

**Comments
on
the IASB's Exposure Draft
ED/2013/7 Insurance Contracts**

Positions of the German Insurance Association

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General Comments:

We welcome and appreciate the opportunity to comment on the revised IASB's Exposure Draft ED/2013/7 *Insurance Contracts*, as issued by the IASB on the 20th June 2013 with the aim to finalise Phase II of the project "Insurance Contracts". With this response the German Insurance Association (GDV) would like to underline the importance of the Board's proposals and reconfirm its core positions and expectations with regard to the future accounting framework for insurance contracts. Furthermore, we will focus on issues which are especially important for German insurers.

We are fully supportive of the considerable efforts undertaken by the IASB to finalise the important insurance contracts project in the near future by creation of a high-quality principle-based standard. Given the close and inherent interaction between accounting for insurance contracts and financial instruments accounting we have developed our assessment of the revised ED's proposals also with regard to and on the basis of the current stage of accounting requirements of IFRS 9 *Financial Instruments*. As already expressed in our response of 19th March 2013 regarding the IASB's Exposure Draft ED/2012/4 the GDV explicitly appreciates the Board's decision to re-open the classification and measurement deliberations on a limited scope basis to explicitly consider the interaction between IFRS 9 (Phase I) and IFRS 4 (Phase II).

The Board's decision to re-expose the amended proposals for the insurance contracts accounting is highly appreciated.

The GDV highly appreciates the IASB's decision to re-expose the revision of the initial Exposure Draft that was issued on 30th July 2010 (as ED/2010/8 *Insurance Contracts*) as the amended exposure draft will allow a holistic assessment of the revised measurement, presentation and disclosure proposals. Also meaningful field test activities can only be conducted on a complete standard text basis.

In advance of our detailed comments to the questions set out in the revised ED/2013/7 we would like to express some general remarks and highlight some crucial issues for thorough consideration that we have identified from a perspective of the German insurance industry. We will also highlight the positive aspects of the revised ED which might be of importance during future convergence deliberations.

In GDV's overall view, the IASB made a significant progress in responding to concerns expressed by the insurance industry in the past.

The GDV is fully supportive of the Board's approach to propose a single comprehensive model for all insurance contracts, being based on current measurement approach. This aims to address the comparability between insurers which is not necessarily guaranteed under the current provisions of IFRS 4 Phase I. We believe that the final principle-based standard IFRS 4 will be robust enough to transparently reflect the business model of long-term oriented insurers and their stable economic performance over time.

In general, we assess the accounting framework as tentatively designed in the **revised ED as a significant step in the right direction** and a valid starting point for further deliberations as some **critical improvements are still needed** to achieve an operationally implementable framework for insurance contracts accounting. Conceptual adjustments are especially necessary for **participating contracts** or contracts with discretionary participation features. This type of contracts is a significant part of business of German insurers. Also, the proposed 'insurance contract revenue' is not *the* expected volume number information indicating the insurers' business performance. For our constructive suggestions and their rationale we refer to our responses to the detailed questions.

In following we highlight our principal views regarding the revised ED/2013/7.

The GDV strongly supports the OCI presentation for changes in current fulfilment value of insurance liabilities driven by discount rate changes on a non-mandatory basis.

The key Board's decision to require the current measurement of insurance contracts is fully supported by the GDV. It will provide a transparent presentation of financial position of insurers in the balance sheet. Nevertheless, the short-term market fluctuations must not obscure the long-term operating performance of insurers in the income statement. Thus, the presentation of changes in the current fulfilment values, if related to discount rate changes, in other comprehensive income (OCI) is a very suitable and transparent approach how to present the real economic performance of long-term oriented insurers with stable cash-flow profiles in profit or loss. We consider the OCI presentation as a key element of the appropriate holistic accounting solution for insurance contracts. In addition, it is inherently interconnected with the proposed introduction of the FVOCI category in IFRS 9. Both decisions are supported by the GDV as they will allow removing the 'market-noise' from the income statement while implementing a 'two-sided OCI presentation approach'. Thus, we strongly encourage the Board to confirm these crucial decisions. Nevertheless, we advocate for introduction of a supplementary option to present the effect of changes in discount rate in profit or loss when it eliminates or significantly reduces an accounting mismatch.

The GDV supports the unlocking of the contractual service margin for changes in estimates of present value of future cash flows related to future coverage or other future services.

The GDV fully supports the interpretation of the contractual service margin as an 'unearned profit' in an insurance contract; this concept should be consistently applied at initial recognition and at subsequent reporting dates. Thus, we agree with the Board's decision to require the offset of changes in cash flow estimates related to future coverage or other future services in the contractual service margin. It will prevent counterintuitive results. Nevertheless, the contractual service margin should be unlocked also for changes in risk adjustment and for changes in financial assumptions (e.g. reinvestment assumptions). Than it will result in an even more understandable and decision-useful information for users. We explicitly agree with the proposed constraint that the contractual service margin shall not be negative; loss-making contracts have no contractual service margin. Regarding our further comments we refer to our response to Question 1.

Concern remains on the measurement of the contractual service margin for reinsurance contracts written on an individual loss basis.

The ED's requirements for reinsurance ceded result in the cedant's deferral of both a net gain and a net loss through the reinsurance contractual service margin. We do not consider this to provide either relevant information or a faithful representation of an entity's performance. From an economic perspective, a reinsurance contract is highly dependent on the underlying direct insurance contracts, and this fact should be taken into consideration when measuring the corresponding reinsurance asset. Consequently, gains or losses on reinsurance contracts written on an *individual* loss basis ought to be immediately recognised in profit or loss by the ceding party. We do not propose any changes to the ED's requirements for reinsurance contracts written on an *aggregate* loss basis. For further details we refer to our response to Question 1.

The GDV supports the reflection of the asset dependency of certain cash flows in the insurance liability valuation, which is the underlying basis for the 'mirroring principle'. However, the *alternative approach* for participating contracts provides a better implementation of it being consistent with general measurement principles of the revised ED.

The GDV supports the reflection of the asset dependency while measuring the related insurance liabilities. However, the revised ED's proposals for accounting for participating contracts have only a restricted scope, are overly complex to implement and apply and do not consider the underlying economics of insurance contracts being a combined package of cash inflows and cash outflows generated by both financial and service elements. Especially, the revised ED's provisions how to implement the mirroring approach would require artificial, operationally very challenging (if not impossible) and arbitrary cash flow bifurcation. For these reasons the IASB's proposal is not operational for day-to-day business application. In addition, the IASB's mirroring approach also creates conceptual problems (e.g. no throughout current fulfilment value in the balance sheet) and raises theoretical aspects; especially the suggested decomposition of cash flows is not appropriate for the German participating mechanism.

