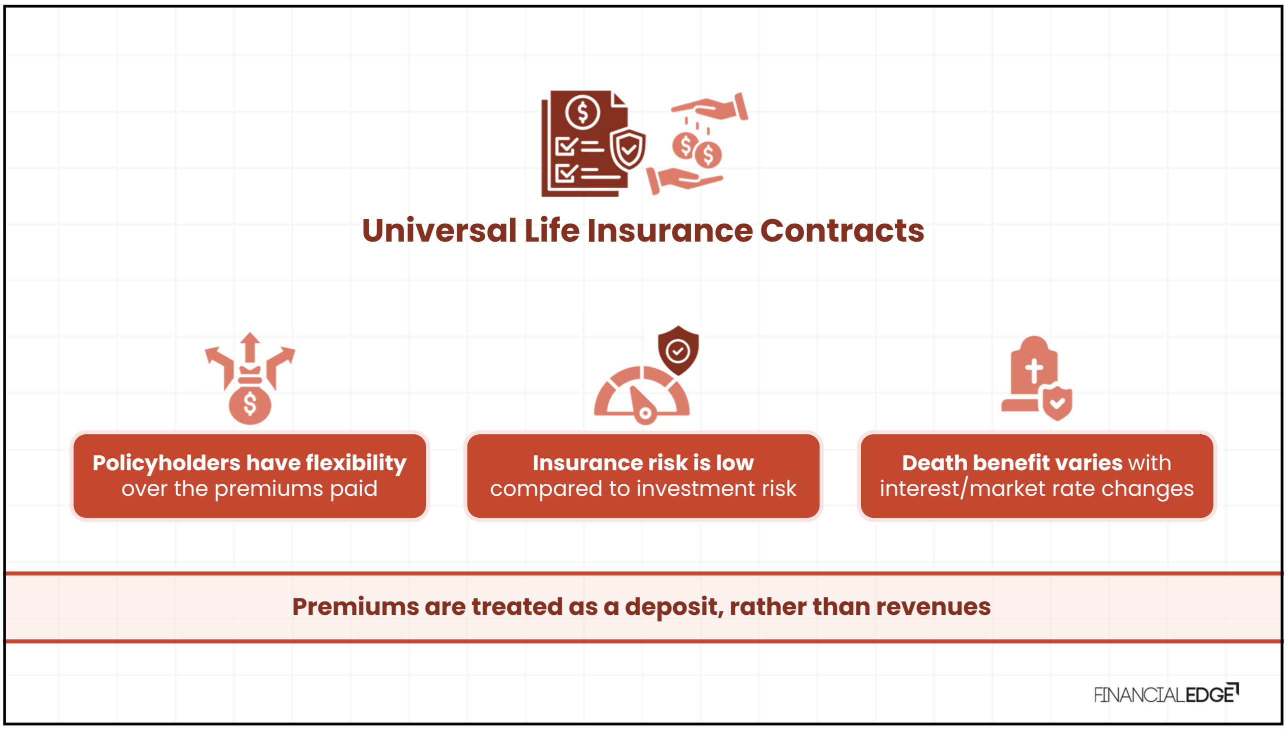
Universal Life Insurance Contracts
Policyholders have flexibility over the premiums paid
Insurance risk is low compared to investment risk
Death benefit varies with interest/market rate changes
Premiums are treated as a deposit, rather than revenues
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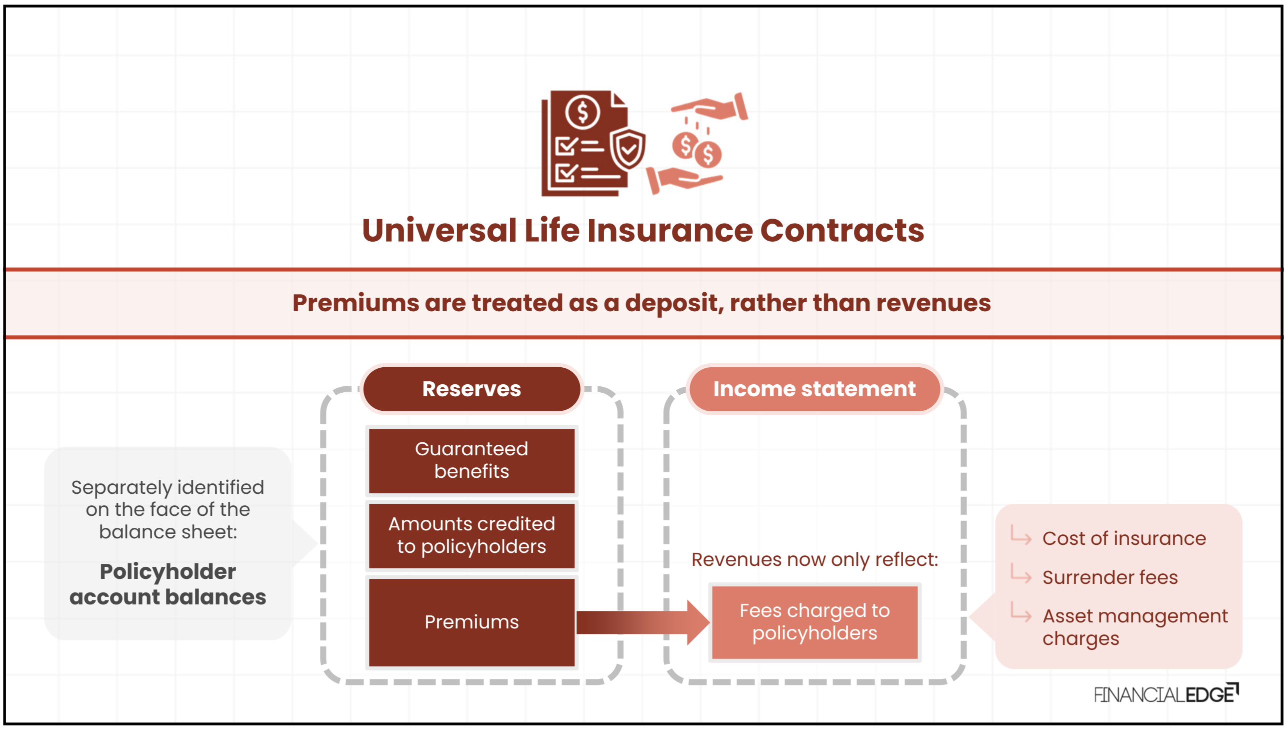
Universal Life Insurance Contracts
Premiums are treated as a deposit, rather than revenues
Separately identified on the face of the balance sheet:
Policyholder account balances
Reserves
Guaranteed benefits
Amounts credited to policyholders
Premiums
Income statement
Revenues now only reflect:
Fees charged to policyholders
Cost of insurance
Surrender fees
Asset management charges
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US GAAP Life Financial Statements

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US GAAP Life Insurance Balance Sheet

Largest item in assets

Typically **fixed income** instruments

- Less liquid than P&C
- Greater risk appetite

Investments and cash	410,000
Premiums receivable	30,000
Deferred acquisition costs	20,000
Separate account assets	140,000
Total assets	**600,000**
Future policy benefits	200,000
Policyholder account balances	230,000
Separate account liabilities	140,000
Equity	30,000
Total liabilities and equity	**600,000**

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US GAAP Life Insurance Balance Sheet

Premiums written that the policyholder has **not yet paid**

Investments and cash	410,000
Premiums receivable	30,000
Deferred acquisition costs	20,000
Separate account assets	140,000
Total assets	**600,000**
Future policy benefits	200,000
Policyholder account balances	230,000
Separate account liabilities	140,000
Equity	30,000
Total liabilities and equity	**600,000**

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US GAAP Life Insurance Balance Sheet

Amounts paid during the **acquisition of new policies**

More material than for P&C since costs are deferred and amortized over a **much longer coverage period**

Investments and cash	410,000
Premiums receivable	30,000
Deferred acquisition costs	20,000
Separate account assets	140,000
Total assets	**600,000**
Future policy benefits	200,000
Policyholder account balances	230,000
Separate account liabilities	140,000
Equity	30,000
Total liabilities and equity	**600,000**

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US GAAP Life Insurance Balance Sheet

Contract holder assumes **all the investment risk** and **directs the investment objectives**

Segregated funds
Hold investments on behalf of the policyholder and insurance company charges a fee

Investments and cash	410,000
Premiums receivable	30,000
Deferred acquisition costs	20,000
Separate account assets	140,000
Total assets	**600,000**
Future policy benefits	200,000
Policyholder account balances	230,000
Separate account liabilities	140,000
Equity	30,000
Total liabilities and equity	**600,000**

