

CEIOPS | Westhafen Tower, 14 floor, Westhafenplatz 1
60327 Frankfurt | Germany

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Contact: Carlos Montalvo Rebueta
Phone: +49(0)6995111922
Fax: +49(0)6995111918
Email: carlos.montalvo@ceiops.eu

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Dear Sir David

ED/2010/8 Exposure Draft: Insurance Contracts

1. CEIOPS welcomes the opportunity to comment on the IASB's Exposure Draft (ED) regarding the final standard relative to "Insurance contracts".
2. As indicated by the IASB, IFRS 4 was intended as a temporary standard and as such CEIOPS sees the new ED as a further advancement of reporting of insurance liabilities ensuring consistency and relevance of information. Indeed, the current use of different valuation methodologies does not provide users with relevant and comparable information about the amount, timing and uncertainty of future cash flows arising from insurance contracts. Furthermore the consistency of valuation methodologies used for insurance contracts and information provided on assets backing insurance liabilities is not guaranteed by the current framework. For this reason, CEIOPS is appreciative of the IASB's valuable work in this area and its commitment to achieving a definitive accounting standard dedicated to insurance contracts that is based on a current value concept. The Board's efforts to provide a comprehensive accounting framework for insurance contracts are appreciated
3. The IASB insurance contracts project has particular significance within Europe, as EU listed groups are required to report under IFRS and many European countries have already adopted IFRS as their national accounting framework. Furthermore, the establishment of a final standard on insurance contract accounting will bring consistency of accounting requirements for European insurance companies and their supervisors facilitating easier analysis and comparison of the differences of valuation and accounting which will exist between their financial statements and those regulatory statements that will be prepared under the Solvency II framework.

4. CEIOPS appreciates the approach chosen by the IASB, relying on current estimates of cash flows, taken into account the time value of money and showing an explicit risk and profit margin.

5. CEIOPS understands and strongly agrees with the requirement to use a risk free rate that reflects the characteristics of the insurance contract liability for the purposes of discounting of insurance liabilities.

6. CEIOPS is of the view that the IASB project is going in the right direction. CEIOPS feels that IASB is right to pursue convergence between IFRS and US GAAP but consider that the primary focus must be to ensure that the IASB's insurance contracts accounting standard produces the best outcome for preparers and users, even where the Boards' views diverge.

7. Although CEIOPS really appreciate the approach the IASB has chosen, CEIOPS is also concerned about some areas. The concerns relate to the internal consistency of the standard on some points. Also, on points where differences with the Solvency II framework cannot be explained from the different perspective of financial statements and regulatory reporting, CEIOPS is concerned about the consequences for the preparers and the users of both reports

8. The main areas which CEIOPS have some concerns are the following:

- Scoping of investment contracts with DPF (according to the new definition of DPF)
- Unbundling requirements
- Discount rates, especially the application of an illiquidity premium
- Replicating portfolio technique
- Incremental costs
- Boundary of contracts
- Presentation
- Transitional provision

9. Another area of concern relates to the volatility in the income statement, especially in combination with the application of IFRS9 (please also see the comments in question 13). CEIOPS favours an approach whereby the assets and liabilities are valued on a market consistent basis to show a realistic balance sheet position. CIEOPS believes that the IASB should consider how to facilitate users in understanding such volatility within the financial statements and to aid transition from existing approaches to new.

10. Regarding the presentation of comprehensive income, CEIOPS urges the IASB to have an in-depth and preliminary debate about what an insurers' annual performance is and how it can be connected with the measurement model proposed for insurance liabilities and financial instruments. The ED does not indeed provide any conceptual basis for the proposed revenue recognition model and simply considers that insurers' annual performance comes down to a mechanical addition of changes in balance sheet items. In our opinion, this is an important issue to be solved and consulted on considering the influence that P&L and aggregated elements such as "net results" have on market participants' behaviour and on managerial and corporate decisions.

11. CEIOPS would strongly disagree with changing the fundamentals of valuing insurance liabilities as proposed in the ED to solve the concerns about volatility in P&L. CEIOPS is willing to contribute to the discussion about how solutions can be reached via the presentation of income.

If you have any questions or wish to discuss all this further with CEIOPS,
please feel free to contact jarl.kure@ceiops.eu.

Kind regards

A handwritten signature in black ink, appearing to read 'Carlos Montalvo', is written above a horizontal line.

Carlos Montalvo

Secretary General

Question 1 – Relevant information for users (paragraphs BC13–BC50)

Do you think that the proposed measurement model will produce relevant information that will help users of an insurer’s financial statements to make economic decisions? Why or why not? If not, what changes do you recommend and why?

12. As insurance supervisors, CEIOPS believes that it is most desirable that the methodologies for calculating items in general purpose financial reports can be used for, or are substantially consistent with, the methodologies used for regulatory reporting purposes, with as few changes as possible to satisfy regulatory reporting requirements. CEIOPS would welcome a financial reporting regime that would only require a minimum number of adjustments to obtain the solvency position and to meet the specific needs of supervisors. There are numerous advantages in terms of governance and financial communication in having valuation principles under IFRS consistent with Solvency II. In this context CEIOPS supports an approach of maximum commonality between Solvency II and IFRS.

13. However, CEIOPS recognizes that the purpose of the financial reporting is only partially compliant and consistent with the objectives pursued by the supervisors through the new solvency framework. In this context, CEIOPS congratulates the Board for their efforts in developing and drawing up a model which provides the users with both:

- valuable information relative to amount, timing and uncertainty of cash flows through a current valuation of the insurance liabilities and an explicit risk adjustment and,
- Information on re-measurement of the fulfillment cash flows and risk adjustment and through the use of a residual margin over the coverage period.

14. CEIOPS supports the IASB in defining one single valuation method for both life and non-life insurance contracts. This ensures consistency and avoids situations where definition issues may lead to a form-over-substance approach.

Question 2 – Fulfilment cash flows (paragraphs 17(a), 22–25, B37–B66 and BC51)

(a) Do you agree that the measurement of an insurance contract should include the expected present value of the future cash outflows less future cash inflows that will arise as the insurer fulfils the insurance contract? Why or why not? If not, what do you recommend and why?

(b) Is the draft application guidance in Appendix B on estimates of future cash flows at the right level of detail? Do you have any comments on the guidance?

(a)

15. Yes, CEIOPS agrees. While the theoretical approach of a fulfillment value chosen by the IASB could be different on some aspects in comparison to the theoretical basis of Solvency II, CEIOPS believes that IASB's proposal is acceptable, also having in mind the difference of context and objectives between supervision and financial reporting.

16. Moreover, practically, CEIOPS believes that the IASB's approach based on a present value of the fulfillment cash flows is broadly in line with the Solvency II approach and CEIOPS welcomes the similarity of approaches.

17. The value of technical provisions under Solvency II corresponds to the current amount insurance and reinsurance undertakings would have to pay if they were to transfer their insurance and reinsurance obligations immediately to another insurance or reinsurance undertaking. This calculation makes use of and is consistent with information provided by the financial markets and generally available data on underwriting risks (market consistency). The value of technical provisions equals the sum of a best estimate, discounted using a risk-free interest rate term structure and a risk margin to ensure that the value of technical provisions meets the transfer value requirement outlined above. The risk margin is calculated to cover the cost of providing eligible own funds equal to the Solvency Capital Requirement necessary to support the insurance and reinsurance obligations over the lifetime thereof.

(b)

18. CEIOPS believes that the guidance regarding the definition of the future cash flows (B37-B66) is at an adequate level of detail, subject to the comments in the following paragraphs.

19. CEIOPS understands that the cash-flows that should be included within the boundary of an existing contract are those that are incremental at a portfolio level. Related to that understanding, CEIOPS has the following concerns:

- CEIOPS favors the inclusion of costs incremental at a portfolio level. The final standard should better explain the level of measurement. Some paragraphs seem to indicate a measurement approach that must be applied at an individual contract (ED.17 and ED.26) where others present the need for an estimate of the cash flows at a portfolio level (ED.23); The description of the level of measurement in B65 indicates that there is no difference from making estimates for individual contracts or for the portfolio level. However, it may be clarified how this statement relates to the notion of incremental costs at portfolio level compared to incremental costs at the contract level.
- The definition of a portfolio (Appendix A) is too broad and probably subject to diverging interpretations. CEIOPS believes that the terms "broadly" and "as a single pool" could be removed.