For these reasons the GDV supports the ***alternative approach for participating contracts*** (outlined in Appendix 5 in EFRAG's Draft Comment Letter). It is also based on the mirroring principle. In addition, it relies on the consistent application of the general measurement principles of the revised ED, however in a way which significantly reduces the operational efforts for entities. In addition, the alternative approach allows for a more transparent and understandable accounting for participating contracts as it ensures a consistent current fulfilment valuation for all insurance liabilities. The industry proposal is also suitable to cover different types of contracts with participating features, thus has a significantly wider scope than the revised ED's proposal. Finally, the industry proposal **does not require** the operationally and theoretically challenging **decomposition of contractual cash flow** and removes the need for the narrow scope exception (paragraphs 33 and 34) which can be removed without replacement. Irrespective of that, the guidelines in paragraphs B86, BC59-BC61 and Illustrative Example 11 must be deleted in the final Standard.

Furthermore, the *alternative approach* is robust enough to **incorporate** the valuation of **options and guarantees**, which are traditionally embedded in insurance contracts in Germany. We disagree, that all changes in value of options and guarantees embedded into insurance contracts should be recognised immediately in profit or loss. This treatment would not consider insurance contract in its entirety as a unity and would not be in agreement with the Board's concept of contractual service margin as an 'unearned profit'. For these reasons the GDV favours to offset the time value changes of options and guarantees against the contractual service margin. The intrinsic value of options and guarantees is treated as an integral part of the insurance contracts' cash flows estimates, thus is reflected in the cash flow projections underlying the current fulfilment value estimate.

Presentation of 'insurance contracts revenue' in the income statement is not fully meeting the expectations of the industry.

The GDV appreciates the efforts undertaken by the IASB to respond to the requests of many insurers that volume information should be presented on the face of the income statement. However, we do not support the proposed definition of the new 'insurance contract revenue' number being the predominant top line in the income statement. Although we understand the Board's comparability arguments, we do believe that traditional volume information should and can be presented in the income statement. For our detailed suggestions and comments we refer to our response to Question 3.

An additional complexity is created by the requirement to disaggregate the "investment component" for presentation purposes in the income statement only. We disagree with this requirement. In our view the "investment component" should be treated as integral and highly interrelated part of the insurance premiums as consideration from the policyholder. We would favour a presentation approach for income statement that does not require the costly disaggregation exercise. Irrespective of that, the proposed definition of "investment component" might be too broad. Thus, at least, we request to clarify that the definition of "investment component" is not intended to go beyond what currently applied "deposit accounting" would require.

The GDV supports the retrospective approach to transition. A sufficient long transition period is crucial for successful implementation of the new principle-based standard.

The GDV fully supports the Board's decision to reconsider the initial transition provisions of ED/2010/8 which especially suggested 'erasing' of the contractual service margin for existing businesses. The revised approach of ED/2013/7 will ensure the **similar treatment of the existing and new business** which is essential for understandable performance presentation of insurers for the many years to come after the transition period. The retrospective approach will allow for consistent and faithful presentation of insurers' performance. Nevertheless, even with the suggested simplifications, such a retrospective approach will be operationally complex, challenging and costly to perform. The transition efforts would be significantly reduced and comparability of the information could be improved if the *alternative approach* for participating contracts accounting could be implemented as it is based on a fully prospective measurement.

Consistent interaction between IFRS 4 and IFRS 9 must be ensured.

An essential basis for a successful accounting framework for insurance contracts are robust accounting provisions of IFRS 9, thus a sufficiently consistent interaction between measurement and presentation provisions for insurance liabilities and financial assets (especially corporate and government bonds and equity). The GDV favours a 'two-sided OCI presentation approach' as stated above. Therefore, at least a broader scope of debt instruments must be eligible for the FVOCI category in IFRS 9. Finally, 'recycling' for gains or losses on equity instruments being measured at FVOCI must be allowed (e.g. at derecognition).

The mandatory effective dates for IFRS 9 and IFRS 4 must be aligned.

The inherent link between insurance liabilities and financial assets makes it indispensable to align the effective dates of finalised IFRS 4 and completed IFRS 9. Thus, we fully support the Board's tentative decision of 24th July 2013 to defer the mandatory effective date of IFRS 9 once again. In addition, we also explicitly agree with the decision that the mandatory effective date for IFRS 9 should be left open pending the finalisation of the impairment and classification and measurement requirements. We would like to reinforce our position that the mandatory effective date of the amended IFRS 9 should be deferred for insurers until the mandatory effective date of the finalised insurance contracts standard. Early application of both standards should be permitted.

Final remark

Being aware of the current stage of insurance contracts accounting we continue to encourage the Board to finalise the standard IFRS 4 Phase II in the near future. Our most **critical comments** above refer to the proposed approach for implementation of the mirroring *principle* and are intended to remove the unnecessary operational complexity and inappropriate artificial requirements in case of participating contracts in which the cost-benefit-relation is not a positive one. The related preferred *alternative approach* for participating contracts is a **constructive contribution** of the insurance industry, which would also remove the inappropriate recognition of changes in options and guarantees; these changes would be treated consistently with other parts of fulfilment cash flows estimates as an integral part of the service of the insurer.

Finally, the GDV supports convergence efforts as they are especially of importance for our members with large US activities. It would be very challenging and disappointing to them if they would be forced to deal with different accounting requirements in future after such a long period of joint deliberations.

For further comments and detailed explanations of our positions and suggestions for changes we refer to our detailed responses to the specific questions enclosed. Some of our comments might go beyond the scope of the revised ED. We believe that not only the key areas where the Board is explicitly asking for comments should be subject to further deliberations. For example, the proposed disclosure requirements are too prescriptive and too exhaustive.

Question 1 - Adjusting the contractual service margin

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if differences between the current and previous estimates of the present value of future cash flows if:

- (a) differences between the current and previous estimates of the present value of future cash flows related to future coverage and other future services are added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative; and
- (b) differences between the current and previous estimates of the present value of future cash flows that do not relate to future coverage and other future services are recognised immediately in profit or loss?

Why or why not? If not, what would you recommend and why?

Yes, in general, we agree that the proposed change in treatment of the contractual service margin will improve the faithful presentation of entities' financial position and performance. Especially, the proposed adjusting of the contractual service margin ('unlocking') will prevent counterintuitive accounting results and remove the logical break between the measurement concept applied at initial recognition and at subsequent balance sheet dates (BC31). However, some further technical adjustments are necessary; for example regarding treatment of changes in risk adjustment and of options and guarantees embedded in insurance contracts.

The adjustment of the contractual service margin for changes in cash flow estimates related to future coverage and other future services is a significant structural change in comparison to the provisions of the initial Exposure Draft ED/2010/8. The GDV fully supports this conceptual change. We also agree with the suggested interpretation of the contractual service margin as 'unearned profit' in an insurance contract (Appendix A to the revised ED/2013/7). Given the long-term nature of insurance it is appropriate that this expected future profit is not recognised at inception but deferred and released reflecting the provision of insurer's services over the coverage period. Consequently, changes from re-measurement of an insurance contract should not be recognised immediately in profit or

loss when the changes in non-financial or financial or estimates (e.g. reinvestment assumptions) relate to future coverage and other future services. This procedure is consistent with the current fulfilment value concept being basic element of the forward-looking building block approach for insurance contracts measurement.