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US GAAP Life Insurance Balance Sheet

Insurance reserves for:

- **Term Life** Policies
- **Whole Life** Policies
- **Fixed Annuities**

Future benefits payable net of any deferred net premium

Investments and cash	410,000
Premiums receivable	30,000
Deferred acquisition costs	20,000
Separate account assets	140,000
Total assets	**600,000**
Future policy benefits	200,000
Policyholder account balances	230,000
Separate account liabilities	140,000
Equity	30,000
Total liabilities and equity	**600,000**

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US GAAP Life Insurance Balance Sheet

For policies like **Universal Life** contracts:

Policyholders have **flexibility over premiums paid**

Benefit is associated with account value **(low insurance risk)**

Investments and cash	410,000
Premiums receivable	30,000
Deferred acquisition costs	20,000
Separate account assets	140,000
Total assets	**600,000**
Future policy benefits	200,000
Policyholder account balances	230,000
Separate account liabilities	140,000
Equity	30,000
Total liabilities and equity	**600,000**

US GAAP Life Insurance Balance Sheet

Covered by **regulatory capital requirements**

Investments and cash	410,000
Premiums receivable	30,000
Deferred acquisition costs	20,000
Separate account assets	140,000
Total assets	**600,000**
Future policy benefits	200,000
Policyholder account balances	230,000
Separate account liabilities	140,000
Equity	30,000
Total liabilities and equity	**600,000**

US GAAP Life Insurance Income Statement

Premiums received for Traditional Life contracts and **amount deferred** for Annuity contracts

Premiums	45,000
Universal life and investment policy fees	5,000
Investment income	20,000
Total revenue	**70,000**
Policyholder benefits and claims	(45,000)
Interest credited to policyholder accounts	(10,000)
Operating costs	(10,000)
Total expenses	**(65,000)**
Tax expense	(2,000)
Net income	**3,000**

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US GAAP Life Insurance Income Statement

Fees received for Universal Life policies

And **fees charged on**:

- Investment products
- Managed funds
- Segregated accounts

Premiums	45,000
Universal life and investment policy fees	5,000
Investment income	20,000
Total revenue	**70,000**
Policyholder benefits and claims	(45,000)
Interest credited to policyholder accounts	(10,000)
Operating costs	(10,000)
Total expenses	**(65,000)**
Tax expense	(2,000)
Net income	**3,000**

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US GAAP Life Insurance Income Statement

Generated from **investments** in the **balance sheet**

Premiums	45,000
Universal life and investment policy fees	5,000
Investment income	20,000
Total revenue	**70,000**
Policyholder benefits and claims	(45,000)
Interest credited to policyholder accounts	(10,000)
Operating costs	(10,000)
Total expenses	**(65,000)**
Tax expense	(2,000)
Net income	**3,000**

US GAAP Life Insurance Income Statement

3 core revenue streams for a **life insurance business**

Premiums	45,000
Universal life and investment policy fees	5,000
Investment income	20,000
Total revenue	**70,000**
Policyholder benefits and claims	(45,000)
Interest credited to policyholder accounts	(10,000)
Operating costs	(10,000)
Total expenses	**(65,000)**
Tax expense	(2,000)
Net income	**3,000**

US GAAP Life Insurance Income Statement

Increase in reserves on existing policies including **interest accretion**

Claims & benefits on:

- **Term Life** insurance
- **Whole Life** insurance
- **Annuity** business

Premiums	45,000
Universal life and investment policy fees	5,000
Investment income	20,000
Total revenue	**70,000**
Policyholder benefits and claims	(45,000)
Interest credited to policyholder accounts	(10,000)
Operating costs	(10,000)
Total expenses	**(65,000)**
Tax expense	(2,000)
Net income	**3,000**

US GAAP Life Insurance Income Statement

For **Universal Life** contracts where the benefit is based on the **policyholder account balance**

Premiums	45,000
Universal life and investment policy fees	5,000
Investment income	20,000
Total revenue	**70,000**
Policyholder benefits and claims	(45,000)
Interest credited to policyholder accounts	(10,000)
Operating costs	(10,000)
Total expenses	**(65,000)**
Tax expense	(2,000)
Net income	**3,000**

US GAAP Life Insurance Income Statement

Includes overheads of the business:

- **Staff** costs
- **IT** costs
- **Head office** costs
- And amortization of **deferred acquisition costs**

Premiums	45,000
Universal life and investment policy fees	5,000
Investment income	20,000
Total revenue	**70,000**
Policyholder benefits and claims	(45,000)
Interest credited to policyholder accounts	(10,000)
Operating costs	(10,000)
Total expenses	**(65,000)**
Tax expense	(2,000)
Net income	**3,000**

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US GAAP Life Insurance Income Statement

Insurance companies have lower tax rates as:

- Some investment income and dividends are **tax deductible** or taxed at a **preferential rate**

Premiums	45,000
Universal life and investment policy fees	5,000
Investment income	20,000
Total revenue	**70,000**
Policyholder benefits and claims	(45,000)
Interest credited to policyholder accounts	(10,000)
Operating costs	(10,000)
Total expenses	**(65,000)**
Tax expense	(2,000)
Net income	**3,000**

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IFRS General Model

Life insurance contracts with **fixed premiums and benefits** (Traditional Life insurance and Fixed Annuities) use the **general model under IFRS**

IFRS General Model 3 Key Principles:

IFRS General Model 3 Key Principles:

1

Future cash flows are **discounted** using **high-quality corporate bond yields**

Discount rates updated each reporting period and reflect current estimates of future cash flows

2

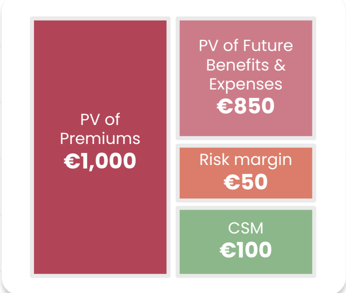
Contract profit or **contractual service margin ('CSM')** is calculated at the start

After deducting expenses, underwriting and acquisition costs, and risk margin due to insurance risk

3

CSM is released to the income statement based on the **proportion of benefits paid in each period**

Recorded on a net basis as 'insurance service revenues'



Model can be applied for all contracts with fixed premiums and benefits **regardless of cash flow timings**