Incremental costs include direct costs and systematic allocation of costs that relate directly to insurance contracts or contract activities (B61). Furthermore in B63 the principle to take into account costs being incremental at the portfolio level is described. CEIOPS believes that it would

be useful to give more guidance on which level the “incremental” criteria should be assessed.

The ED states that costs that do not relate directly to the contract or contract activities, such as general overheads, should not be included in the best estimate (B62(f)). CEIOPS believes that it would be useful to define more precisely what the Board considers as *general* overheads. From an accounting perspective CEIOPS generally agrees with the principles as stated in the ED, however CEIOPS wants to highlight that this is an area of divergence between the ED and Solvency II approach. In Solvency II it is stated that expenses should include both overhead expenses and expenses which are directly assignable to individual claims, policies or transactions. Overhead expenses include, for example, expenses which are related to general management and service departments which are not directly involved in new business or policy maintenance activities and which are insensitive to either the volume of new business or the level of in-force business. The allocation of overhead expenses firstly amongst existing business and future business, and secondly amongst different portfolios of existing business, should be done on an economic basis following realistic and objective assumptions.

20. The principle that aims at including costs that are incremental at a portfolio level isn't applied in a consistent and appropriate manner to acquisition costs. Indeed, under B61(f) only the acquisition costs that are incremental at an individual contract level shall be retained within the boundary of an existing contract.

21. Regarding the paragraphs B44-B47, see comments on question 5

Question 3 – Discount rate (paragraphs 30–34 and BC88–BC104)

(a) Do you agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability? Why or why not?

(b) Do you agree with the proposal to consider the effect of liquidity, and with the guidance on liquidity (see paragraphs 30(a), 31 and 34)? Why or why not?

(c) Some have expressed concerns that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts. Are those concerns valid? Why or why not? If they are valid, what approach do you suggest and why? For example, should the Board reconsider its conclusion that the present value of the fulfilment cash flows should not reflect the risk of non-performance by the insurer?

(a)

22. CEIOPS understands and strongly agrees with the implicit requirement in the ED that for the purposes of discounting of insurance liabilities a risk free rate term structure should be used that reflects the characteristics of the insurance contract liability. CEIOPS considers it important that reference to the “risk free rate term structure” is explicitly made in paragraph 30. It also would be more

clear if the open list on items reflecting the contract liability (currency, timing) should be changed by deleting the wording "for example". Furthermore the word "yield curve" should be replaced by "risk free rate term structure".

23. In addition to that, CEIOPS thinks that discounting of all insurance liabilities should be done by using the rate outlined in paragraph 30. However, at present the requirements in paragraph 32 are not clearly set out and could be interpreted as either a) permitting adjustment of discount rates to reflect the performance of associated assets - which CEIOPS understands could only apply in cases where cash flows according to the contract exactly match cash flows on associated assets by way of a replicating , or b) reflecting the dependence between the performance of the assets and the liability cash flows - which CEIOPS understands would be captured in the cash flow projection rather than the discount rate. However, this is not clear from the current text and, as such, CEIOPS suggests moving these requirements out of the subchapter "Time value of money" in order to make it clearer in which circumstances replicating portfolio techniques may be appropriate. Therefore, CEIOPS requests the IASB to clarify its approach in paragraph 32, which at present could be misinterpreted as permitting the use of rates based on return of assets.

Regarding paragraph 32 CEIOPS only does see the rationale for allowing the usage of replicating portfolio techniques when the amount, timing, or uncertainty of cash flows from an insurance contract depends on the performance of specific assets (e.g. unit-linked contracts) and there is an exact match of cash flows. CEIOPS suggests that the Board give clarification on the criteria mentioned (i.e. "depend wholly or partly") as this might produce arbitrary and incomparable results. Furthermore CEIOPS is of the view that the major criteria for application ("exact match of cash flows") of the replicating portfolio technique should be explicitly stated within this paragraph in order to prevent abuse or inconsistent application of such an approach. The absence of a clear and rigorous framework regarding the use of replicating portfolio techniques may fail the requirements of users of the financial statements if it leads to less transparency, particularly since this approach does not provide users with information on the risk margin and the discount rate that is otherwise required for the valuation of insurance contracts. In general CEIOPS believes that the usage of such techniques would benefit from this requirement being accompanied by a clear set of criteria for their application (e.g.: requirements on the assets – observable in active markets (if applicable), exact match in all possible scenarios, items which from the start are not deemed to be replicable such as servicing expenses).

(b)

In CEIOPS there are diverging views on the inclusion of an illiquidity premium in the discount rate used for valuation of insurance liabilities in the financial statements¹.

For CEIOPS' views from a Solvency II point of view, CEIOPS also refers to CEIOPS' cover letter² to the report from the Task Force on Illiquidity Premium³.

¹ https://www.ceiops.eu/fileadmin/tx_dam/files/consultations/consultationpapers/CP40/CEIOPS-L2-Final-Advice-on-TP-Risk-free-rate.pdf

² https://www.ceiops.eu/fileadmin/tx_dam/files/publications/submissionstotheec/20100303-CEIOPS-Cover-Letter-Report-Liquidity-Premium.pdf

³ https://www.ceiops.eu/fileadmin/tx_dam/files/publications/submissionstotheec/20100303-CEIOPS-Task-Force-Report-on-the-liquidity-premium.pdf

CEIOPS' view is disagreement with the inclusion of an illiquidity premium in the discount rate. In the ED context, CEIOPS view believes that the IASB's proposal for the introduction of an "illiquidity premium" is not based on sound conceptual and practical accounting reasoning, in particular under a fulfillment approach.

CEIOPS' view has the following concerns.

- 1) According to the IASB the illiquidity reflects the fact that, compared to financial instruments, policyholders cannot liquidate their investment in some insurance contracts or at least not without incurring significant cost, whereas this is not the case with investment in for example government bonds.

First, this comparison seems to ignore the actual nature of insurance contracts and the real expectations of policyholders covered by insurance contracts (protection, safety...). A life or non life insurance contract cannot be seen only as an instrument arbitrated by the policyholder with financial instruments.

Furthermore, the introduction of an illiquidity premium is inconsistent with the concept of fulfillment value. Policyholders' greater or lower ability to liquidate insurance contracts has no demonstrated impact on the insurer's liability towards these policyholders, especially under a fulfillment approach. The value of an insurance liability - which has the same illiquidity feature at any point in time since its origin - is usually not influenced when markets perception of liquidity of financial instruments change.

- 2) Discounting deals with the time value of money. It is common valuation practice to reflect the risks of an item being valued either in the future cash flows or in the discount rate. Under the first methodology, the discount rate must be the rate of an instrument that is free of risks in order to present the perfect arbitrage against which the item being valued is assessed.

In the present value of the fulfillment cash flows, all future cash flows must be taken into account on a probably weighted basis, which means that the liquidity features of these cash flows is already taken into account. Furthermore, a liability with highly unpredictable cash flows in terms of timing will have a significant risk adjustment (when compared to the expected cash-flows), whereas a liability with more predictable cash flows (which is the case for not-redeemable contracts) will have a reduced risk adjustment. Moreover, the fact that the duration of cash flows from a contract is shorter than the duration of cash flows from another contract (not-redeemable) has an impact on the discount rate. In fact, the interest rates usually increase with the duration. This indicates that illiquidity characteristics can already be reflected in the risk free rate term structure.

So, introducing again illiquidity features in the discount rate leads to double counting of the liquidity element.