The GDV agrees with the proposed constraint that the contractual service margin shall not be negative (paragraph 30). It is consistent with the provision that losses at initial recognition are not deferred over time. In addition, we also agree that the contractual service margin should be reinstated if the change in estimates reverses in subsequent periods. It is conceptually right that there is no constraint how high the reinstated value can be. Thus, the amount of the contractual service margin can exceed the one at previous initial recognition. Unfortunately, there might be different interpretations how the rebuilding of the contractual service margin should work in detail. With regard to our position we refer to our analysis in Question 7.

Although we reiterate our continuous support for explicit and separate risk adjustment ('risk margin') as an important component in presenting an economic valuation of the insurance contract liability, we believe that the principle of contractual service margin as 'unearned profit' should be more consequently implemented, i.e. the changes in the risk adjustment should also be offset against the contractual service margin. Thus, we request to offset also the periodical changes in risk adjustments against the contractual service margin as far they refer to future cash flows estimates, i.e. the future coverage periods. We acknowledge the rationale for the Board's tentative decision (BC36 and BC37). However, we have the strong view that the risk adjustment is integral to an insurer's business model, and it can be reliably measured. In addition, insurers are used to distinguish and determine separately the part of the risk adjustment that relates to the reporting period, to the incurred claims and the part that refers to future coverage based on actuarial assumptions. Thus, adjusting of the contractual service margin for changes in parts of risk adjustment would add some complexity to the building block model. But it would also make the contractual service margin for subsequent measurement consistent with measurement at initial recognition; thus, any potential increase in complexity would be outweighed by an increased consistency of the model. Finally, immediate recognition of all changes in risk adjustments in profit or loss would introduce an additional element of counterintuitive volatility in profit or loss which is not related to the current

reporting period. We strongly believe that such effects should be avoided and we think that it is essential to measure the contractual service margin consistently with its intended interpretation as future “unearned profit”.

With regard to our position on the appropriate treatment of changes in value of options and guarantees embedded in insurance contracts in combination with the concept of an unlocked contractual service margin we refer to our response to Question 2. The same refers to our positioning with regard to the treatment of changes in financial estimates (e.g. assumptions regarding returns from assets backing insurance contracts).

Although we consider it conceptually right to accrete interest on the contractual service margin as suggested by the Board for the building block approach, we assess that the operational costs for prepares might exceed the potential benefits of this exercise for users, especially in cases of short-term contracts. For practical reasons only, we recommend to not require (but to allow) the accretion of interest on the unlocked contractual service margin (using the interest rate yield curve determined at the contract inception) in such cases, similar to the simplified approach (paragraph 40). Regarding the implicit accretion of interest on the adjusted contractual service margin in case of participating contracts we refer to our detailed response to Question 2.

Alternative approach for measurement of contractual service margin for reinsurance assets in reinsurance contracts written on an individual loss basis necessary

The GDV fully agrees with the IASB’s differentiation between reinsurance contracts written on aggregate loss basis and reinsurance contracts written on individual loss basis (BCA132) because this depicts adequately the nature of the reinsurance business. And we do not request any changes to the revised ED’s requirements for reinsurance contracts written on *aggregate* loss basis.

However, the GDV is concerned about the proposed measurement of reinsurance ceded, in particular regarding the measurement of the contractual service margin for a reinsurance asset (i.e. from the perspective of the primary insurer) in case of reinsurance contracts on *individual loss basis* (BCA132). The IASB’s proposed measurement requirements might not appropriately reflect the economics of this kind of reinsurance transactions. The GDV favours the immediate recognition of

day one losses or gains from reinsurance contracts for cedant, to extend when justified by underlying economics (i.e. the relief generated by the reinsurance cover).

From an economic perspective, a reinsurance contract is highly dependent on the underlying direct insurance contracts. We believe this rationale should be reflected when measuring the corresponding reinsurance asset; i.e. the measurement of the contractual service margin of the reinsurance asset should be based on the risk transferred from the cedant to the reinsurer. Contrary to the calibrating of the contractual service margin in relation to reinsurance premium paid and the proposed complete deferral of the day one losses or gains over time (revised ED's proposal) we suggest an immediate recognition in profit or loss, as a result of determination of contractual service margin for the reinsurance asset in relation to proportion of the risk adjustment of the reinsurance asset to the risk adjustment of the insurance liability, applied to the residual margin of the insurance liability. This suggested approach for reinsurance contracts on *individual loss basis* would also avoid misleading presentation in the balance sheet.

Thus, to the extent the benefit of the purchase of reinsurance contract for the cedant is irrevocable it should be realised at inception of the contract and not be deferred. The additional advantage of the proposed treatment would be also that the balance sheet reader would get the right impression to what extent the reinsurance asset refers to the share ceded in fact to reinsurer. Furthermore, the suggested treatment would prevent accounting arbitrage opportunities as it would not be possible to defer the recognition of realised economic gains or losses. Finally, the suggested treatment would remove the asymmetric measurement which is creating intercompany differences for group accounting.

We do not propose any changes to the ED requirements for reinsurance contracts written on an aggregate loss basis.

Question 2 - Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items

If a contract requires an entity to hold underlying items and specifies a link between the payments to the policyholder and the returns on those underlying items, do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if the entity:

- (a) measures the fulfilment cash flows that are expected to vary directly with returns on underlying items by reference to the carrying amount of the underlying items?
- (b) measures the fulfilment cash flows that are not expected to vary directly with returns on underlying items, for example, fixed payments specified by the contract, options embedded in the insurance contract that are not separated and guarantees of minimum payments that are embedded in the contract and that are not separated, in accordance with the other requirements of the [draft] Standard (ie using the expected value of the full range of possible outcomes to measure insurance contracts and taking into account risk and the time value of money)?
- (c) recognises changes in the fulfilment cash flows as follows:
 - (i) changes in the fulfilment cash flows that are expected to vary directly with returns on the underlying items would be recognised in profit or loss or other comprehensive income on the same basis as the recognition of changes in the value of those underlying items;
 - (ii) changes in the fulfilment cash flows that are expected to vary indirectly with the returns on the underlying items would be recognised in profit or loss; and
 - (iii) changes in the fulfilment cash flows that are not expected to vary with the returns on the underlying items, including those that are expected to vary with other factors (for example, with mortality rates) and those that are fixed (for example, fixed death benefits), would be recognised in profit or loss and in other comprehensive income in accordance with the general requirements of the [draft] Standard?

Why or why not? If not, what would you recommend and why?

Unfortunately, the **GDV can't support the proposed application** of mirroring concept (i.e. recognition of inherent linkage between insurance liabilities and underlying assets for purposes of valuation of insurance contracts) because it would not provide relevant information that faithfully represents the entity's financial position and performance. In particular, the proposed approach would not ensure a consistent current fulfilment measurement of all insurance contracts (balance sheet effect). In addition, artificial volatility from immediate recognition of changes in time value of options and guarantees that relate to future services distorts presentation of performance for the current reporting period (income statement effect).

