Office of the Superintendent of Financial Institutions Canada
Bureau du surintendant des institutions financières Canada

Guideline

Subject: **Source of Earnings Disclosure** (Life Insurance Companies)

Category: **Accounting**

No: **D-9** **Date:** **December 2004**
Revised: **July 2010**

This Guideline, which applies to life insurance companies and life insurance holding companies incorporated under the *Insurance Companies Act*,[1] establishes the Office of the Superintendent of Financial Institutions' (OSFI) expectations for the disclosure of a company's source of earnings (SOE). The methodology for the calculation of an SOE analysis was developed in co-operation with the Canadian Institute of Actuaries (CIA).

The revised Guideline is effective for annual financial reporting periods in fiscal years beginning on or after January 1, 2011.

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[1] This Guideline does not apply to Canadian incorporated fraternal benefit societies or property and casualty companies, or to Canadian branches of foreign life insurance companies, fraternal benefit societies, or property and casualty companies.

Introduction

This Guideline outlines OSFI's expectations regarding the methodology, content and form of the SOE disclosure, which is intended to be a supplement to the disclosure required by International Financial Reporting Standards (IFRSs). The Guideline should be used in combination with other OSFI guidelines applicable to life insurance companies.

Public disclosure of reliable and timely information facilitates the understanding of the financial position of companies by both existing and prospective stakeholders, including shareholders, policyholders, analysts, directors, management and regulators. Because of the complexities and inherent uncertainties in the insurance industry, this SOE disclosure should enhance the ability of a company's stakeholders to better form a view as to the quality, potential volatility and sustainability of earnings.

OSFI expects SOE disclosure to appear in either the notes to the annual public financial statements or as part of other disclosures within or accompanying the company's public annual report (for example, as a part of a management discussion and analysis (MD&A) section, a supplementary disclosure section or another form of management commentary accompanying the company's annual report). Where a company does not issue annual public financial statements or an annual report, OSFI expects SOE disclosure to be publicly available, e.g. upon request or on an internet web site. It is expected that the company will include some commentary explaining the SOE analysis methodology and results, and not just present the numbers in isolation.

Description of the Methodology

Source of earnings analysis is a methodology for identifying and quantifying the various sources of IFRSs income of a life insurance company. It is a presentation of net income in a different format from the traditional income statement form. It provides an analysis of the difference between actual income and the income that would have been reported had all assumptions at the start of the reporting period been realized during the reporting period.

For blocks of business that have life insurance contract liabilities valued according to the CIA Standards of Practice, the best-estimate assumptions referred to in this Guideline are those that were used in the valuation of insurance contract liabilities at the end of the previous reporting period. For blocks of business that are not valued in this manner (e.g. annual group life and health), the best-estimate assumptions used should be those that were used in the most recent business plan or pricing.

The income that is to be analyzed is the consolidated net income that appears in the company's financial statements. For stock companies, this includes any transfers from the participating accounts to the shareholder account, but does not include an analysis of earnings of the participating accounts. For mutual insurance companies, it includes all income.

Where it is not in conflict with this Guideline, the methodology used should be consistent with any SOE material promulgated by the CIA.

Form of Disclosure

OSFI expects the following SOE format would be the minimum disclosure to be shown. Additional detail can be added at the discretion of the company. OSFI expects the disclosure to show at least two years' results, including when IFRS is introduced.

Source of Earnings Analysis

	YYYY	**YYYY-1**
Expected Profit on In-Force Business		
Impact of New Business		
Experience Gains & Losses		
Management Actions and Changes in Assumptions		
Other		
Earnings on Operations (pre-income tax)		
Earnings on Surplus		
Income before Income Tax		
Income Taxes		
Net Income		

a) Expected Profit on In-Force Business

This component of the SOE represents the portion of the consolidated net income on business in-force at the start of the reporting period that was expected to be realized based on the achievement of its best-estimate assumptions. It includes, but is not limited to, the following.

(i) Release of provisions for adverse deviations (PfAD).

(ii) Expected net management fees.

(iii) Expected net earnings on deposits.

(iv) Scheduled amortization of balance sheet allowances for acquisition or other capitalized expenses.

b) Impact of New Business

This component of the SOE represents the point-of-sale impact on net income of writing new business during the year. This is the difference between the premium received and the sum of the expenses incurred as a result of the sale and the new liabilities established at the point of sale. The definition of what constitutes new business should be consistent with other metrics in the financial statements that refer to new business.

c) Experience Gains and Losses

This component of the SOE represents gains and losses that are due to differences between the actual experience during the reporting period and the best-estimate assumptions at the start of the reporting period. This component should also include the impact of currency changes. It should not include the effect on net income of management actions or changes in assumptions during the year. See the Appendix for further explanation of what is included under management actions and changes in assumptions.