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- 3) The Board has stated as a principle that the valuation of a liability must be conducted independently of the asset mix of the reporting entity (see BC95 to BC97 of the ED). Therefore an illiquidity premium reflecting varying degrees of liquidity in the asset markets is not appropriate.
 - 4) The illiquidity premium as it currently stands in the ED, i.e. without convincing conceptual background and guidance for application, is likely to result in unreliable, not-comparable and not-transparent IFRS financial statements. Serious doubts can indeed be raised about the possibility to find a reliable, unbiased and justified method to assess this "illiquidity premium" on an ongoing basis. The wide range of current practices in the discounting applied to Embedded Value reports as published by many cross-border insurance groups, is a good illustration of the potential divergence that can appear with the implementation of the ED's illiquidity premium.

Minority view

On the other hand, a minority of CEIOPS' Members support the inclusion of an illiquidity premium in the valuation of the technical provision of insurance contracts and investment contracts. In the ED context, the minority view believes that the IASB's proposal for the "illiquidity premium" is based on sound conceptual and practical accounting reasoning.

- 1) The minority view agrees with the IASB that the illiquidity reflects the fact that compared to financial instruments, policyholders cannot liquidate their investment in some insurance contracts or at least not without incurring significant cost, whereas this is not the case with investment in some government bonds.

This comparison reflects the very nature of insurance – pooling risk to achieve certainty from uncertainty. The degree of the certainty and hence predictability of the underlying cash flows vary by product. Where a cash flow is highly predictability, it is necessary to reflect any illiquidity observed in replicating assets in the valuation of the liability cash flow in order to achieve market consistency.

The minority view believes that the introduction of an illiquidity premium is clearly consistent with the concept of fulfillment value. Policyholders' greater or lower ability to liquidate insurance contracts impacts on the value of insurer's liability towards these policyholders, at any particular point in time. The value of an insurance liability changes to reflect the illiquidity of financial instruments observed in the markets to ensure market consistency.

- 2) Discounting is about the time value of money. It is common valuation practice to reflect the risks of an item being valued either in the future cash flows or in the discount rate. Under the first methodology, the discount rate must be the rate of an instrument that is free of risks in order to present the perfect arbitrage against which the item being valued is assessed.

When valuing the best estimate of insurance contracts, all future cash flows must be taken into account on a probability weighted basis. The distribution of the cash flows provides information about the predictability of the cash flow, however a wide distribution of potential cash flows or a narrow distribution of potential cash flows may still give the same best estimate. And therefore the best estimate clearly does not incorporate the liquidity features of the cash flow.

The fact that the duration of cash-flows from a contract is shorter than the duration of cash-flows from another contract (not-redeemable) has an impact on the best estimate and the discount rate. The rate curve usually increases with time however this is often considered to be as a result of the term premium which should not be confused with an implicit illiquidity premium.

Therefore, to ensure consistency between the liability and asset sides of the balance sheet, illiquidity features need to be incorporated into the discount rate.

- 3) The introduction of an illiquidity premium in the fulfillment value due to a varying degree of liquidity between financial instruments makes no reference to the specific assets or investment strategy of the reporting entity and is therefore consistent with the principle stated by the Board that the valuation of a liability must be conducted independently of the asset mix of the reporting entity (see BC95 to BC97 of the ED).
- 4) Transparency regarding the use of the illiquidity premium is particularly important as the understanding, application and market practice of this concept is continuing to develop. The use of illiquidity premium in the discounting applied to EEV's illustrates the efforts that have already gone into the development of this concept.

(c)

24. CEIOPS believes that valuation of insurance contracts should take into account parameters inherent to the contract (mortality, lapse etc.) that reflect the future fulfillment of the insurer's obligation towards the policy holder. CEIOPS strongly believes that factors like the own credit standing should not be taken into account under a fulfillment value approach, as the fulfillment value does not change due to changes of the companies' own credit standing.

25. Interest rate term structures can be observed in the market covering certain timeframes. However, the nature of long-term-insurance liabilities is such that they may exceed the timeframes for which observable inputs are available. Consequently, disclosure requirements should be introduced underlining and explaining the approaches chosen on extrapolation, in order to help users of financial information to better understand the effect of the extrapolation applied and its sensitivity to changes in the extrapolation methodology. CEIOPS welcomes sufficient flexibility in the proposal to incorporate the proposed Solvency II approach.

Question 4 – Risk adjustment versus composite margin (paragraphs BC105–BC115)

Do you support using a risk adjustment and a residual margin (as the IASB proposes), or do you prefer a single composite margin (as the FASB favours)? Please explain the reason(s) for your view.

26. CEIOPS believes that the aim of the new accounting model for insurance contracts should provide relevant information for users about the amount, timing and uncertainty of future cash-flows.

27. CEIOPS is fully convinced that the value to fulfill an obligation must include an explicit adjustment for risk for the following reasons:

- The risk margin is needed to convey useful information to users of financial statements about the uncertainty associated with the liability. The risk related to possible developments in amounts or timing is an important element of information for users and should not be separated from the measurement on the balance sheet. Reflecting risk in the measurement model of the liability also gives information to users in a concise way about the way the reporting entity manages the risks.
- If the risk adjustment is not separately identified it can not be remeasured on an appropriate basis and post initial recognition would fail to acceptably represent the uncertainty associated with the remaining cash flows.
- The principle of an explicit adjustment for risk is present in many existing and draft standards where the valuation approach is prospective and includes an assessment of uncertainty (e.g. Exposure Draft on Amortised Cost and Impairment; revision of IAS19). It is also included in the current provisions standard IAS 37 (paragraph 42) and more explicitly in the draft revised IAS 37 intended to cover liability measurement.

28. The use of a composite margin would fail to meet these objectives. Indeed, the composite margin is not able to provide information regarding the uncertainty that is explicit, current (i.e. remeasured at each reporting period) and would fail to ensure comparability of different entities' approaches towards risks. Furthermore, the use of a composite margin could lead to underestimating of insurance liabilities in circumstances where contracts are onerous, as the onerous contracts test would be based only on the cash flows and would lead to consequent liabilities that are lower than expected present value of the future cash flows adjusted for the effects of uncertainty. The composite margin mixes two different elements (i.e. uncertainty of cash flows and premium allocation model) that must be treated separately both at the inception and in the subsequent measurement. Also CEIOPS believe that for certain life products (e.g. annuities) the application of the composite margin approach would be very complex.

29. CEIOPS would also like to highlight that there will be practical advantages and comparability benefits between IFRS and Solvency II in requiring the separate disclosure of the risk margin.

Question 5 – Risk adjustment (paragraphs 35-37, B67-B103 and

BC105–BC123)

(a) Do you agree that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected? Why or why not? If not, what alternatives do you suggest and why?

(b) Paragraph B73 limits the choice of techniques for estimating risk adjustments to the confidence level, conditional tail expectation (CTE) and cost of capital techniques. Do you agree that these three techniques should be allowed, and no others? Why or why not? If not, what do you suggest and why?

(c) Do you agree that if either the CTE or the cost of capital method is used, the insurer should disclose the confidence level to which the risk adjustment corresponds (see paragraph 90(b)(i))? Why or why not?

(d) Do you agree that an insurer should measure the risk adjustment at a portfolio level of aggregation (i.e. a group of contracts that are subject to similar risks and managed together as a pool)? Why or why not? If not, what alternative do you recommend and why?

(e) Is the application guidance in Appendix B on risk adjustments at the right level of detail? Do you have any comments on the guidance?

(a)

30. CEIOPS agrees that that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected. CEIOPS believes that the lack of reference to an exit value, and so to an amount required by another market participant, implies that the measurement of the risk margin will be based on an entity specific approach. In this context, CEIOPS agrees that the introduction of a maximum notion is needed to ensure that the definition is suitably rigorous and that preparers set the risk adjustment at an understandable and consistent level. Permitting the use of an amount within a range up to the maximum amount would provide scope for manipulation, and would be less comparable.

(b)

31. CEIOPS understand the aim of the IASB of improving comparability with the limitation of the choice of techniques that an undertaking would be allowed to use and, consequently, CEIOPS supports the Board's decision to restrict the permitted techniques to those described in the ED. In addition to ensuring comparability and consistency of techniques used, where undertakings are permitted to use those techniques for solvency purposes, this is likely to minimise costs and maximise benefit for both supervisors and undertakings.