In the following we would like to explain in more detail why we disagree with the Board's revised proposal for participating contracts accounting (i.e. "mirroring *approach*") and what alternative approach we do favour. For clarity purposes we outline which adjustments to the revised ED are necessary to allow for application of the preferred alternative approach. Finally, we highlight how the favoured OCI presentation (Question 4) interacts with the alternative approach we support.

Rationale for our refusal of the Board's proposal for "mirroring *approach*"

We would like to explicitly highlight that we appreciate and fully support the introduction of the "mirroring *principle*" for participating contracts accounting. Especially, in our previous response to the initial Exposure Draft ED/2010/8 we have requested a consistent accounting approach which considers the interconnectedness of insurance liabilities and underlying financial and non-financial assets, especially to avoid artificial accounting volatility. We fully acknowledge that the Board's proposal is a conceptual attempt to address this crucial issue for insurers. However, the principles and the prescribed technique of the proposed IASB's approach to implement such a solution (as outlined in the revised Exposure Draft ED/2013/7) do not meet our expectations. They are overly complex and too sophisticated to be operational. For example the explicit requirement to decompose the contractual cash flows (paragraph B85) is introducing an unfeasible level of complexity in the accounting framework as it would request an artificial, operationally very challenging cash flow splitting exercise which is not in line with the current actuarial practice and cannot be fulfilled on a non-arbitrary basis. In addition, the suggested approach would cause significant theoretical concerns. Finally, the **suggested decomposition of cash flows is not appropriate** for German participating mechanism. From the perspective of German regulatory

environment the policyholder participation includes not only the contractual and discretionary participation in the assets returns (i.e. investment result); but it must also consider obligatory required participation in risk result and cost result if positive.

Thus, the required **decomposition of contractual cash flows is a critical area of the revised proposals**. Instead the insurance contracts should be treated in their entirety as a unity, as a package of contractual cash inflows and cash outflows. Irrespective of our further comments below, the proposed guidelines in paragraph B86, and the explanations in BC59-BC61 must be deleted. Also the prescribed interpretation in paragraph B85 and the Illustrative Example 11 should be removed. They are not in line with the aim of a principle-based standard.

In addition, the current Board's proposal has a **restrictive scope** only as it requires that the entity holds the underlying assets and a link to the policyholder payments resulting from these assets needs to be specified. In GDV's strong view, all participating contracts should be treated in a similar way. Thus, a robust principle-based accounting framework for insurance contracts should not need to distinguish between contracts with "contractual linkage" and other contracts with participating features.

The revised ED/2013/7 introduces potentially **constraints regarding the full prospective recalibration of the contractual service margin** with regard to the shareholders' profit expectations which might not be in line with the principle of 'no gain recognition at contract's inception' and the function and the Board's interpretation of the contractual service margin as a future 'unearned profit'. In our view, all changes in future gross profit expectations (e.g. cumulative effects of changes in reinvestment assumptions) should not be recognised in profit or loss immediately, but should be deferred by a transparent offset against the contractual service margin until the moment of realisation. The GDV sees it as a critical element of the robust measurement concept for insurers as their profits are earned / realised over the coverage time. Thus, all changes in *non-financial* or *financial* assumptions which affect the profitability of insurance contract should be available to be reflected in the fully prospectively measured contractual service margin.

Furthermore, also **options and guarantees** embedded in the insurance contracts are inherent part of these insurance contracts and thus represent services provided by insurer. For these reasons we object the

proposed accounting treatment of options and guarantees which are traditionally embedded in long term insurance contracts in Germany and are not unbundled for the purposes of ED/2013/7 (paragraph 10 (a)). We are deeply concerned that the revised ED requires that all subsequent changes in the (intrinsic and time) value of the embedded options and guarantees would be immediately recognised in profit or loss, resulting in economically misleading and thus inappropriate performance volatility. **We strongly disagree with that proposal.** In our view, also for consistency purposes, the contractual service margin should be adjusted for changes in estimates of options and guarantees that affect future cash flows and future services. This would be consistent with the treatment of the other parts of fulfilment cash flows and as well consistent with the determination of the contractual service margin at initial recognition.

The GDV supports the *alternative approach* for participating contracts (Appendix 5 of the EFRAG's Draft Comment Letter)

For the critical reasons stated above the **GDV favours and strongly supports the *alternative approach* for participating contracts** as outlined in Appendix 5 of the Draft Comment Letter of European Financial Reporting Advisory Group (EFRAG). In general, the alternative approach proposes a fully prospective current measurement of all insurance contracts and is based on the present value of the fulfilment cash flows, i.e. conceptually follows the general building blocks approach. The alternative approach represents a consistent application of the 'unlocking principle' with regard to participating contracts and designs a less complex approach for application of the 'mirroring principle'. Especially, the alternative approach incorporates the mirroring principle **without** the need for arbitrary **decomposition of contractual cash flows** which is operationally not feasible in German product environment as results from the field test exercise are demonstrating.

The *alternative approach* suggests that insurance contracts should be valued in their entirety as a package of cash inflows and cash outflows. The **asset dependency** of the insurance liability is reflected in cash flow projections and likewise by determination of the discount rate. Cash flow projections and discount rates need to be aligned to avoid a distortion of results. The similar provision regarding the discount rate is already prescribed in paragraph 26 (a) of the revised ED; this should be retained and be available for all contracts with similar characteristics. We also agree with the suggested principle that entities should update the locked-

in discount rates for profit or loss recognition when there is an expectation that any changes in the projected returns will affect the cash flows attributed to insurance contracts liability (paragraph 60 (h)). Indeed, the use of *current* portfolio book yield is necessary to reflect the current projections of future cash flows, i.e. the asset returns dependency *and* the reinvestment assumptions when the duration of the liability exceeds the duration of the underlying assets.

The underlying character of participating business makes it indispensable to adjust the contractual service margin also for changes in estimates relating to returns from assets backing insurance liabilities (i.e. financial assumptions (as reinvestment assumptions)). The application guidance in paragraph B68 (d) clarifies that contractual service margin is not adjusted for changes in estimates of cash flows that depend on investment returns *if* those changes arise as a result of changes in the value of the underlying items. We interpret this provision that contractual service margin can be adjusted for changes in estimates of cash flows that depend on investment returns *if* those changes arise as a result of e.g. adjusted reinvestment assumptions if those changes influence forecasted periodical yield, i.e. interest income from the underlying items. We assume that changes in these estimates are offset against the contractual service margin. It is also consistent with the implicit provision of paragraph B67 (a) that investment returns on underlying items are considered in measurement of expected cash flows, if they depend on investment returns and not at fair value of underlying items. Thus, we disagree with the interpretation of other Board's decision as described in BC41 and suggest deleting or rewording of this paragraph.

In addition, the alternative approach suggests a consistent treatment of changes in time value of **options and guarantees** which are not unbundled. To avoid economically misleading performance volatility it is recommended that the re-measurement of options and guarantees should be included in the re-measurement of the insurance contract as a package of rights and obligations. Thus, future value changes should be available for offset by a corresponding unlocking of the contractual service margin. As explained above, this is consistent with the treatment of the other parts of fulfilment cash flows and as well consistent with the determination of the contractual service margin at initial recognition.