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IFRS Reserves and Earnings

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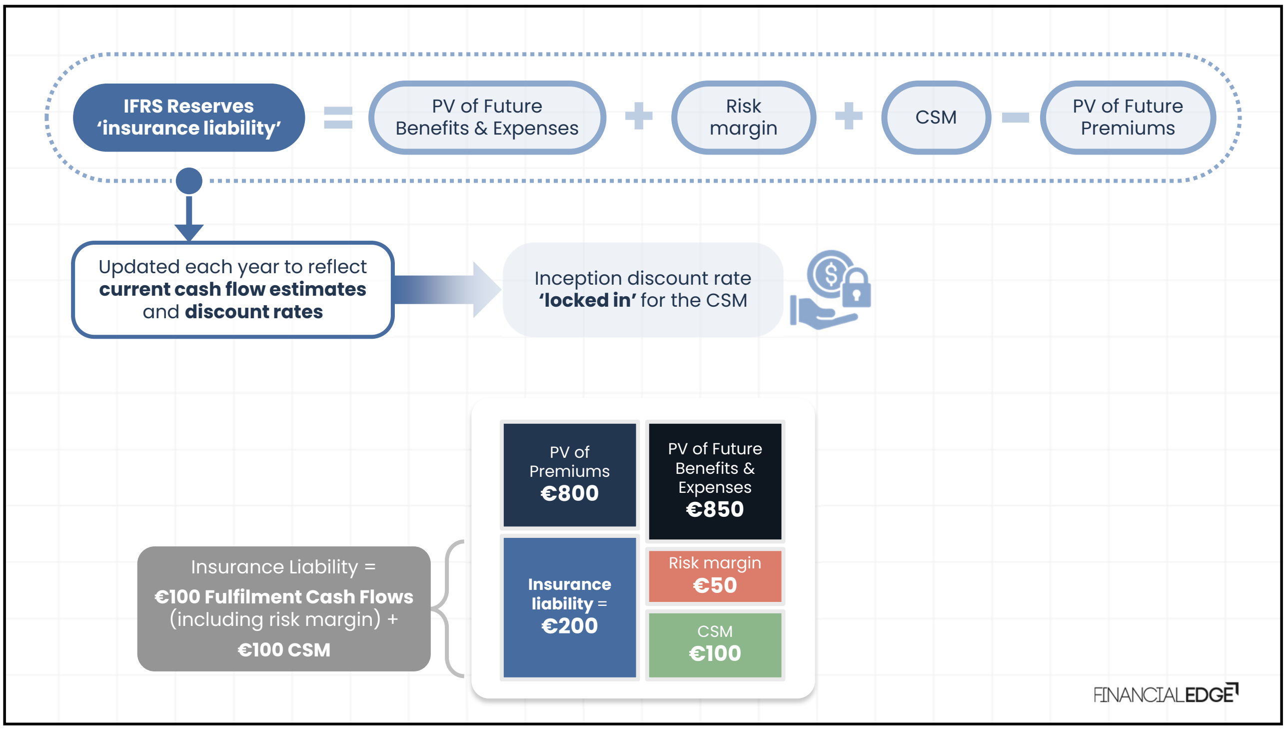
IFRS Reserves
'insurance liability'
=
PV of Future
Benefits & Expenses
+
Risk
margin
+
CSM
−
PV of Future
Premiums
Updated each year to reflect
current cash flow estimates
and discount rates
Inception discount rate
'locked in' for the CSM
PV of
Premiums
€800
PV of Future
Benefits &
Expenses
€850
Insurance
liability =
€200
Risk margin
€50
CSM
€100
Insurance Liability =
€100 Fulfilment Cash Flows
(including risk margin) +
€100 CSM
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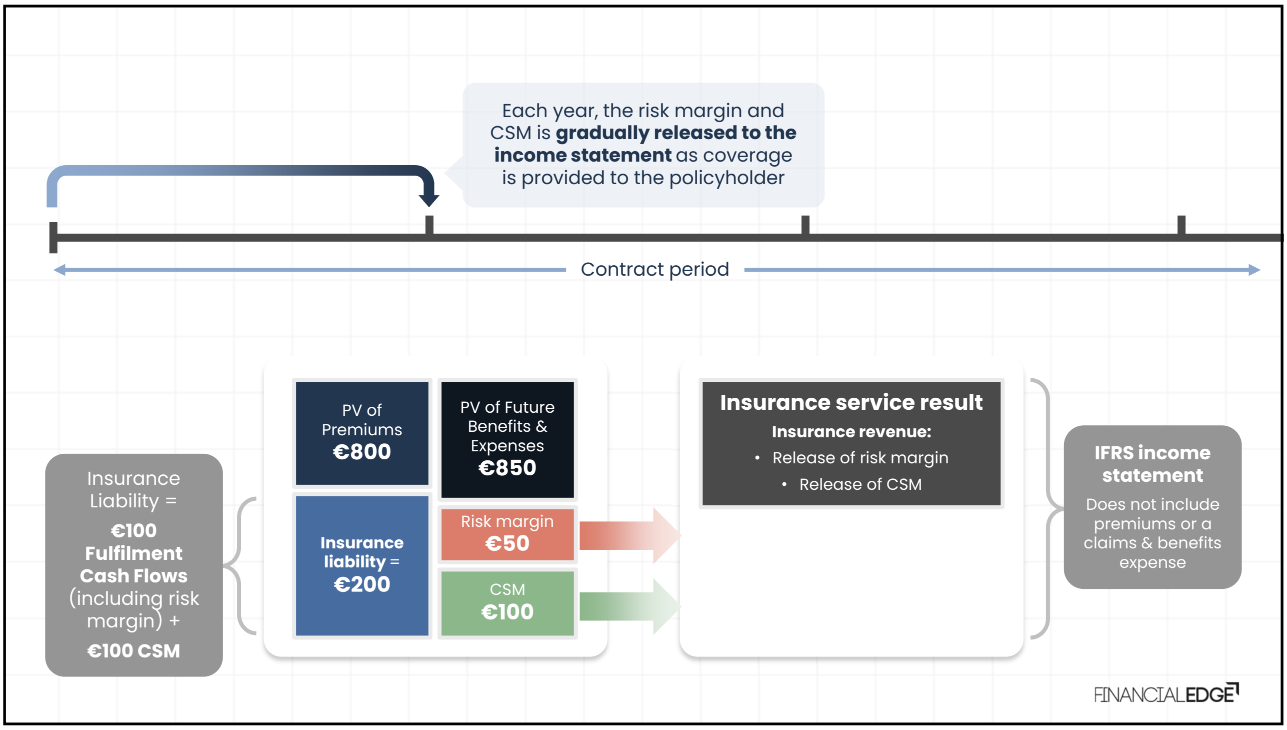
Each year, the risk margin and
CSM is gradually released to the
income statement as coverage
is provided to the policyholder
Contract period
PV of
Premiums
€800
PV of Future
Benefits &
Expenses
€850
Insurance
liability =
€200
Risk margin
€50
CSM
€100
Insurance
Liability =
€100
Fulfilment
Cash Flows
(including risk