32. However, CEIOPS is concerned that this limitation could prevent the use of appropriate techniques that may be developed in the future. Consequently, CEIOPS believes that the Board could complement the restrictive use of three techniques with a rebuttable presumption that these techniques meet the criteria

laid out in the guidance and should be used unless management can demonstrate that their alternative technique provides a more appropriate and relevant measure, with a strengthening of the requirements regarding disclosures about the appropriateness of the techniques used and the consistency of their application over time and line of business.

(c)

33. CEIOPS disagrees with the second sentence of paragraph 90 (b) (i) which requires insurers to disclose the corresponding value using the confidence level method in all cases, i.e. even when the insurer used the tail expectation technique or the cost of capital instead of the confidence level. This requirement gives the impression that the confidence level method is considered to be superior to the other methods in a fulfilment approach, and in particular to the cost of capital method, and from a conceptual point of view, this has not so far been demonstrated by the Board. Moreover, the Board itself recognizes that there are instances where the confidence level would not be technically the most appropriate method (see B95 in Appendix B). CEIOPS believes that a risk exists that this type of disclosure would lead to false comparability providing inadequate answer to the investors' expectations. Furthermore, this requirement could be an incentive for insurers to use the confidence level in all situations for cost reasons (to avoid two sets of calculations, once for the measurement of the liability and a second time for this specific disclosure); and this would not be consistent with the Board's principles-based approach.

(d)

34. As mentioned in our response to question 2 CEIOPS agrees with the Board that a consistent measurement approach should be applied at a portfolio level subject to our comments on the definition of a portfolio in question 2b. Consequently, this approach should apply to the valuation of the risk margin.

35. The measurement of the risk margin should include diversification effects at the portfolio level but should not include diversification between portfolios. A consistent and practical approach is to use the same level of measurement as in other parts of the ED.

In Solvency II, CEIOPS' view is that diversification between lines of business should not be allowed.

(e)

36. CEIOPS believes that the application guidance in Appendix B (B75-B102) on risk adjustments is at the adequate level of detail. However, CEIOPS would propose to include guidance on the effects of interrelationships between direct contracts and reinsurance contracts (please refer to question 16 as well). Regarding B103, see the comments below.

Question 6 – Residual/composite margin (paragraphs 17(b), 19–21, 50–53 and BC124–BC133)

(a) Do you agree that an insurer should not recognise any gain at initial recognition of an insurance contract (such a gain arises when the expected present value of the future cash outflows plus the risk adjustment is less than the expected present value of the future cash inflows)? Why or why not?

(b) Do you agree that the residual margin should not be less than zero, so that a loss at initial recognition of an insurance contract would be recognised immediately in profit or loss (such a loss arises when the expected present value of the future cash outflows plus the risk adjustment is more than the expected present value of future cash inflows)? Why or why not?

(c) Do you agree that an insurer should estimate the residual or composite margin at a level that aggregates insurance contracts into a portfolio of insurance contracts and, within a portfolio, by similar date of inception of the contract and by similar coverage period? Why or why not? If not, what do you recommend and why?

(d) Do you agree with the proposed method(s) of releasing the residual margin? Why or why not? If not, what do you suggest and why (see paragraphs 50 and BC125–BC129)?

(e) Do you agree with the proposed method(s) of releasing the composite margin, if the Board were to adopt the approach that includes such a margin (see the Appendix to the Basis for Conclusions)? Why or why not?

(f) Do you agree that interest should be accreted on the residual margin (see paragraphs 51 and BC131–BC133)? Why or why not? Would you reach the same conclusion for the composite margin? Why or why not?

(a)

37. This solution is coherent with the measurement attribute chosen by the IASB (i.e. the current fulfilment approach), in which such gain should be recognised as income in profit or loss over the coverage period (i.e. the period over which the service is provided). Also this is considered to be consistent with IASB's general revenue recognition approach.

(b)

38. CEIOPS agrees that the residual margin should not be less than zero. If the purpose of the residual margin is to avoid profit at the inception of the contract, it seems sensible not to have a negative residual margin and to recognize the loss immediately in profit and loss. In addition, this appears to be consistent with the IASB's general approach towards revenue recognition.

(c)

CEIOPS believes that an insurer should be allowed to estimate the residual margin at a level that aggregates insurance contracts into a portfolio of insurance contracts and, within a portfolio, by similar date of inception of the contract and by similar coverage period. If the residual margin re-measured at each reporting date, it is unnecessary the differentiation of the residual margin by similar date of inception of the contract and by similar coverage period.

(d)

39. CEIOPS recognizes that the question about the re-measurement of the residual margin or the locked-in approach (as proposed by IASB) is a difficult and controversial issue. CEIOPS thinks that the question could be addressed in two different way, namely:

1. To consider the residual margin a remedy to avoid a profit at the inception of the contract (BC 121): in that case it is sensible to agree with the IASB proposal to lock-in the residual margin determined at initial recognition and release it over the coverage period (paragraph 50) with the possibility to adjust – in an asymmetric way (paragraph 53) – the residual margin recognised in profit or loss for the portion of contracts that are no longer in force at the end of the reporting period.

2. To consider the residual margin as a margin that reports profitability of the contracts over their coverage period (IN 10 (b)), or alternatively over the coverage and settlement period: in that case it makes sense that the residual margin should be re-measured in order to have a current representation of the profitability as it comes from the re-estimate of future cash flow.

As CEIOPS understands the residual margin as it is constructed in the ED, it is meant to be a plug to avoid the profit at inception. Nevertheless, as some parts of the ED can be interpreted differently, CEIOPS would urge the IASB to clarify the concepts behind the residual margin.

Whichever way the question is considered, CEIOPS is concerned to ensure that changes in the present value of the fulfilment cash flows will be presented transparently.

(e)

40. CEIOPS does not agree with the FASB proposal to have a single composite margin. The composite margin approach would not include a separately identified and remeasured risk adjustment, but would instead be amortised over the coverage period and claims handling period on a formulaic basis that is intended to approximate the pattern of the decline of risk under the contract.

41. In our view, the IASB's preferred approach of applying a risk adjustment and residual margin provides a more appropriate measurement outcome. In particular, the inclusion of a specific risk adjustment ensures that the firm's assessment of uncertainty is clearly presented and appropriately remeasured. This is preferable to the composite margin approach, where the implicit risk margin will neither be separately presented nor remeasured.

(f)

42. CEIOPS understands the Board's arguments to accrete interest on the residual margin, given the principle of including the time value of money and consistency with other standards, when the residual margin is seen as one of the building block. However, CEIOPS is aware of other views where the residual margin is seen as a plug, in which case the accretion of interest does not add much value, given that the net impact will be expected to be small and complexity is increased.

43. If the residual margin remeasured, the accretion of interest is not necessary.

Question 7 – Acquisition costs (paragraphs 24, 39 and BC135–BC140)

(a) Do you agree that incremental acquisition costs for contracts issued should be included in the initial measurement of the insurance contract as contract cash outflows and that all other acquisition costs should be recognised as expenses when incurred? Why or why not? If not, what do you recommend and why?

44. Insurance undertakings are compensated for incurred incremental acquisition costs by premiums paid under the contract and the premium is included in contractual cash flow. Therefore, it is appropriate to include incremental acquisition costs in the contractual cash flows at initial recognition. Also it is appropriate to expense all other acquisition costs since these costs do not relate to the insurance contracts subject to the initial recognition. Nevertheless, CEIOPS would advise the IASB to include in the final standard first of all clear guidance on the definition of incremental acquisition costs, acquisition costs and overhead costs and secondly on which level those costs have to be assessed (incremental on portfolio level or single contract level). CEIOPS would highlight that the commercial strategy of undertakings can vary substantially between those distributing through external intermediaries and those distributing directly. CEIOPS would ask the IASB to consider whether their proposed treatment of the incremental acquisition costs will provide an appropriate economic picture for both commercial strategies.

45. As mentioned before, the principle that aims at including costs that are incremental at a portfolio level is not applied in a consistent and appropriate manner to acquisition costs. Indeed, under B61(f) only the acquisition costs that are incremental at an individual contact level shall be retained within the boundary of an existing contract.