We are aware that some insurers prefer to present changes in time value of options and guarantees in other comprehensive income (OCI) as the recalibrated contractual service margin might not always be sufficient to capture the whole impact in case of volatile movements in time value of options and guarantees. However, in GDV's view the use of OCI presentation for these purposes would contradict the understandable interpretation of the contractual service margin as unearned future profit; especially when OCI becomes negative. Thus, the changes in time value of options and guarantees shouldn't be treated differently as other fulfilment cash flows. We argue that the currently reported future profitability of the insurance contracts is consistently presented in the contractual service margin. Nevertheless, in both views (i.e. offset against contractual service margin or use of the OCI presentation) there is a common understanding that an immediate recognition in profit or loss should be avoided as an inappropriate effect.

The *alternative approach* for participating contracts proposed by the European insurance industry relies on the general principles of the measurement model of the revised ED. Consequently, the GDV suggests deleting the paragraphs 33 and 34 (and the corresponding references, e.g. in paragraph 80 or related applications guidance in paragraphs B83 - B87) of the revised ED without replacement. In addition, an explicit provision to accrete interest on the contractual service margin is not necessary in the alternative approach as it will be calculated on a full prospective basis at every balance sheet date. As the contractual service margin reflects the remaining unearned profit, the release pattern of the margin is based on the changes of the present value of expected future profits. Implicitly the accretion of interest would correspond to the 'book yield' being used for calculation of the current fulfilment values of the insurance liability and for determination of interest expense in profit or loss. Consequently it would be updated according to the changes in the reinvestment assumptions; similarly to the provisions of the revised ED/2013/7 (paragraph 60 (h)).

The GDV kindly requests the following **indispensable adjustments** of the proposals in the revised ED/2013/7 which are **necessary to implement the *alternative approach* for participating contracts** instead of the narrow-scoped *mirroring approach* of the IASB:

- The requirement to decompose contractual cash flows for participating contracts must not be included in the final standard.

- The exemption treatment for insurance contracts that require the entity to hold underlying items and specify a link to returns on those underlying items (“mirroring approach”) must be removed.
- The contractual service margin must be calculated in a fully prospective way to achieve methodological consistency between initial and subsequent measurement and transparent presentation of unearned future profits from insurance contracts.
- The contractual service margin must be unlocked also for changes in financial assumptions (e.g. reinvestment assumptions) to consistently reflect the remaining unearned profit of insurance contracts.
- The changes in value of options and guarantees embedded in insurance contracts and being not subject to unbundling requirements must be treated as inherent part of insurance contracts’ cash flows estimates.

Furthermore, we would like to summarise the **advantages of the *alternative approach*** in relation to the Board’s provisions (as outlined in the revised ED/2013/7):

- The narrow scope exception for some ‘participating contracts’ can be removed and general principles of the IASB’s current measurement model can be applied.
- The artificial decomposition of contractual cash flows is not necessary what significantly reduces operational complexity.
- The alternative approach treats all insurance contracts with participating elements in a similar way.
- The inherent link between insurance liabilities and underlying assets is considered by defining the asset dependent discount rate *and* in the cash flow projections for the valuation of insurance liabilities (including the forecast regarding policyholders’ participation in the predicted assets returns).

[*Note: From the perspective of German regulatory environment cash flow projections need to explicitly include the forecast participation in risk result and cost result when positive.*]

- The results of the alternative approach for participating insurance contracts are consistent with non-participating insurance contracts

as in both cases a full current measurement of insurance liabilities is ensured.

- The income statement reflects the long-term nature of insurance contracts; only realised returns for services provided are presented. The expected future profit is transparently reflected by the fully prospectively calculated and recalibrated contractual service margin. Both contribute to more understandable financial statements of insurers towards users.

Finally, if the **alternative approach** for participating contracts could be implemented, it **would also significantly reduce the transition efforts** (as it is based on a fully prospective measurement); and thus increase the comparability of the information provided.

The use of the preferred OCI presentation and the *alternative approach*:

- From the GDV's perspective the 'two-sided OCI presentation' is a key element of the *alternative approach* of the insurance industry for robust and consistent accounting framework for participating contracts when considering the German product environment with participating mechanisms based on statutory accounting and the realisation principle. Entities would use the OCI to present changes in the insurance liability arising from changes in the current discount rates in the period in which the duration of the insurance liability and related assets are matched (i.e. asset-liability matched period). Accordingly, the cumulated amounts presented in OCI would reflect effects of short-term movements in the discount rates that reverse automatically over time and that do not affect performance.
- However, interest rate movements will impact the performance of the entity if the entity is exposed to reinvestment risk after the matched period (i.e. if there is an asset-liability mismatch period). In that case, the present value of future profits will change and entities would adjust the contractual service margin to reflect a higher or lower expected reinvestment yield in the gross profit arising from the portfolio. The reinvestment yield would be measured based on market assumptions. Thus, there would be no cumulated OCI amounts to be reported. Thus, the effect of any duration mismatch as an economic mismatch would be fully transparently reported in contractual service margin and then released in profit or loss.

Nevertheless, we would like to highlight that the *alternative approach* for participating contracts developed by the *European* insurers is also consistently applicable to a portfolio of insurance contracts and the related assets that are managed on a *fair value through profit or loss basis*. The alternative approach can also be applied for different participation mechanisms for policyholders; e.g. irrespective if policyholder participation refers to periodical fair value changes or only to the final fair value surplus. Finally, depending on the specific composition of the portfolio of assets backing insurance liabilities (e.g. debt instruments not available for FVOCI-category, equity not measured at FVOCI, investment property) might make the profit or loss presentation of current value changes in the insurance liability more appropriate. For these reasons we support a non-mandatory use of OCI presentation in the final standard to allow for profit or loss presentation if more appropriate. Thus, we advocate for introduction of a *supplementary option* to present the effect of changes in discount rate in profit or loss when it eliminates or significantly reduces an accounting mismatch.

Question 3 - Presentation of insurance contract revenue and expenses

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if, for all insurance contracts, an entity presents, in profit or loss, insurance contract revenue and expenses, rather than information about the changes in the components of the insurance contracts?

Why or why not? If not, what would you recommend and why?

In the initial ED/2010/8 the IASB proposed a 'summarised margin approach' which completely eliminated the presentation of traditional volume numbers (i.e. premiums, claims and expenses) from the income statement. It was solely focused on reporting of changes in expected values of the elements of the building blocks model (i.e. change in contractual service margin, change in risk adjustment, experience adjustment); thus it was driven by the approach for insurance liabilities measurement. Considering the prospective character of the margins and the importance of an appropriate and widely accepted top line in the income statement the GDV tended to be concerned if information produced by the 'summarised margin approach' would be decision-useful for users of financial statements. More or less the 'summarised margin approach' seemed to depreciate the relevance of income statement to some extent as the pure presentation of margin changes themselves might not be meaningful enough, neither for preparers nor for users. Nevertheless, we do recognise that the 'summarised margin approach' effectively eliminated the need for investment component disaggregation; it was unnecessary to separate the deposit receipts from the premium because the whole premium amount was proposed to be treated in the same way as deposit elements.