margin) +
€100 CSM
Insurance service result
Insurance revenue:
• Release of risk margin
• Release of CSM
IFRS income
statement
Does not include
premiums or a
claims & benefits
expense
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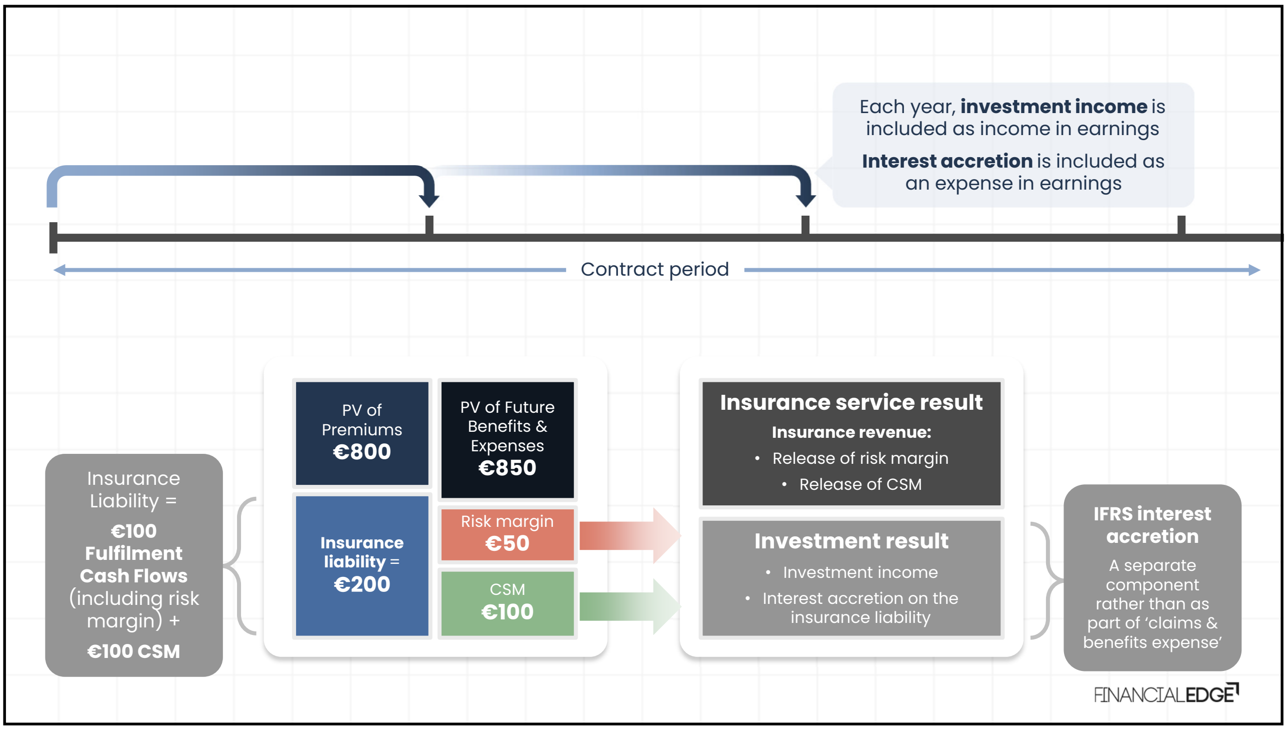
Each year, **investment income** is included as income in earnings
Interest accretion is included as an expense in earnings
Contract period
Insurance Liability =
€100 Fulfilment Cash Flows (including risk margin) +
€100 CSM
PV of Premiums
€800
PV of Future Benefits & Expenses
€850
Insurance liability =
€200
Risk margin
€50
CSM
€100
Insurance service result
Insurance revenue:
Release of risk margin
Release of CSM
Investment result
Investment income
Interest accretion on the insurance liability
IFRS interest accretion
A separate component rather than as part of 'claims & benefits expense'
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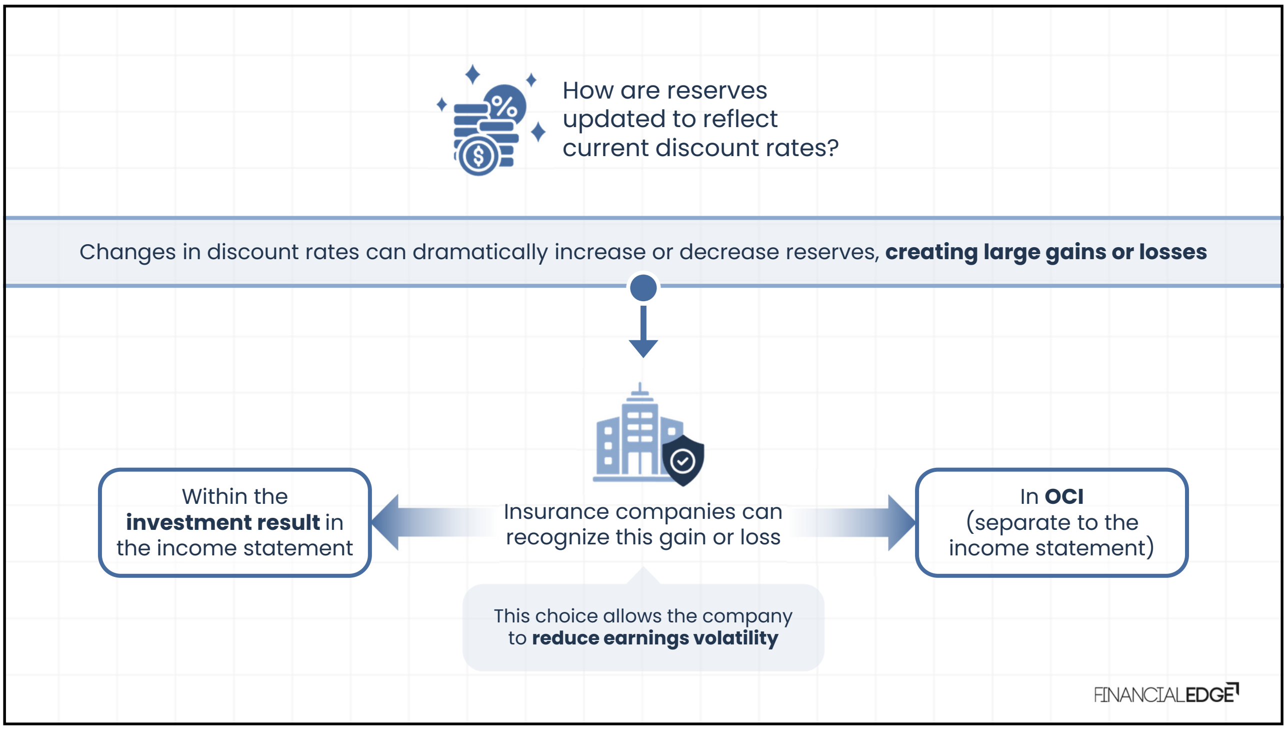
How are reserves updated to reflect current discount rates?