Question 8 – Premium allocation approach

(a) Should the Board (i) require, (ii) permit but not require, or (iii) not introduce a modified measurement approach for the pre-claims liabilities of some short-duration insurance contracts? Why or why not?

(b) Do you agree with the proposed criteria for requiring that approach and with how to apply that approach? Why or why not? If not, what do you suggest and why?

46. CEIOPS supports that the possibility of applying a Premium Allocation Approach (PAA) for the pre-claims part of short-duration contracts should be included in the standard. CEIOPS understands PAA as a cost-reducing approach that could be justified in cases where this approach is likely to produce an outcome that do not materially differ from an outcome based on a full building block approach.

47. It is CEIOPS' view that PAA should be permitted rather than required based on the understanding that the PAA is a simplified approach intended to produce a proxy without affecting the basic measurement attribute and the fact that the application of the full building block approach is the norm. It therefore seems appropriate that the simplified approach is optional and that entities should not be prohibited from applying the full approach.

48. CEIOPS is of the opinion that PAA should be limited to cases where the value of the pre-claims liability is unlikely to change in the coverage period apart from the change stemming from the amortisation over that period. It seems reasonable that this is fulfilled for contracts falling within the scope proposed in the ED, i.e. not longer than approximately 1 year and without embedded derivatives. CEIOPS therefore supports these criteria.

49. CEIOPS recommends that the rationale for allowing the simplified approach is stated more clearly than in the ED. Such clarification would help when the entities shall implement the criteria.

50. Furthermore, CEIOPS recommends that it is clarified that contracts exceeding approximately 1 year can be embraced by the PAA in instances where they form only an insignificant part of a portfolio of contracts that otherwise meets the criteria for being subject to the PAA.

Question 9 – Contract boundary principle

Do you agree with the proposed boundary principle and do you think insurers would be able to apply it consistently in practice? Why or why not? If not, what would you recommend and why?

51. The ED proposes that the boundary is the point at which the insurer is no longer required to provide coverage or has the right or the practical ability to reassess the risk of the particular policyholder and, as a result, can set a price that fully reflects that risk. In CEIOPS' view the principles proposed for the contract boundaries are appropriate, subject to the following comment.

52. For most types of insurance it is common to manage contracts at a portfolio level i.e. as group of contracts. For example, a health insurance contract might be written with repricing of the individual contract being based on a reassessment of risk at the portfolio level rather than the individual policyholders (i.e. the individual contract).

53. These contracts give rise to a question relative to the level at which the reassessment of the risk should be considered (i.e. the portfolio level or the level of each individual benefiting from the insurance coverage). The Board considered (BC57) that if the insurer can re-price an existing contract but cannot at that time reassess the individual policyholder's risk profile then that point lies within the boundary of the existing contract.

54. The ability to reassess the risk at the portfolio level for such contracts and to re-price the contract opens the broad ability to take into account the consequence of the change of each individual policyholder. In such instances, the risks relating to the individuals are mutualised and should not be seen as separate and independent. This is a relevant factor pricing and management of such contracts, and therefore differs to the aggregation of individual contracts with separable and independent risks within a portfolio.

55. Arguably, an approach where the principles above are assessed in respect of the portfolio as a whole would be more consistent with the general measurement approach applied in the ED. In this context, the Board could consider whether an ability to reassess risk on a portfolio basis and re-price individual contracts in line with that reassessment of risk would provide an acceptable approach on a portfolio basis. For the above reasons CEIOPS is convinced that the ability to assess the risk and to re-price at the portfolio level should be considered consistent with, rather than distinct from the Board's proposed contract boundary principle.

Question 10 – Participating features

(a) Do you agree that the measurement of insurance contracts should include participating benefits on an expected present value basis? Why or why not? If not, what do you recommend and why?

(b) Should financial instruments with discretionary participation features be within the scope of the IFRS on insurance contracts, or within the scope of the IASB's financial instruments standards? Why?

(c) Do you agree with the proposed definition of a discretionary participation feature, including the proposed new condition that the investment contracts must participate with insurance contracts in the same pool of assets, company, fund or other entity? Why or why not? If not, what do you recommend and why?

(d) Paragraphs 64 and 65 modify some measurement proposals to make them suitable for financial instruments with discretionary participation features. Do you agree with those modifications? Why or why not? If not, what would you propose and why? Are any other modifications needed for these contracts?

(a)

56. CEIOPS agrees with the IASB proposal that measurement of insurance contracts should include participating features on an expected present value basis. This measurement approach provides a value that is consistent with the general measurement model of insurance contracts proposed in the ED. As it is further explained in answer to question 2, CEIOPS is supportive of the expected present value measurement.

(b)

57. CEIOPS believes that contracts issued with DPF issued by insurers should have the same measurement approach as is used for insurance contracts.

However, in CEIOPS' view, the treatment of such contracts in accordance with the existing IFRS 4 has worked well and, as such, CEIOPS is minded that the most advisable approach for the IASB might be to consider retaining the current requirements and definition.

58. This might reduce the concerns raised by the proposals in the ED, where paragraph 2 of the ED, which defines the scope covered by the standard, must be read together with the definition of the Discretionary Participation Feature (DPF) in appendix A in order to fully understand which contracts are really covered by the standard. CEIOPS is minded to express our concern that including important limitations of the scope of the standard through a definition provided in the appendix may be misleading for both preparers and users. If the Board wants to limit the scope of the standard - as CEIOPS believes was the reason for changing the definition of DPF - it would be more transparent to do it directly in the scope section of the standard (i.e. paragraph 2 of the ED).

59. CEIOPS is aware that the proposal in the ED is likely to lead to the inclusion of some contracts that do not meet the definition of an insurance contract (i.e. financial instruments with discretionary participation features). While such contracts do not contain insurance risk, IFRS 4 (and the ED) is the only source of guidance in respect of the treatment of discretionary participation features, thereby providing a logical rationale for their inclusion in scope regardless of the existence of insurance contracts sharing in participation

(c)

60. As indicated by the question above, the definition of discretionary participation features from IFRS 4 phase 1 has been amended to include an additional requirement requiring that "there also exist insurance contracts that provide similar contractual rights to participate in the performance of the same insurance contracts, the same pool of assets or the profit or loss of the same company, fund or other entity". CEIOPS understands that the reason of including this additional requirement was to limit the scope of the instruments covered by the definition, and thereby the scope of financial instruments expected to be caught be the requirements of the ED. In our understanding only companies that sell insurance contracts meet this requirement. Consequently, DPF offered in contracts issued by other companies, which do not meet the criteria set by the new definition (i.e. investment companies etc.) would be measured according to measurement requirement set in IAS 39 (and IFRS 9 in the future).

61. However, CEIOPS would like to draw IASB' attention to the fact that the additional requirement, formulated as is currently proposed in the ED, opens the door for possible manipulation. In particular, companies may change their pool of assets, by adding or withdrawing other contracts that meet the IFRS 4 definition of an insurance contract, in order to use a valuation method that suits them. For example a life insurance company selling only investment contracts would not meet the definition proposed by the ED. Also, insurance companies may create different pools of assets, to be able to value part of their investments contracts with DPF according to IFRS9. This may even result in valuing the assets on an amortized costs basis. So the ED leaves a possibility for insurance company to measure their contracts according to standards other than IFRS 4 (namely IAS39/IFRS9).

(d)

62. CEIOPS fears that the ED creates an inconsistency regarding the treatment of the future premiums resulting from insurance contracts and those resulting from investment contracts with DPF. For the insurance contracts the future premiums can be taken into account only insofar as their pricing is determined in advance, providing a valuable advantage to the policyholder. For the investment contracts the future premiums are taken into account without the guaranty of any similar advantage to the policyholder. Thus, paragraph 64 in the ED does not define a boundary criterion for the investment contracts with DPF and the future premiums of these contracts could be taken into account without limit or condition.