In the revised ED/2013/7 the IASB requests comments on the 'insurance contract revenue' number in comparison to the previous proposal. The newly created insurance contract revenue number is meant to represent the consideration for insurer's coverage and other services provided for the policyholder during the reporting period.

In GDV's assessment, the presentation approach for income statement remains one of the prominent and controversial areas of the insurance contract project. We continuously believe that the predominant importance of income statement's design should not be underestimated and traditionally used volume information should be presented in the income statement as relevant information to users about insurers' business performance. Thus, we support the Board's proposal to re-introduce "incurred claims and other expenses" (paragraph 57) as volume information into the income statement. Our concern is the newly created 'insurance contract revenue' number (paragraph 56), although we acknowledge the consistency with the revenue recognition project and the argument regarding the enhanced comparability with other industries. In addition, we appreciate the IASB's efforts to consider the previous request to present a volume amount in the income statement. Nevertheless, the proposed approach is operationally burdensome. In addition, the proposed "insurance contract revenue" seems to not provide relevant information for users. Especially, we do not support the prescribed *definition* of "insurance contract revenue" (paragraph B90) for insurance contracts within the scope of general building block model. We believe that it would not provide users of financial statements with key performance indicators of insurers they are traditionally used to.

In the GDV's view, both margin and volume information is essential for the understanding of an insurer's business performance. Thus, we continue to believe that traditional volume information (i.e. premiums, claims and expenses) should be presented on the face of the income statement for all insurance contracts. The current proposal of the revised ED does not offer a complete approach for useful performance reporting for insurers. The Board seems to overstate the comparability argument with other industries and possibly neglects the importance of gross premiums information for users of insurers' financial statements. It should be ensured that users of insurers' financial statements are not confused by new income statement design where the commonly known key business indicators, as premiums, have to be discovered within notes what might create unneeded 'search costs'. Thus, we tend to believe that neither the initial summarised margin approach (ED/2010/8) nor the 'insurance contract revenue' (ED/2013/7) approach provide in separation sufficiently beneficial and understandable information for users. Especially, we believe that traditional volume numbers (e.g. premiums as customer's consideration) are compatible with measurement model based on current expected fulfilment values.

Finally, we would like to highlight that the Board's proposal how to present the premiums for the optional simplified premium allocation approach (paragraph B91) meets the expectations of German insurers as the relevant volume information ("amount of the expected premium receipts allocated in the period") are presented on the face of income statement.

Concerns regarding obligatory investment component disaggregation

An unnecessary complexity without a significant benefit for users is created by suggested requirement for disaggregation of 'investment components' (paragraph 58). The expected benefits of this provision for users might not outweigh the significant operational efforts for preparers as the data required are not readily available and are inherently difficult to obtain. Furthermore, allocation of some of these 'investment components' would be unduly arbitrary and would not provide comparable information. We note that the 'investment component' disaggregation is required for income statement presentation purposes only and not for presentation in the statement of financial position. In addition, the Board's proposal is to present disaggregated insurance contract revenue and claims, while users of insurers' income statements are traditionally used to focus on simple gross volume measures (premiums, claims and expenses). As such the costs of the disaggregation exercise for entities will outweigh any potentially negligible benefits for users.

For these reasons the GDV does not support the requirement to disaggregate 'non-distinct' investment components from premiums and claims as they are highly interrelated with the insurance component. In addition, the required computation would be very challenging. Furthermore, conceptually, paragraph 58 is inconsistent with the revised ED's proposal not to unbundle 'non-distinct' elements of insurance contracts (paragraph 10 (b)). The GDV explicitly supports the Board's decision not to unbundle the investment components when they are not distinct and highly interrelated with the insurance contracts (B31). In those cases the disaggregation for income statement's presentation purposes only might be a disproportionate requirement.

Should the requirement to disaggregate the 'investment component' be included in the final standard, there might be further clarification of the 'Investment component' definition needed. The tentatively suggested definition of 'investment component' (Appendix A) might be too broad and

have the unintended consequence that also some components are to be identified and separated out of premiums although it might not have been the intention of the IASB while following the idea of 'deposit accounting'. Thus, we believe that the current definition might capture a wide range of insurance contracts and their components. For example a surrender value in term life assurance might include not only a deposit element but also represent premium elements which inherently refer to future coverage, having not pure saving character but also risk premium character. Further, sliding commissions and no-claims bonuses might be classified as investment components and require disaggregation, surrender values may be caught, as will life contingent annuity contracts which sometimes have a minimum pay-out if death occurs in the initial years of the contract. Thus, we believe the disaggregation requirements will be more complex than the IASB might have envisaged.

We encourage the IASB to clarify that clauses typically used in reinsurance contracts like sliding scale commissions or experience refunds do not lead to the requirement for disaggregation of investment component. Thus, we suggest an explicit amendment to BC91 or BCA206 that any price adjustments clause or claims sensitive clause is not necessarily resulting in a disaggregation requirement.

Question 4 - Interest expense in profit or loss

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if an entity is required to segregate the effects of the underwriting performance from the effects of the changes in the discount rates by:

- (a) recognising, in profit or loss, the interest expense determined using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows; and
- (b) recognising, in other comprehensive income, the difference between:
 - (i) the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date; and
 - (ii) the carrying amount of the insurance contract measured using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows?

Why or why not? If not, what would you recommend and why?

Yes, we strongly agree with the Board's assessment that the proposed segregation of the effects of the underwriting performance from the effects of changes in the discount rates would significantly improve the faithful presentation of **entities' performance** and make it more **transparent**. The introduction of the other comprehensive income (OCI) presentation for current value changes related to discount rate movements would provide very relevant information to users and preparers.

We would like to reiterate our key position regarding the essential need to distinguish between short-term volatility ('market noise') and long-term trends in the underlying performance of insurers regarding the income statement presentation, with the aim to avoid economically misleading and inaccurate volatility in performance presentation. We appreciate that the IASB intends to address this major market volatility issue in net income of

long term oriented insurers relying on the OCI presentation approach in IFRS 4 while finalising the project. **The GDV strongly supports the transparent OCI presentation approach as it creates an explicit added value to users and preparers.**

The GDV is supportive of the Board's general measurement model for insurance liabilities based on current fulfilment values as outlined in the revised ED. And we support the consistent presentation of current fulfilment values of insurance liabilities in the balance sheet. However, the underlying long-term business performance of insurers can only be properly reflected in the income statement if short-term market values fluctuations are separated from the income statement and presented fully transparently in other comprehensive income. Thus, we appreciate the introduction of the OCI presentation for changes in current fulfilment value of insurance liabilities related to changes in the discount rate (paragraph 64) as key performance indicators of insurers will not be overshadowed or distorted by short-term market volatility ('market noise').