For non-insurance contracts (e.g. investment contracts) backed by assets classified as available for sale (AFS), the change in the liability will be included in net income but any changes in assets that are AFS will appear in other comprehensive income (OCI). If this is material to a company, the effect of this is expected to be disclosed in commentary or in a footnote to the above SOE table.

d) Management Actions and Changes in Assumptions

This component of the SOE includes the following.

(i) Management actions.
(ii) Changes in best-estimate assumptions.
(iii) Changes in the assumptions for margins for adverse deviations (MfAD).
(iv) Changes in the methodology for valuation of policy liabilities, due either to new standards or the refinement of valuation methods.
(v) Correction of errors.

Refer to the Appendix for further explanation of what is included under Management Actions and Changes in Assumptions.

e) Other

This component of the SOE represents the result of any source of earnings not addressed under the previous categories. Any such additional source of earnings should be disclosed separately if they are material, given the materiality level used in producing the financial statements.

This component of the SOE can also reflect situations where a company is not able to identify fully all components of the SOE. Where this part of the component is large, the company should endeavor to refine its analysis methods.

f) Earnings on Surplus

This component of the SOE represents the net income earned on the company's surplus funds.

All companies are expected to disclose the above components to allow for consistent comparisons between companies. Companies may consider it appropriate to show further detail as subcomponents. This is especially important where such amounts are material, and is encouraged where it does not conflict with this Guideline and would better allow the stakeholders to understand the SOE analysis. The additional disclosure could take the form of expanding the table shown above, or it could be included in a commentary accompanying the SOE analysis.

Level of Disclosure Required

While IFRS 8 only applies to certain entities, OSFI expects, at a minimum, the SOE analysis to be disclosed at the same level as that required in respect of the segmented information reported in the notes under IFRS 8, whether or not the company is required to apply IFRS 8 for financial reporting purposes.

OSFI encourages companies to exercise the option of disclosing SOE information at a more detailed level of segmentation if this would give more meaningful information to the company's stakeholders, or if a more detailed level is consistent with other disclosure in the public financial statements. For instance, if a more detailed level of disclosure of financial information is used in the MD&A to explain the company's operations, the company should consider disclosing the SOE on a consistent basis.

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APPENDIX

Definition of Management Actions and Changes in Assumptions

This appendix provides further explanation of the components to be included under the category of Management Actions and Changes in Assumptions.

Any material amounts or transactions included in this category of the SOE analysis should be disclosed as separate items within this category. For instance, if in the same segment there is a material increase in income due to a new reinsurance contract and a decrease in income due to a valuation basis change, the two amounts should be shown separately. Materiality in this case should be based on a level that is appropriate for the size of the segment, and not based on the materiality level used for the total company.

Management actions should include the following. These are examples and are not meant to be all-inclusive.

(i) Changes in the price of a product.
(ii) Changes in fees or fee structure.
(iii) Changes in asset mix, whether in category of asset, quality of asset, duration, etc. This would include the impact of investment management changes that are material and either change the previous investment policy or are outside of the existing investment policy. This category would not include changes due to normal trading activity within an established investment policy, or changes in the asset mix due to the aging of the assets, new business, etc.
(iv) New or revised reinsurance deals on in-force business.
(v) Acquisition or sale of a block of business or company.

Basis changes should include the following. These are examples and are not meant to be all-inclusive.

(i) Changes in any best-estimate assumptions for in-force business. This includes changes in mortality, morbidity, lapse, policyholder dividends, expenses, ultimate interest rates, equity returns, real estate returns, default rates, etc. This also includes changes in PfADs where the MfADs are a function of the best-estimate actuarial liabilities.
(ii) Changes in MfAD levels, including changes in the conditional tail expectation (CTE) level.
(iii) Changes due to refinements in valuation calculation systems.
(iv) Changes due to new actuarial or accounting standards.
(v) Correction of errors. This category is for any errors that are not material to the total, but could be regarded as material in a particular segment shown in the SOE analysis.
(vi) Changes in non-formula bulk actuarial or other liabilities. This category does not include actuarial liabilities that are consistently calculated using an aggregate level methodology, as opposed to a policy-by-policy level calculation. An example is the

C-3 PfAD. This category includes any amounts that the actuary has set up that 1) are not calculated using a direct link to the underlying policies and contingencies, 2) are not required by CIA standards or 3) which can be changed at the actuary's discretion. This category would include, for example, general contingency reserves, general data integrity reserves, experience fluctuation reserves, non-formulaic cyclical reserves, etc.

(vii) New economic scenario for Canadian Asset Liability Method. When deterministic scenarios are used, any changes in the interest scenario results from one year to the next, if the same scenarios are run, is not a basis change. Cases where the scenarios are unchanged, but a different scenario from the same set of scenarios is the most adverse, would be considered an experience gain or loss. However, a basis change would occur in cases where the use of a new scenario, or the removal of a previous scenario, causes a reserve to increase or decrease relative to the previous set of scenarios. If a company uses stochastic modeling, it should consider any changes from one year to the next to be experience gains or losses, unless the methodology has been materially changed.