63. According to the paragraph 64 in the ED, the future premiums can be taken into account as long as there is a contractual right to receive benefits arising from the DPF. The contractual provisions of certain contracts can result in distributing participations for the benefit of new generations of policyholders. Because of this mutualisation between generations of contracts, the provisions of paragraph 64 could lead to taking into account without limitation all the premiums of the future contracts which could be affected by this mutualisation.

64. For these reasons CEIOPS proposes to define a boundary principle for investment contracts with DPF consistent with the one proposed by the ED for insurance contracts:

“Regarding investment contracts with DPF, premiums are part of the contract and should be included in the measurement if they provide the policyholder with a financial advantage or guarantee promised explicitly in the contract with a commercial substance (i.e. have discernible effect on the economics of the transaction) that the policyholder would not have received without paying the new premiums.”

Question 11 – Definition and scope

(a) Do you agree with the definition of an insurance contract and related guidance, including the two changes summarised in paragraph BC191? If not, why not?

(b) Do you agree with the scope exclusions in paragraph 4? Why or why not? If not, what do you propose and why?

(c) Do you agree that the contracts currently defined in IFRSs as financial guarantee contracts should be brought within the scope of the IFRS on insurance contracts? Why or why not?

(a)

65. The definition is appropriate. The definition in IFRS 4 has worked well since the adoption of that standard. The changes identified in BC 191 provide further clarification of relevant considerations and so are also considered to be appropriate.

Given the application and scope of the ED and other standards, the requirement for significant risk transfer ensures a clear definition and distinction between insurance and investment contracts. This should help to ensure that where contracts are not, in substance, insurance contracts then they fall under other

more appropriate standards and are accounted for on a basis that is consistent with other similar contracts.

Concerning BC 191 CEIOPS has doubts about the added value of the additional criteria about the "notion of loss". However, if this is kept CEIOPS asks the Board to consider to include the additional requirement that business that meets the definition of an insurance contract in the primary insurance sector also should be considered as (re)insurance if this business (or parts of it) is reinsured and the reinsurer covers the risks inherent in this portfolio on an analogous basis.

(b)

66. In CEIOPS' view, the exclusion of fixed fee service contracts from the scope of the standard requires further consideration and/or clarification from the Board. Based on the current drafting of paragraph 4(e) it is unclear whether preparers will be able to distinguish between contracts that would and would not be in the scope of the standard. Given that compensation may be considered to take a form other than cash or another financial asset, a distinction between the provision of a service as opposed to the provision of compensation could, at times, be seen as arbitrary. Where fixed-fee service contracts entail the provision of a form of compensation, exclusion from the standard would be inconsistent from a theoretical standpoint. Therefore, a clearer description of this distinction would facilitate consistent treatment by preparers and would increase comparability.

67. As noted in the basis for conclusions (BC208-9) the rationale for the exclusion of certain fixed-fee service contracts may be consistent with revenue recognition treatment where such contracts entail the provision of service rather than compensation. However, in CEIOPS' view, the Board should consider being more explicit in its rationale here to ensure that only those fixed-fee service contracts that would more appropriately be covered by the requirements of another specified standard are excluded from the requirements of an insurance contracts standard. Care should be taken to ensure that the rationale and resulting exclusions expressed here are mirrored by that applied to the Board's revised revenue recognition standard in order to ensure that no relevant contracts fall outside of the existing standards.

68. Indeed, regarding the paragraph 4 (e), it would be useful if the standard were to provide examples of contracts that, in the Board's view, are expected to fall within the scope of the standard as well as those expected to be excluded. In some instances, such as an agreement to repair specified equipment in the case of malfunction, a contract might be considered to provide both goods and services to the counterparty. Further clarification of how such contracts should be assessed would be of use.

69. In addition, the Board may wish to consider it would be useful to users of financial statements if preparers were required to demonstrate through disclosure that the exclusion of such fixed-fee service contracts results from the application of accounting principles that better reflect the characteristics of those contacts and notably the uncertainty arising from the timing and amounts of the future cash-flows.

70. The other scope exceptions listed in the ED appear reasonable. Exceptions should only arise for items where existing accounting requirements apply (e.g. scoped into leasing or business combinations standards). However, it is noted that the exceptions listed in the ED are more specific than is often the case in

other standards. The Board may wish to consider whether the detail provided for some of the exception might better be expressed in the application guidance to the standard rather than in the body of the standard.

(c)

71. Given the nature of financial guarantee contracts which are not derivatives and the accounting options that currently exist, their inclusion appears appropriate and would mark an improvement on current accounting practices. It is important that the accounting treatment reflects the substance of the guarantees, strengthens comparability and ensures application of sound measurement principles to them.

Question 12 – Unbundling

Do you think it is appropriate to unbundle some components of an insurance contract? Do you agree with the proposed criteria for when this is required? Why or why not? If not, what alternative do you recommend and why?

72. CEIOPS admits that unbundling of the non-insurance elements within an insurance contract may increase transparency if there is no evident link with the insurance component.

73. However, CEIOPS strongly believes that in defining the unbundling criteria the IASB should ensure that it will be an exceptional measure, used only in specific cases where unbundling provides for more relevant measurement and presentation, and not the common practice.

74. Paragraph 8 states that some components can be unbundled if they are “not closely related to the insurance coverage specified in a contract” and gives some examples of such components. It is still not clear for CEIOPS what is meant by the term “closely related” and it would welcome more precise guidance for identifying those component that the ED proposes should be unbundled.

75. As CEIOPS understands it, investment contract with DPF should not be unbundled. In CEIOPS opinion that is appropriate because all investment contract with DPF should be in scope of the standard.

Question 13 – Presentation

(a) Will the proposed summarised margin presentation be useful to users of financial statements? Why or why not? If not, what would you recommend and why?

(b) Do agree that an insurer should present all income and expense arising from insurance contracts in profit or loss? Why or why not? If not, what do you recommend and why?

a) Summarised margin presentation

76. Subject to the comments made below CEIOPS is of the view that the summarised margin presentation in the statement of comprehensive income is

appropriate because it provides relevant information to users and it is consistent with the measurement model proposed by the IASB for Insurance Contracts. It is indeed important to ensure that the presentation of insurance contracts is consistent throughout all the statements prepared under IFRS.

77. It can be expected that the summarised margin presentation will be quite different from current practice in many jurisdictions. This aspect should not be underestimated as it implies cost and time for both preparers and users to get acquainted with the new model. For this reason, CEIOPS suggest that additional disclosures are required in the notes in order to explain the transition from the old presentation model to the new one (and explaining the impact on equity). Guidance could also be provided by the Board to facilitate the transition and understanding of the new presentation model.

78. CEIOPS basically agrees with the IASB's proposal in paragraph 74 of the ED.

79. However, CEIOPS would like to advise the Board to consider possibilities to include volume (e.g. premium) information in the presentation, where relevant. To be operational, such an approach combining volume information and margin would require further guidance from the Board, resulting in consistent presentations and understandable for users. To this end, several issues would need to be resolved, such as (i) the determination of which premium cash flows, claims expenses, or part of them have to be presented in the income statement and (ii) the link between these items and the changes in the liabilities amount that are reflected in the comprehensive income statement.

80. CEIOPS also agrees with the Board that a summarised margin presentation approach must be complemented by information on volumes in the notes. In this regard, CEIOPS sees that the amounts of premiums, claims and expenses that have to be disclosed as per paragraph 87 (c) and (d) are the payments received or made in respect of these elements. This approach is likely to result in more comparable and understandable information. However, it can be questioned whether payments received or made are really representative from an accounting point of view. It will later be important to back-test from whether this information is sufficient and whether it results in comparable presentations in disclosures and aids transition to the new presentation model.

81. CEIOPS is concerned that the presentation model proposed in paragraph 75 for short-duration contracts that are measured in accordance with paragraphs 56-60 will reduce the comparability between these contracts and those accounted using the building block approach.

82. Furthermore, CEIOPS urges the Board to consider the interaction between the presentation proposals made in the ED on Insurance Contracts and the tentative decisions taken on its separate project on financial statement presentation. It would be useful to know how the latter could work for the insurance sector taking account the presentation proposals of the ED on Insurance Contracts which - as indicated above - seem more relevant for the insurance business.