Changes in discount rates can dramatically increase or decrease reserves, **creating large gains or losses**
Within the **investment result** in the income statement
Insurance companies can recognize this gain or loss
In **OCI** (separate to the income statement)
This choice allows the company to **reduce earnings volatility**
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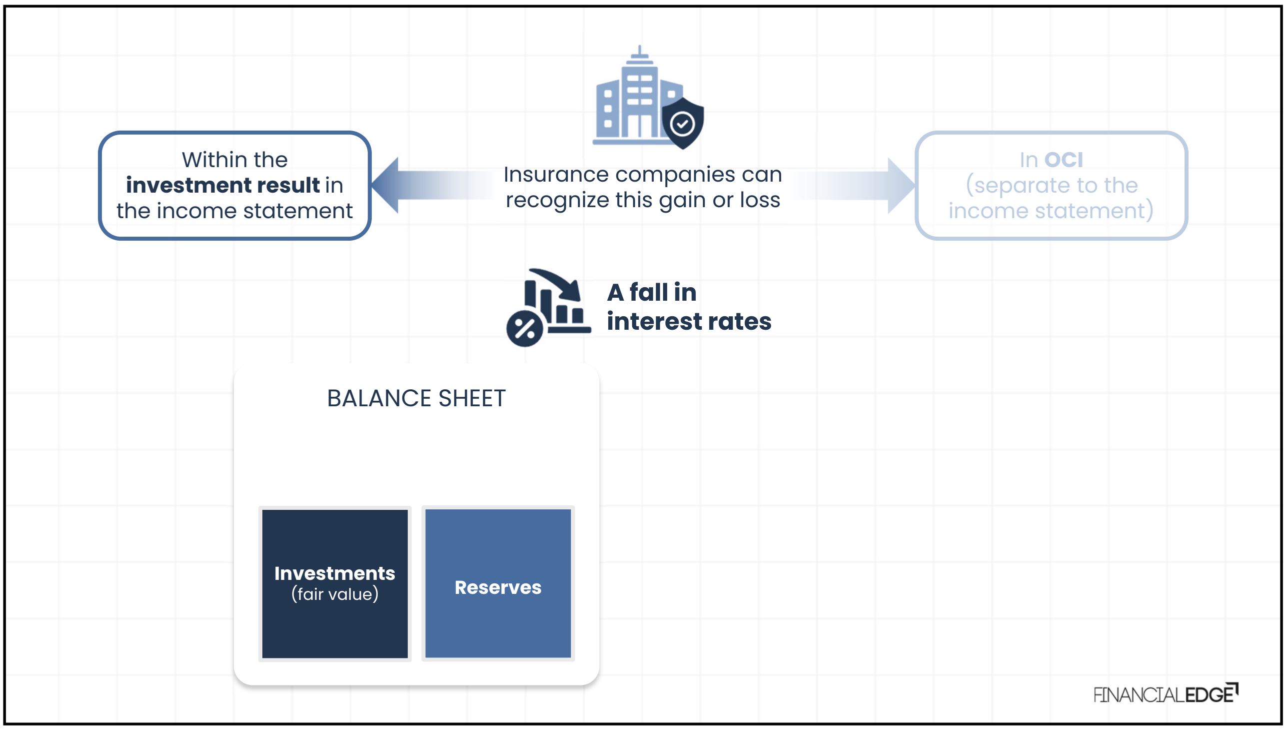
Within the
investment result in
the income statement
Insurance companies can
recognize this gain or loss
In **OCI**
(separate to the
income statement)
A fall in
interest rates
BALANCE SHEET
Investments
(fair value)
Reserves
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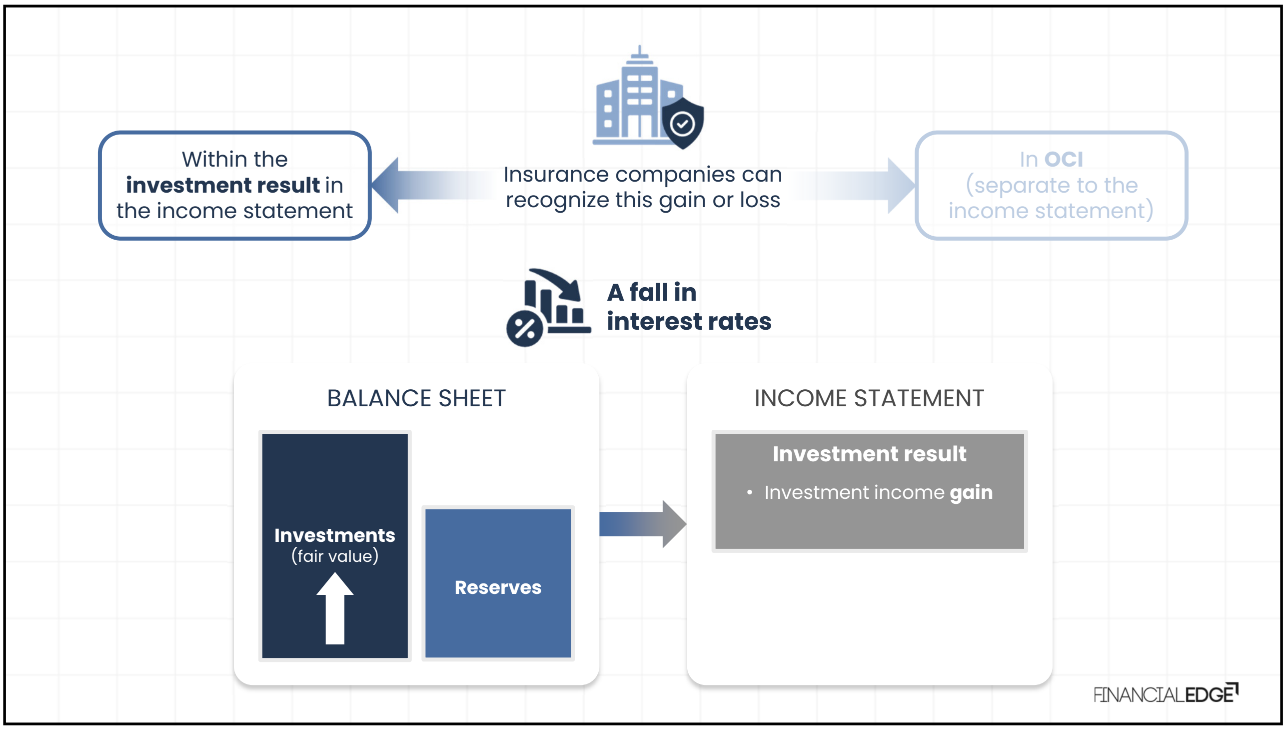
Within the
investment result in
the income statement
Insurance companies can
recognize this gain or loss
In **OCI**
(separate to the
income statement)
A fall in
interest rates
BALANCE SHEET
Investments
(fair value)
Reserves
INCOME STATEMENT
Investment result