The Board's pragmatic decision to limit the use of the OCI presentation for effects of changes in the discount rates only, is a valid one. It addresses the most significant source of the volatility in insurance contracts' current measurement. In addition, we support the proposed updating mechanism as defined in paragraph 60 (h) of the revised ED which is underlying also the design of the *alternative approach for participating contracts*.

Irrespective of our strong support for the introduction of the OCI presentation for current fulfilment value changes in IFRS 4 when related to discount rate changes, we do recognise the existing diversity of different insurance products. Therefore, we recommend the introduction of a supplementary alternative for profit or loss presentation of current fulfilment value changes related to changes in discount rate in IFRS 4; similar to the full fair value option which is common on the asset side for financial instruments in IFRS 9. Especially, in case of unit-linked products with fair value participations of the policyholder and when these products are managed on the fair value basis or the underlying items are not available for FVOCI measurement category the alternative profit or loss presentation might be more appropriate. Especially, an alternative possibility for profit or loss presentation would reflect the matter of fact that not all asset categories are currently available for FVOCI category and significant accounting mismatch may arise if large share of assets would be outside the FVOCI treatment. For these reasons we advocate for

supplementary optional use of profit or loss presentation when it eliminates or significantly reduces accounting mismatch.

Finally, we would like to underline that the two-sided OCI presentation is a key element of the *alternative approach* for robust and consistent accounting framework for participating contracts when considering the German product environment with a participating mechanisms based on statutory accounting and realisation principle. Nevertheless, the *alternative approach* is also applicable to a portfolio of insurance contracts and the related assets that are managed on a fair value through profit or loss basis. The *alternative approach* can also be applied for different participation mechanisms for policyholders; e.g. irrespective if participation refers to periodical fair value changes or only to the final fair value increase. For further explanations we refer to our detailed response to Question 2. Also for these reasons we support a non-mandatory use of the OCI presentation for discount rate changes in the final IFRS 4.

Supplementary notes on the interaction with IFRS 9

A holistically integrated and **consistent accounting approach** for insurers requires a similar accounting treatment of all assets covering long-term insurance liabilities. Indeed, a robust two-sided OCI presentation approach is necessary. Ideally, the OCI presentation should be available for any investment (especially all debt instruments, investment properties, and also equities) designated to cover insurance liabilities. However, the GDV acknowledges the strategic Board's decision not to develop industry specific standards. For pragmatic reasons we support the limited amendments to IFRS 9 *Financial Instruments* as proposed by the IASB in the ED/2012/4. Especially, the suggested introduction of the **FVOCI category** for simple debt instruments will improve (although not fully ensure) the level playing field for the insurance industry in comparison to banks' accounting practice where a consistent use of amortised cost accounting is, in general, already feasible.

A conceptually consistent use of the OCI presentation also requires that 'recycling' of realised gains or losses is allowed, latest at derecognition (e.g. at the moment of realisation through sale) of affected items. Therefore we advocate for introduction of **recycling** in case of equities being optionally measured at FVOCI in IFRS 9. Regarding our further positions on ED/2012/4 we refer to our response of 19th March 2013.

Question 5 - Effective date and transition

Do you agree that the proposed approach to transition appropriately balances comparability with verifiability?

Why or why not? If not, what do you suggest and why?

Transition requirements

Yes, in general, we support the proposed revised transition provisions.

The initial Exposure Draft ED/2010/8 suggested direct release of future expected profits resulting from existing business on transition date to retained earnings. It was a very controversial proposal as it would completely erase the contractual service margin related to the existing business, i.e. insurance contracts being in force at the transition date. Effectively, the income statement presentation would reflect a kind of a start-up's performance. The GDV had heavily opposed such approach as it would distort the faithful presentation of insurers for a significant period of time after the transition date.

Therefore, we appreciate the suggested revised approach for transition. We welcome the suggested introduction of the retrospective transition provisions in line with IAS 8 *Accounting policies, changes in accounting estimates and errors*, with the use of practical expedients. The proposed retrospective application of new accounting principles is a suitable way to insure the **consistency in accounting treatment between existing and new business** after the transition period. The general approach and the developed modified/simplified application of the retrospective transition requirements better meets the expectations of the insurance industry and will provide consistent, and therefore useful and understandable information to users, analysts and policyholders. Nevertheless, the suggested approach is still subject to deeper analysis during the field-test activities.

The GDV would not share the view that, in some cases, the estimates of the contractual service margin may not be verifiable (page 10 of the revised ED). We do believe that also affected entities would implement verifiable pragmatic solutions which can be audited by statutory auditors

as plausible. Thus, we would not favour the misleading description of the operational challenges on transition.

We would like to highlight that the *alternative approach* of the insurance industry for participating contracts suggests the fully prospective recalibration of contractual service margin. Therefore, the *alternative approach* would eliminate the need for its retrospective recalculation upon transition to the new IFRS 4 and thus significantly reduce complexity at transition.

Finally, irrespective of the proposed simplifications *and* irrespective of our strong support for the *alternative approach* for participating contracts, we would like to confirm our strong view that suitable transition period of at least three years after the final release of the standard is indispensable to properly implement new principle-based requirements. Especially German life insurers will need considerable time in order to adopt the final standard. All insurers will have to invest considerable efforts to adjust existing IT systems for the new accounting framework and to train their staffs. Also users would need time to learn to understand how the new principle-based measurement and presentation requirements have been implemented after the announcement of the final standard (and after endorsement in the EU).

Mandatory effective date

With regard to the mandatory effective date we refer to our General Comments and to the core position of the insurance industry that an **alignment of mandatory effective dates of IFRS 9 and IFRS 4 is of essential importance.**

In our previous responses towards IASB regarding the proposed changes to IFRS 9 we kept continuously to state that the inherent linkage between insurance liabilities and financial assets makes it indispensable to align the effective dates of IFRS 4 and IFRS 9. Thus, we support the Board's decision of 24th July 2013 to defer the mandatory effective date of IFRS 9. We also agree with the decision that the mandatory effective date should be left open pending the finalisation of the impairment (Phase II) and classification and measurement (Phase I) requirements. In addition, the Board decided that IFRS 9 should remain available for early application.

Referring to these decisions we would like to reinforce our position that the implementation of IFRS 9 and IFRS 4 in two separate rounds would lead to significant operational costs and would be also very challenging to users with regard to interpretation of presented business performance. Therefore, we recommend that the mandatory effective date of the amended IFRS 9 should be deferred for insurers until the mandatory effective date of the finalised insurance contracts standard. Nevertheless, early application of both standards should be permitted.

If the mandatory effective dates cannot be aligned, we generally request that insurers should be granted an unrestricted ability to reclassify financial instruments at the date of transition. However, this approach would not be the GDV's first preference as it would impose an operational burden on insurers to deal effectively with two transition dates. It is more efficient to require insurers to adopt the completed IFRS 9 *Financial Instruments* and the final IFRS 4 *Insurance Contracts* at the same time.