83. CEIOPS would finally like to draw the attention of the Board to the fact that CEIOPS is currently developing reporting templates that insurance undertakings subject to Solvency II will have to communicate to their supervisors. While the work is under progress on this within CEIOPS and having in mind that Solvency

II has no income statement concept, CEIOPS believes that the presentation model envisaged by the IASB is likely to be broadly consistent with CEIOPS approach, considering the package of templates that will form part of Solvency II reporting framework. If appropriate CEIOPS would be happy to present our model to you, including the type of templates used in our quantitative impact studies (QIS – the 5th one being in progress).

b) Presentation of all income and expense arising from insurance contracts in profit or loss

84. CEIOPS strongly agrees with the Board's proposal that subsequent measurement of insurance liabilities shall reflect all available information at the end of the reporting period, including current discount rates. This, in itself, is appropriate as it results in relevant valuation of insurance liabilities.

85. CEIOPS understands that under the IASB model, the impact of the re-measurement of liabilities will systematically be presented in profit or loss (P&L). Though this presentation is consistent with the balance sheet approach for liabilities, CEIOPS wonders whether the Board has considered that the proposed P&L-presentation tends to ignore the long term nature of some of the insurance business and may not provide a relevant view of the performance of insurance undertakings.

86. A first key element to consider is the long term nature of the insurance business with insurance liabilities spanning over multiple years, sometimes over decades. Re-measuring systematically insurance liabilities through P&L means that insurers' annual performance will be largely influenced by changes in the financial and non-financial hypothesis used for measuring the liability. While it is important to have a current valuation on the balance sheet, CEIOPS is not fully convinced that mechanically reflecting in P&L all changes – in particular on financial elements - provide useful information to users because

- (a) especially the changes in financial elements reflect short term positive or negative fluctuations in these hypotheses and have only remote connection with the ultimate fulfilment of the liability; this result in information to users about performance that may not portray the reality of the insurance business as of the reporting date and has no predictive value about future performance ;
- (b) as for initial measurement, re-measurements of insurance liabilities imply long term estimates and projections that carry an important degree of uncertainty; reflecting this in P&L - in particular concerning financial elements - does not have the same meaning as doing it on the balance sheet because of the "crystallisation" effect that accompanies booking of changes in P&L, Posting all liabilities' changes through P&L may convey to users the wrong message that all gains and losses are robust elements of performance and available for e.g. distribution.

87. The second and probably even more important element to consider is the fundamental interaction between insurance liabilities and investments covering these liabilities. This interaction is at the core of the so-called Asset-Liability-Management (ALM) which forms a substantive part of insurers activities, a important source of risk for them and a primary driver of their short and long term performance.

88. CEIOPS agrees with the Board that, to avoid accounting mismatches between liabilities and assets, insurers may choose to adopt a fair valuation for their assets when they apply the ED approach for IFRS4 Phase II as mentioned in the BC. This is possible under both IAS39 and IFRS9. An important difference however between IAS39 and IFRS 9 is that the later allows fair value changes to be reflected in comprehensive income statement only, while the former maintains a fair value through OCI category. When combining the ED and IFRS 9, all changes in fair value of financial assets and current values of liabilities (change in discount rate) will go to P&L and will form a large part of an insurer's income statement. This is again appropriate for some changes, but CEIOPS sees the problem that it is not fairly reflecting the long term nature of insurance business.

89. On this basis, CEIOPS urges the IASB to have an in-depth and preliminary debate about what an insurers' annual performance is and how it can be connected with the measurement model proposed for insurance liabilities and financial instruments. The ED does not indeed provide any conceptual basis for the proposed revenue recognition model and simply considers that insurers' annual performance comes down to a mechanical addition of changes in balance sheet items. In our opinion, this is an important issue to be solved and consulted on considering the influence that P&L and aggregated elements such as "net results" have on market participants' behaviour and on managerial and corporate decisions.

90. CEIOPS would strongly disagree with changing the fundamentals of valuing insurance liabilities as proposed in the ED to solve the concerns about volatility in P&L. CEIOPS is willing to contribute to the discussion about how solutions can be reached via the presentation of income.

Question 14 – Disclosures

(a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?

(b) Do you think the proposed disclosure requirements will meet the proposed objective? Why or why not?

(c) Are there any disclosures that have not been proposed that would be useful (or some proposed that are not)? If so, please describe those disclosures and explain why they would or would not be useful.

91. Though CEIOPS basically agrees with the disclosure principles, CEIOPS would like to raise the following comments:

- Further disclosure should be specifically required in relation to the discount rate, in particular on the hypothesis and methodologies used for the illiquidity premium (if the Board includes this in the final standard). There should also be specific requirements for testing the sensitivity of the liability to changes in the discounting as this is likely to have an important impact.
- Although CEIOPS disagrees with the requirement in the second sentence in paragraph 90(b)(i), disclosure of the methods and inputs used for calculating the risk adjustment should be required explicitly.

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- The management of the relationship between assets and liabilities (ALM) is a key element of risk in the insurance business. It has also connections with the accounting values of the assets covering insurance liabilities. CEIOPS therefore suggest that additional disclosure is introduced on the ALM and on the risks related to this, by group of insurance contracts (matching of assets and liabilities in terms of duration, liquidity risk, re-investment risk ...). Further disclosures should also be required on the insurance risk mitigation techniques used by the insurer (hedging, SPVs ...).
 - Insurers should be required to explain the effect of the adoption of IFRS 4, Phase II when applying the standard for the first time. The disclosure could be limited to the key elements of the technical provisions and on the impact on equity before and after adoption of the Phase II; limited to the last financial year where Phase I figures have been published. It would also be useful to require insurers to explain in more depth the new presentation model when used for the first time in order to facilitate users' understanding of the new framework.

Question 15 – Unit-linked contracts

Do you agree with the proposals on unit-linked contracts? Why or why not? If not what do you recommend and why?

92. CEIOPS agrees with the proposal to require separate presentation of assets, liabilities, income and expenses for unit-linked contracts as single line items. CEIOPS agrees that given the specific characteristics of these contracts, related information should not be commingled with the undertaking's other assets, liabilities, income and expenses.

93. However, CEIOPS also encourages the IASB to consider carefully the presentation issues of unit-linked investment contracts in order to assure comparability in the insurance sector.

94. CEIOPS supports the need to change other standards to address accounting mismatches. These changes may however need to be further extended on a principles based basis (e.g. investments in associates held in funds underlying unit-linked contracts, instances where property occupied by the insurer is part of returns encompassed by participation features). Further clarification on the articulation of the proposed treatment of the insurer's own shares, as well as, of own debt liabilities (own bonds) and other standards would provide useful guidance to users.

95. The ED addresses the following accounting mismatches that can occur under current accounting rules for unit-linked insurance contracts:

- (a) Insurer's own shares: These are not recognised as assets under IAS 32 "Financial Instruments: Presentation";
- (b) Property occupied by the insurer: an accounting mismatch occurs because IAS 16 "Property, Plant and Equipment" would treat it as owner-occupied in which changes in fair value would be recognised in profit or loss.

96. The ED proposes to eliminate the accounting mismatches by requiring the above items to be measured at fair value through profit or loss to the extent those changes in the value of the pool of assets relate to the interest of unit-linked contract holders.

97. CEIOPS agrees with the proposed approach regarding property occupied by the insurer as a pragmatic way to avoid accounting mismatches. However, the problem is not only related to owner-occupied property in pools of assets related to unit-linked contracts. The problem is wider and relates to all types of assets and liabilities the return on which is part of the profit or loss shared with policyholders according to either contracts with DPF or unit-linked contracts. CEIOPS therefore recommends that a generalised provision is inserted stating that a fair value option can be applied on assets or liabilities when the value adjustments on those assets or liabilities according to participation or unit-linked features in the contract are shared with the policyholder. Such a provision seems necessary to avoid the accounting mismatches that are currently avoided by the so-called "shadow accounting" in IFRS 4 for contracts with DPF.