• Investment income **gain**
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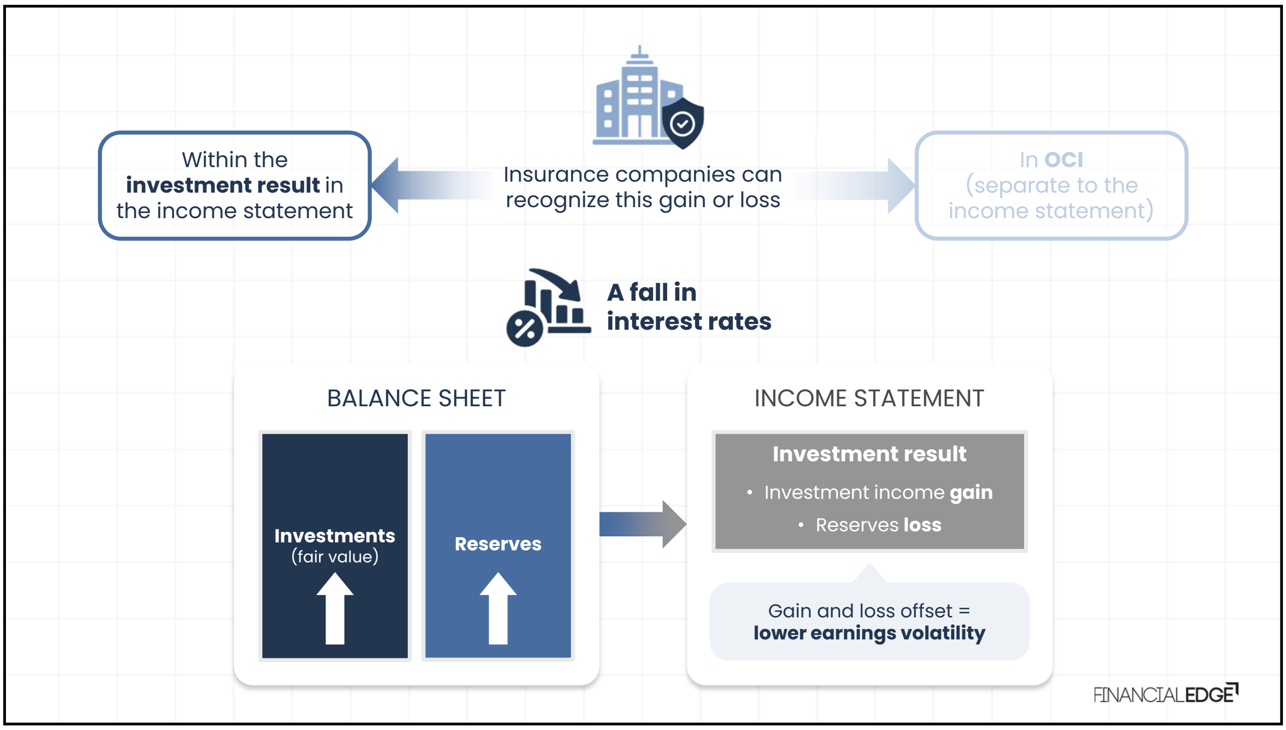
Within the investment result in the income statement
Insurance companies can recognize this gain or loss
In OCI (separate to the income statement)
A fall in interest rates
BALANCE SHEET
Investments (fair value)
Reserves
INCOME STATEMENT
Investment result
• Investment income gain
• Reserves loss
Gain and loss offset = lower earnings volatility
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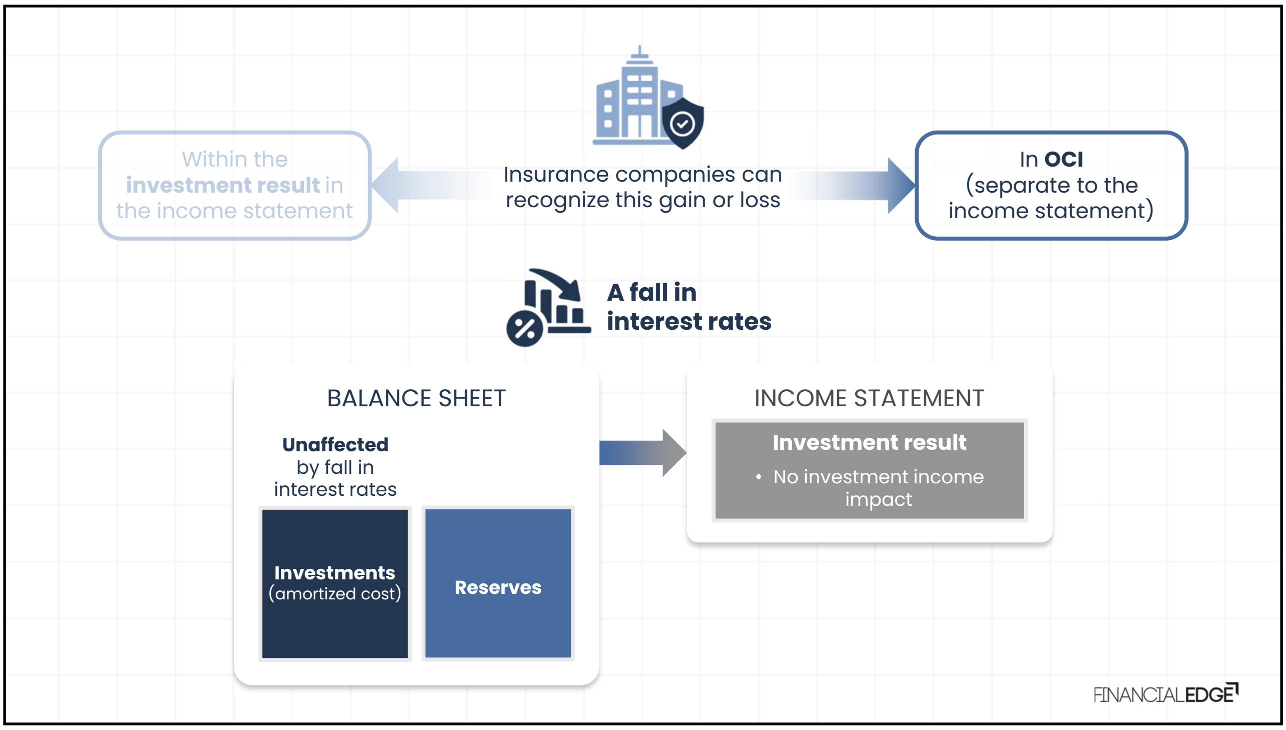
Within the investment result in the income statement
Insurance companies can recognize this gain or loss
In OCI (separate to the income statement)
A fall in interest rates
BALANCE SHEET
Unaffected by fall in interest rates
Investments (amortized cost)
Reserves
INCOME STATEMENT
Investment result
• No investment income impact
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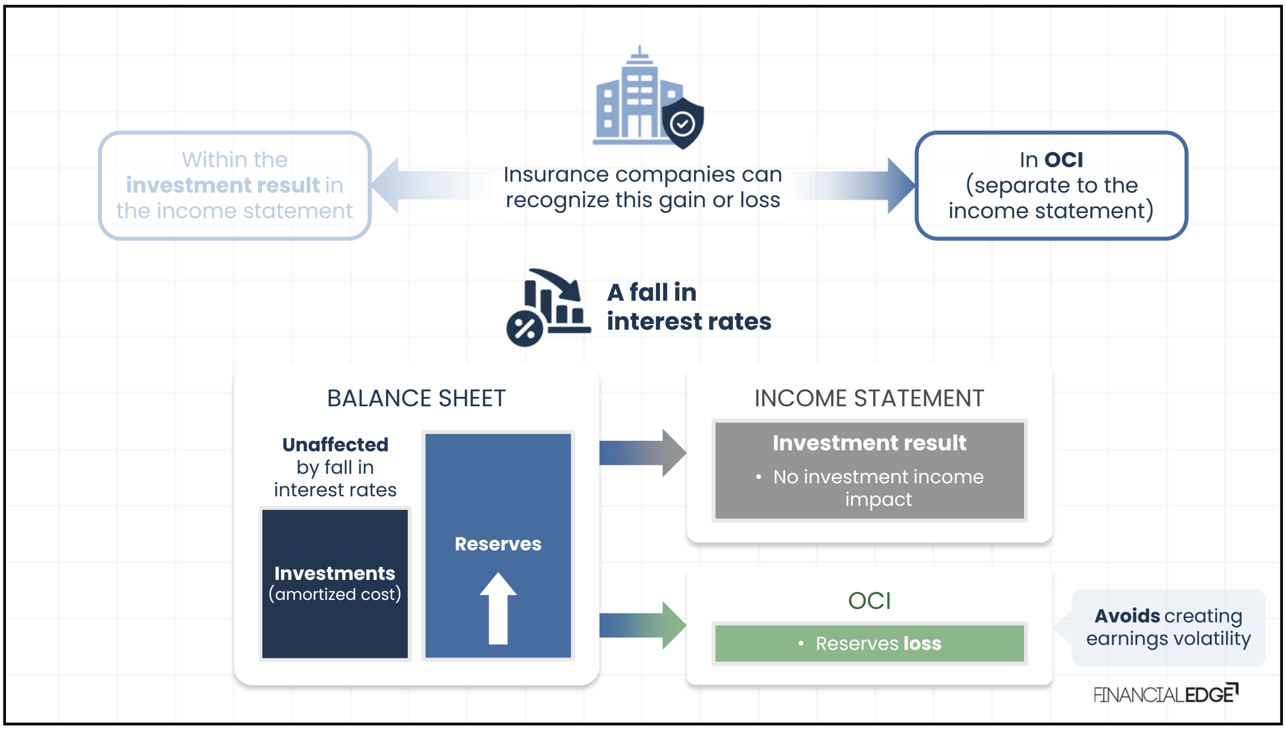
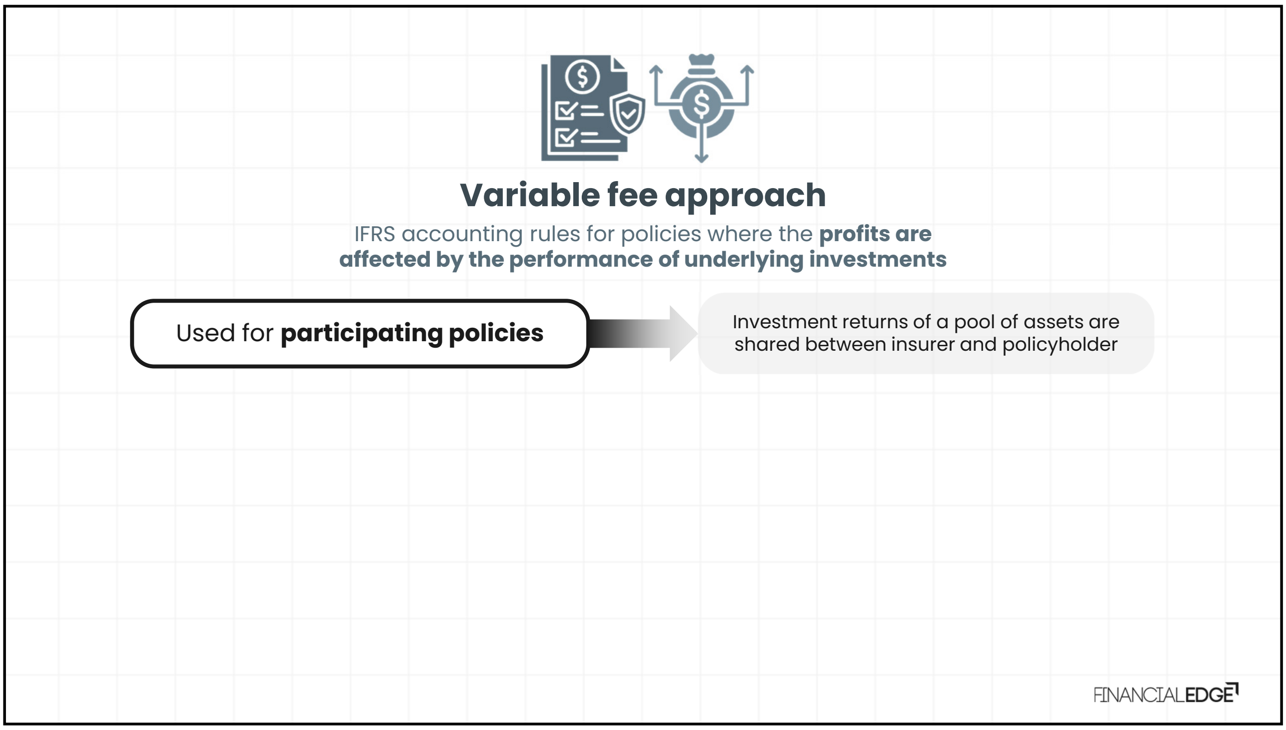