98. Regarding own shares, these instruments are not an asset and shall be deducted from the insurer's equity (IAS 32.33 and IAS 32 AG 36). This principle should be maintain in all the cases where the own shares are only used as an economic hedging of the engagements taken based as reference on the value of equities including own shares. However, CEIOPS believes that the IASB's proposition could be justified in the specific context where, and only where, the own shares are part of a separate account characterized by the following: (i) the account is insulated from the general account liabilities and (ii) the assets underlying the contract of the insurance company are protected against the own credit risk of the insurer (the policyholder is not subject to insurer default risk to the extent of the assets held in the separate account). If an exception regarding the recognition of own shares is inserted in the standard CEIOPS considers that a similar exception should be inserted for own bonds.

99. More generally, CEIOPS encourages the Board not to consider unit linked contracts as a homogeneous population, but to consider the diversity of their natures and legal contexts.

Question 16 – Reinsurance

(a) Do you support an expected loss model for reinsurance assets? Why or why not? If not, what do you recommend and why?

(b) Do you have any other comments on the reinsurance proposals?

100. CEIOPS supports that ceded reinsurance contracts are measured applying the same principles as for direct insurance contracts except that the risk of non-performance which is not taken into account in the case of direct insurance shall be taken into account in the case of ceded reinsurance. It is important that the measurement of the direct insurance contracts and the related reinsurance contracts are based on the same assumptions and estimates in order not to create artificial net assets or liabilities.

101. In many cases ceded reinsurance will reduce the size of the relevant risk adjustment on the direct insurance contracts when the direct contract and the

reinsurance contract are looked at as a whole. It would be appropriate if it was clarified in the application guidance whether and, if so, how such effects relating to the interrelationship between the direct contracts and the reinsurance contracts could be taken into account in the estimation of the risk adjustments.

CEIOPS believes it is necessary to explain how to value the reinsurance assets when the premium allocation approach is used for the underlying insurance contracts.

Question 17 – Transition and effective date

(a) Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?

(b) If the Board were to adopt the composite margin approach favoured by the FASB, would you agree with the FASB's tentative decision on transition (see the appendix to the Basis for Conclusions)?

(c) Is it necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9? Why or why not?

(d) Please provide an estimate of how long insurers would require to adopt the proposed requirements.

(a)

102. CEIOPS disagrees with the proposal in sub-paragraph 100(a) of the ED to set the residual margin to zero for insurance contracts reported at the transition date. While CEIOPS understands that the retrospective building of a residual margin on existing contracts at the date of transition may be difficult and may result in undue cost, in our view a more preferable outcome is achieved if preparers are permitted or required to apply full retrospective application or, where this is not possible or would result in undue cost, apply a proxy calculation as an intermediate solution. A requirement to apply full retrospective application would avoid preparers cherry-picking the approach used, although CEIOPS acknowledges that for some preparers a proxy approach might be the only practical option.

103. The residual margin requirements of the ED should then be applied prospectively from the date of transition. If the Board do not feel that the residual margin requirements of the ED could not be appropriately applied in such circumstances CEIOPS encourages them to consider further whether an acceptable approach could be determined for prospective treatment of the residual margin at transition.

104. CEIOPS acknowledges that calculation of a residual margin at transition for existing contracts may be difficult. However, the decision not to include a residual margin appears arbitrary and a source of inconsistent information for users of financial statements regarding the performance of insurance contracts before and after the transition date, particularly since unrecognized profits at the transition date would immediately be recorded in retained profit rather than recognized in the profit and loss in subsequent periods.

105. CEIOPS shares the concerns of the IASB that there is not an ideal and perfect solution. However, CEIOPS believes that where full retrospective application is not possible or practical a solution consisting of retaining the difference between carrying amounts under previous accounting standards and the first three building blocks as a residual margin provides a preferred solution than the Board's proposal to take the difference on transition to retained profit.

106. Our considerations are based on the fact that numerous accounting frameworks around the world, regarding insurance contracts, are generally based on valuation principles requiring the use of assumptions included in the pricing of the premium for the insurance liabilities valuation and amortization of acquisition costs. Such approaches have some consistency of outcome with the residual margin approach and while they are not exactly the same as those resulting of the application of the ED, CEIOPS believes that the carried amounts resulting from these accounting frameworks are likely to result in an acceptable proxy for the residual margin determination at transition.

107. Consequently, CEIOPS believes that the Board should re-consider its decision that a residual margin would not be determined and recognized for existing contracts at the date of transition.

(b)

108. The transitional composite margin treatment proposed by FASB has the same weaknesses as those identified in a. above and has the disadvantage of not requiring the subsequent re-measurement of the risk adjustment. Furthermore, the composite margin approach at transition appears theoretically inconsistent, requiring as it does the application of a risk adjustment at transition while not requiring a specific risk adjustment within its basic building blocks.

(c)

109. CEIOPS supports the IASB's proposals to align application of IFRS 9 with application of the final insurance standard for the following reasons:

- The business model of the insurer is based on the matching of assets and liabilities and it is essential for the users to have at the transition date a consistent approach for the valuation of the assets and the liabilities reflecting their relationship.
- Given the significance of the insurance contracts standard and potential changes that it may bring for some preparers, it is likely that reclassification of assets under IFRS 9 will be required upon adoption of the insurance contracts standard.
- Subject to the comments in d) below, CEIOPS believes that aligning application dates would avoid the need for successive reclassification or redesignation of financial assets (at the effective date of IFRS 9 and subsequently at the effective date of the insurance contract standard) – something that would be burdensome for preparers and would be difficult for users to understand.

(d)

110. Considering the inadequacies in the current situation, in particular the lack of a consistent accounting framework for insurance obligations, CEIOPS sees an urgent need for this new standard.

111. However, CEIOPS accepts that the new standard is complex to apply and, as such, a sufficient period of time will be required for field testing and for preparers in order to ensure that it is implemented correctly as the changes will require substantial resources and a proper dialogue with stakeholders.

112. There are also still several important issues that need to be addressed properly prior to issuing the final standard.

113. The transition date should take into account these various points.

Question 18 – Other comments

Do you have any other comments on the proposals in the exposure draft?

Insurance contracts acquired in a portfolio transfer or business combination

114. In CEIOPS' understanding the ED propose a slightly different treatment if the present fulfilment cash flows exceeds the consideration received in a portfolio transfer compared to the similar situation when the present fulfilment cash flows exceeds the fair value of a portfolio acquired in a business combination.

115. Paragraph 40 (b) of the ED requires that the insurer shall recognise the excess described above immediately as an expense if it is related to a portfolio transfer. The Example 3 in B107 confirms the proposed treatment. However, paragraph 41 indicates that the insurer should review the measurement of the portfolio which might lead to recognition of intangible or other assets rather than a loss for a part of the difference (or the whole difference) between the present fulfilment cash flows and the consideration received in a portfolio transfer.

116. CEIOPS' view is that Example 3 in B107 could be clarified and includes a comment that an insurer shall recognise an intangible or other asset instead of the loss or part of the loss if there is a value that should be reflected in connection with the portfolio acquired.

117. Furthermore, CEIOPS understands that Paragraph 42 (b) propose that the difference between the present value of the fulfilment cash flow and the fair value of the portfolio should increase the carrying amount of goodwill recognised in the business combination. The suggested treatment is also described in Example 4 in B109. CEIOPS understands that the proposal could lead to different treatment if the portfolio is acquired in a business combination or if it is a portfolio transfer. The proposed treatment could also lead to different treatment in subsequent reporting periods since the intangible or other assets normally is amortised but the goodwill amount is only subject to impairment test.

Recognition and derecognition

CEIOPS supports the Boards' proposals regarding recognition of insurance contracts (paragraph 13 and following in the ED), i.e. that the ED's measurement model should be fully applied as of when the insurer becomes a party to the contract.

Question 19 – Benefits and costs

Do you agree with the Board's assessment of the benefits and costs of the proposed accounting for insurance contracts? Why or why not? If feasible, please estimate the benefits and costs associated with the proposals.

CEIOPS believes that the new standard will contribute much to an improved and more comparable and transparent presentation of insurance liabilities, outweighing the costs associated with implementation.