IFRS Variable Fee Approach


Variable fee approach
IFRS accounting rules for policies where the profits are affected by the performance of underlying investments
Used for participating policies
Investment returns of a pool of assets are shared between insurer and policyholder
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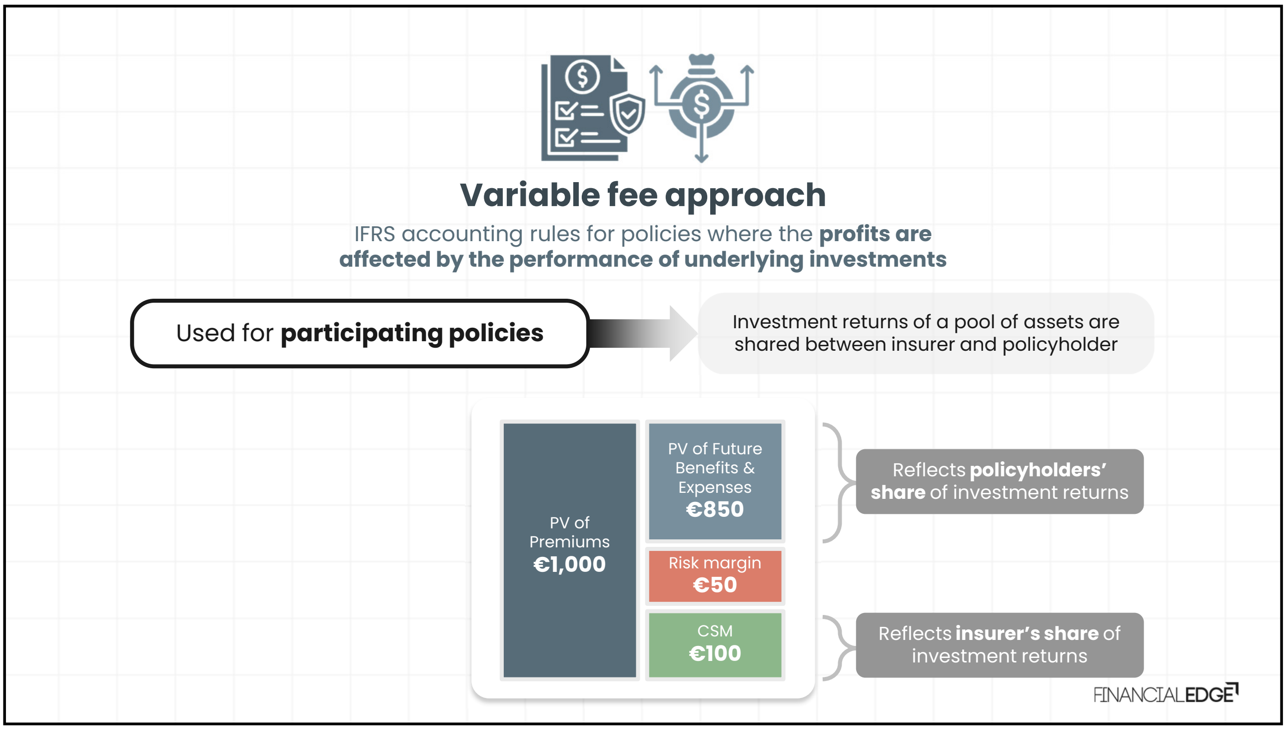
Variable fee approach
IFRS accounting rules for policies where the profits are affected by the performance of underlying investments
Used for participating policies
Investment returns of a pool of assets are shared between insurer and policyholder
PV of Premiums
€1,000
PV of Future Benefits & Expenses
€850
Risk margin
€50
CSM
€100
Reflects policyholders' share of investment returns
Reflects insurer's share of investment returns
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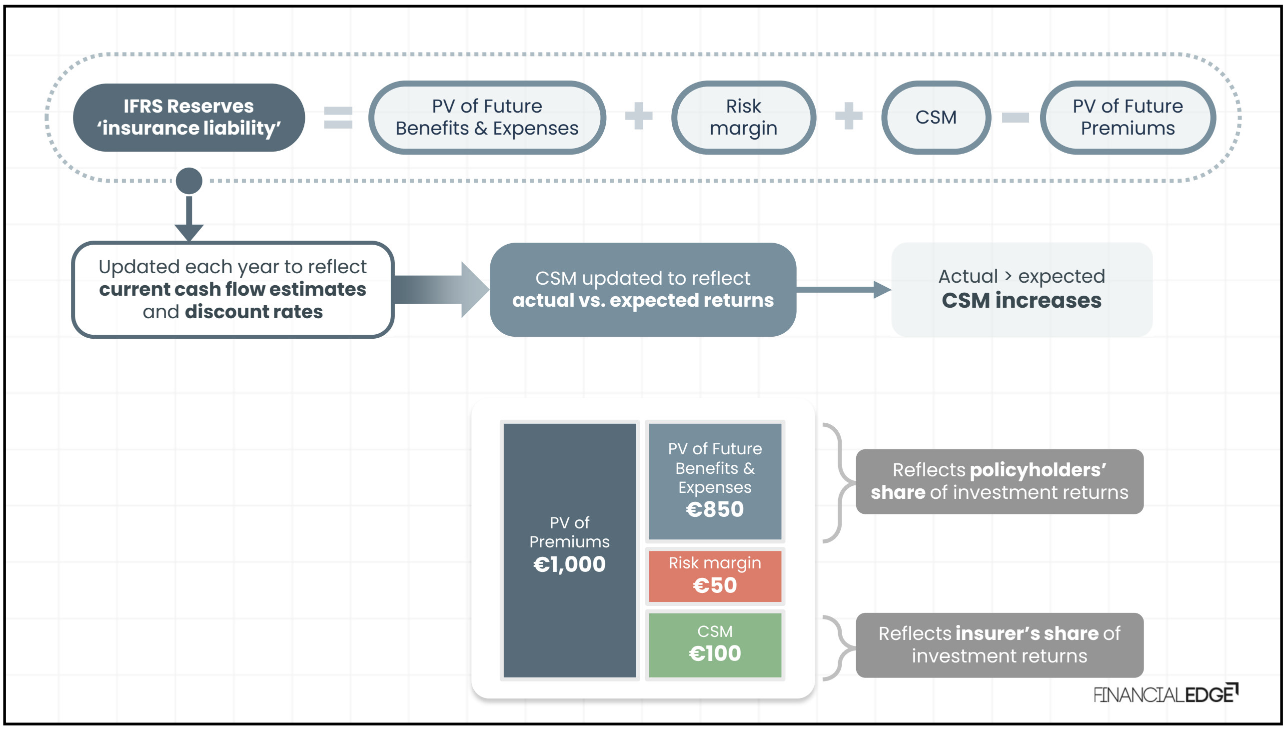
IFRS Reserves 'insurance liability'
=
PV of Future Benefits & Expenses
+
Risk margin
+
CSM
–
PV of Future Premiums
Updated each year to reflect **current cash flow estimates** and **discount rates**
CSM updated to reflect **actual vs. expected returns**
Actual > expected **CSM increases**
PV of Premiums €1,000
PV of Future Benefits & Expenses €850
Risk margin €50
CSM €100
Reflects **policyholders' share** of investment returns
Reflects **insurer's share** of investment returns
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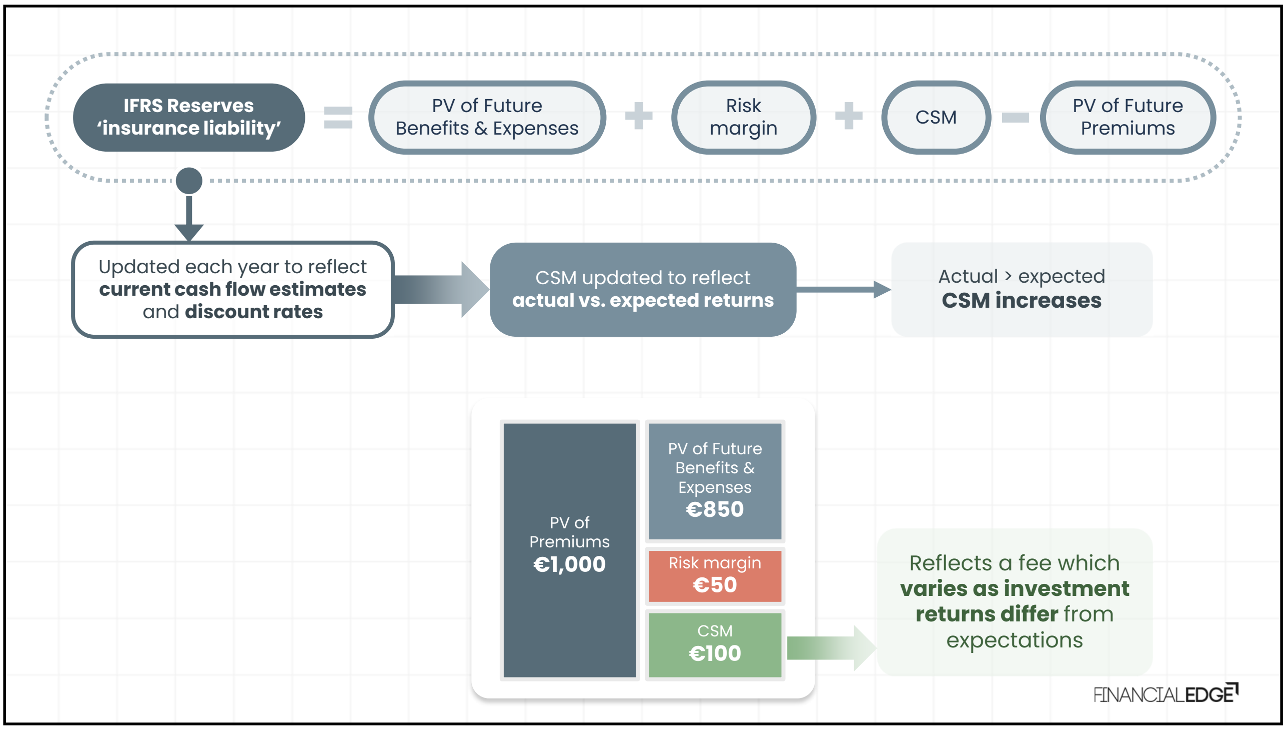
IFRS Reserves 'insurance liability'
=
PV of Future Benefits & Expenses
+
Risk margin
+
CSM
–
PV of Future Premiums
Updated each year to reflect **current cash flow estimates** and **discount rates**
CSM updated to reflect **actual vs. expected returns**
Actual > expected **CSM increases**
PV of Premiums €1,000
PV of Future Benefits & Expenses €850
Risk margin €50
CSM €100
Reflects a fee which **varies as investment returns differ** from expectations
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IFRS Life Financial Statements

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IFRS Life Insurance Balance Sheet

More aggregated than a **US GAAP balance sheet**

Investments	500,000
Cash	45,000
Total assets	**545,000**
Insurance contract liabilities	95,000
Investment contract liabilities	320,000
Net asset value attributable to unitholders	30,000
Borrowings	90,000
Equity	10,000
Total liabilities and equity	**545,000**

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IFRS Life Insurance Balance Sheet

Largest item in assets

Includes value of investments held within unit trusts for **unit linked policies**

- Separately disclosed on the **face of the balance sheet**
- In the **footnotes** to the accounts

Investments	500,000
Cash	45,000
Total assets	**545,000**
Insurance contract liabilities	95,000
Investment contract liabilities	320,000
Net asset value attributable to unitholders	30,000
Borrowings	90,000
Equity	10,000
Total liabilities and equity	**545,000**

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IFRS Life Insurance Balance Sheet

Cash held for **operational purposes**

Any **insurance contract assets** are included within **insurance liabilities**

- E.g. **premiums receivable** or **deferred acquisition costs**

Investments	500,000
Cash	45,000
Total assets	**545,000**
Insurance contract liabilities	95,000
Investment contract liabilities	320,000
Net asset value attributable to unitholders	30,000
Borrowings	90,000
Equity	10,000
Total liabilities and equity	**545,000**

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IFRS Life Insurance Balance Sheet

Reserves for all insurance policies with **significant insurance risk**

- Traditional Life
- Annuities
- Participating Life with **significant guaranteed benefits**

Investments	500,000
Cash	45,000
Total assets	**545,000**
Insurance contract liabilities	95,000
Investment contract liabilities	320,000
Net asset value attributable to unitholders	30,000
Borrowings	90,000
Equity	10,000
Total liabilities and equity	**545,000**

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IFRS Life Insurance Balance Sheet

Policies with **low insurance risk** that **offer investment services** to policyholders

For European insurers:

- **Unit-linked** policies
- Participating policies with **minimal guaranteed benefits**

Investments	500,000
Cash	45,000
Total assets	**545,000**
Insurance contract liabilities	95,000
Investment contract liabilities	320,000
Net asset value attributable to unitholders	30,000
Borrowings	90,000
Equity	10,000
Total liabilities and equity	**545,000**

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IFRS Life Insurance Balance Sheet

350,000 investments

(held within unit trusts for unit linked policies)

− **320,000** investment contract liability

(current account value of unit linked policies)

= **Net asset value of 30,000**

(belongs to the unitholders)

Investments	500,000
Cash	45,000
Total assets	**545,000**
Insurance contract liabilities	95,000
Investment contract liabilities	320,000
Net asset value attributable to unitholders	30,000
Borrowings	90,000
Equity	10,000
Total liabilities and equity	**545,000**

IFRS Life Insurance Balance Sheet

Long dated borrowings and equity are covered by European **regulatory capital requirements**

Investments	500,000
Cash	45,000
Total assets	**545,000**
Insurance contract liabilities	95,000
Investment contract liabilities	320,000
Net asset value attributable to unitholders	30,000
Borrowings	90,000
Equity	10,000
Total liabilities and equity	**545,000**

IFRS Life Insurance Income Statement

1 Insurance section	Insurance revenue	12,000
	Insurance expense	(10,000)
	Insurance service result	**2,000**
2 Investment section	Investment return	20,000
	Finance expense on insurance contracts	(1,000)
	Change in investment contract liabilities	(18,000)
	Insurance and investment result	**3,000**
3 Other	Fees from fund management and investment contracts	1,000
	Other finance costs	(500)
	Profit before tax	**3,500**
	Tax expense	(1,000)
	Net income	**2,500**

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IFRS Life Insurance Income Statement

Reflects profits released on insurance contracts

- Contractual service margin (CSM)
- Risk margin

Insurance revenue	12,000
Insurance expense	(10,000)
Insurance service result	**2,000**
Investment return	20,000
Finance expense on insurance contracts	(1,000)
Change in investment contract liabilities	(18,000)
Insurance and investment result	**3,000**
Fees from fund management and investment contracts	1,000
Other finance costs	(500)
Profit before tax	**3,500**
Tax expense	(1,000)
Net income	**2,500**

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IFRS Life Insurance Income Statement

Non-contractual **operating expenses**

Staff costs

Acquisition costs

Insurance revenue	12,000
Insurance expense	(10,000)
Insurance service result	**2,000**
Investment return	20,000
Finance expense on insurance contracts	(1,000)
Change in investment contract liabilities	(18,000)
Insurance and investment result	**3,000**
Fees from fund management and investment contracts	1,000
Other finance costs	(500)
Profit before tax	**3,500**
Tax expense	(1,000)
Net income	**2,500**

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IFRS Life Insurance Income Statement

Effectively the **underwriting profit**

Insurance revenue	12,000
Insurance expense	(10,000)
Insurance service result	**2,000**
Investment return	20,000
Finance expense on insurance contracts	(1,000)
Change in investment contract liabilities	(18,000)
Insurance and investment result	**3,000**
Fees from fund management and investment contracts	1,000
Other finance costs	(500)
Profit before tax	**3,500**
Tax expense	(1,000)
Net income	**2,500**

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IFRS Life Insurance Income Statement

Investment return

Insurance revenue	12,000
Insurance expense	(10,000)
Insurance service result	**2,000**
Investment return	20,000
Finance expense on insurance contracts	(1,000)
Change in investment contract liabilities	(18,000)
Insurance and investment result	**3,000**
Fees from fund management and investment contracts	1,000
Other finance costs	(500)
Profit before tax	**3,500**
Tax expense	(1,000)
Net income	**2,500**

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IFRS Life Insurance Income Statement

Investment return

– Finance expense on insurance contracts
(interest accretion)

Insurance revenue	12,000
Insurance expense	(10,000)
Insurance service result	**2,000**
Investment return	20,000
Finance expense on insurance contracts	(1,000)
Change in investment contract liabilities	(18,000)
Insurance and investment result	**3,000**
Fees from fund management and investment contracts	1,000
Other finance costs	(500)
Profit before tax	**3,500**
Tax expense	(1,000)
Net income	**2,500**

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IFRS Life Insurance Income Statement

Investment return

− Finance expense on insurance contracts

(interest accretion)

− Change in investment contract liabilities

(amounts credited to policyholder accounts for unit linked policies)

Insurance revenue	12,000
Insurance expense	(10,000)
Insurance service result	**2,000**
Investment return	20,000
Finance expense on insurance contracts	(1,000)
Change in investment contract liabilities	(18,000)
Insurance and investment result	**3,000**
Fees from fund management and investment contracts	1,000
Other finance costs	(500)
Profit before tax	**3,500**
Tax expense	(1,000)
Net income	**2,500**

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IFRS Life Insurance Income Statement

Investment result

+ Insurance result

= **Insurance and investment result**

(effectively the operating profit)

Insurance revenue	12,000
Insurance expense	(10,000)
Insurance service result	**2,000**
Investment return	20,000
Finance expense on insurance contracts	(1,000)
Change in investment contract liabilities	(18,000)
Insurance and investment result	**3,000**
Fees from fund management and investment contracts	1,000
Other finance costs	(500)
Profit before tax	**3,500**
Tax expense	(1,000)
Net income	**2,500**

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IFRS Life Insurance Income Statement

Insurance revenue	12,000
Insurance expense	(10,000)
Insurance service result	**2,000**
Investment return	20,000
Finance expense on insurance contracts	(1,000)
Change in investment contract liabilities	(18,000)
Insurance and investment result	**3,000**
Fees from fund management and investment contracts	1,000
Other finance costs	(500)
Profit before tax	**3,500**
Tax expense	(1,000)
Net income	**2,500**

Interest expense on their borrowings

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IFRS Life Insurance Income Statement

Insurance revenue	12,000
Insurance expense	(10,000)
Insurance service result	**2,000**
Investment return	20,000
Finance expense on insurance contracts	(1,000)
Change in investment contract liabilities	(18,000)
Insurance and investment result	**3,000**
Fees from fund management and investment contracts	1,000
Other finance costs	(500)
Profit before tax	**3,500**
Tax expense	(1,000)
Net income	**2,500**

Profit for shareholders

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