Question 6 - The likely effects of a Standard for insurance contracts

Considering the proposed Standard as a whole, do you think that the costs of complying with the proposed requirements are justified by the benefits that the information will provide? How are those costs and benefits affected by the proposals in Questions 1 - 5? How do the costs and benefits compare with any alternative approach that you propose and with the proposals in the 2010 Exposure Draft? Please describe the likely effect of the proposed Standard as a whole on:

- (a) the transparency in the financial statements of the effects of insurance contracts and the comparability between financial statements of different entities that issue insurance contracts; and
- (b) the compliance costs for preparers and the costs for users of financial statements to understand the information produced, both on initial application and on an on-going basis.

Note: Some of our following remarks refer to issues, on which an explicit assessment is not requested by the IASB. Nevertheless, we believe, that they also should be considered during the coming re-deliberations of the revised ED/2013/7.

The general assessment of the revised proposals for IFRS 4

As a matter of fact, the implementation of the new principle-based **standard will be very challenging and demand considerable operational efforts from all preparers, especially insurers.** Nevertheless, the final standard IFRS 4 is intended to eliminate the diversity and weaknesses in current financial reporting requirements for insurance contracts. We appreciate the enormous work invested by the IASB-Board and its staff. We strongly encourage the Board to finalise the standard in the near future.

In general, the revised ED/2013/7 is a **significant improvement** in comparison to the initial ED/2010/8 from July 2010. Especially, we acknowledge the revised provisions for the transition approach, the decision to unlock the contractual service margin and the suggested OCI presentation as an essential approach to address the legitimate insurers'

concerns regarding the inappropriate volatility in the performance reporting under the current measurement environment.

Furthermore, we explicitly acknowledge that IASB undertook considerable efforts to address the crucial issue of insurance accounting: the inherent interaction between insurance liabilities and financial and non-financial assets (e.g. financial instruments as corporate or government bonds) backing these liabilities. A consistent interaction between accounting provisions of IFRS 4 and IFRS 9 is crucial for a transparent, consistent and decision-useful presentation of insurers' financial position in the balance sheet and their long-term underlying business performance in profit or loss. As highlighted above and in our previous comment letters towards IASB, technical adjustments of current IFRS 9 accounting provisions are needed; especially the introduction of the FVOCI category is essential. In addition, it should be supplemented by introduction of FVOCI option for financial instruments being otherwise measured mandatorily 'at amortised cost'. Furthermore, a wider scope of FVOCI category has to be ensured as not only simple debt instruments should be eligible to preferable FVOCI treatment. Finally, as stated above, insurers should not be required (but permitted) to adopt IFRS 9 before the mandatory effective date of IFRS 4. Otherwise the usefulness of financial reporting for users in the period between the adoption of IFRS 9 and IFRS 4 would significantly suffer. Also preparers would challenge two significant transition exercises in short succession. We believe that these issues might also influence the balance between costs of implementation and benefits of the new insurance contracts standard.

Nevertheless, there are some **critical areas of the revised proposals in ED/2013/7 remaining** which require significant adjustments to achieve a workable accounting framework where the compliance cost for preparers does not overweight the expected benefits for users. With regard to these critical areas, which are outlined above in our response, we do not think that Board's proposed solutions would improve the transparency of financial reporting of insurers at a reasonable cost. Especially, we believe that the *alternative approach* for participating contracts would mend the main insufficiencies of the IASB's current proposal and make use of the mirroring principle in a workable way and thus close the operational gap.

The *alternative proposal* for participating contracts provides a feasible application of the mirroring principle

As explained above, the critical area of our fundamental concern remains the appropriate accounting treatment of participating business. The proposed revised measurement model exception is not appropriate to adequately reflect the nature of the German participating business. Especially, the implicit **requirement to arbitrary split the contractual cash flows is fundamentally objected** by German insurers. The *alternative approach* applies the mirroring principle in combination with the prospective recalibration of contractual service margin resulting in a more understandable and consistent presentation of participating contracts. In addition, the *alternative approach* significantly reduces the complexity of the accounting framework as it does not require the overly complex and artificial decomposition of contractual cash flow. Further, the *alternative approach* treats the **options and guarantees embedded in insurance contracts** as integral part of the insurance contracts' cash flows when they are not unbundled. Finally, the proposed consistent prospective recalibration of the contractual service margin would also significantly reduce the transition burden for insurers and other entities.

The revision of accounting provisions for financial instruments should consider the inherent interaction with the insurance contracts project.

In the GDV's response of 19th March 2013 to the IASB's Exposure Draft ED/2012/4 *Classification and Measurement: Limited Amendments to IFRS 9 (Proposed Amendments to IFRS 9 (2010))* we have expressed our support for the proposed changes in provisions for financial instruments accounting, especially for the proposed introduction of fair value through other comprehensive income (FVOCI) category for simple debt instruments in IFRS 9. In addition, we have indicated which technical supplementary adjustments are still requested to achieve a more consistent accounting approach for insurers. While we acknowledge the IASB's strategic decision not to develop industry specific accounting standards, the implementation of the suggested improvements is necessary as it would ensure level playing field for insurers. The banking industry is already enabled to use consistent accounting provisions on both sides of the balance sheet. The same level of consistency must be ensured for insurers' accounting, although the core accounting requirements are defined basically in two major standards (IFRS 4 Insurance Contracts and IFRS 9 Financial Instruments). For a detailed

explanation of our pragmatic positions regarding financial instruments accounting we refer to our submitted response.

With regard to the proposed conceptually new impairment rules for debt instruments (as outlined in the ED/2013/3 *Financial Instruments: Expected Credit Losses*) we refer to our comment letter as of 24th June 2013. While we again expressed our support for the proposed introduction of FVOCI-category in IFRS 9, we especially highlighted that an aligned treatment of 'at amortised cost' and 'at FVOCI' categories with regard to impairment provisions is an important element of a consistent accounting framework for insurers to achieve a meaningful income statement presentation. In addition, we supported the suggested treatment of debt instruments with low credit risk (e.g. high quality corporate bonds). While the mirroring principle refers to the underlying assets, also the impairment rules will influence the insurance liability valuation in a significant way.

Nevertheless, a final evaluation of the interaction and consistency between IFRS 9 and finalised IFRS 4 will not be possible before IFRS 9 is completed. For this reason we would currently like to reserve our right to assess the principles and provisions of IFRS 4 again once the final IFRS 9 is released. Only a consistent treatment of financial and non-financial assets and insurance liabilities will provide a transparent and understandable income statement where the real performance will not be overshadowed by inappropriate artificial market or accounting volatility.

The proposed disclosure requirements are too exhaustive

We agree that a principle-based accounting framework requires an appropriate level of disclosures. However, the revised proposal contains requirements which would be overly burdensome without real benefit for users. In our assessment the proposed disclosure requirements are too detailed and too complex. We do not believe that such prescriptive rules based requirements should be included (e.g. the reconciliation of received premiums into insurance contract revenue, *paragraph 79*). We continue to argue that disclosure requirements should be more principle-based.

In addition, the required reconsolidation to achieve an accrual adjustment from the premiums received to "insurance contracts revenue" should not be only 'hidden' in the notes. When the premium reconciliation is important, it should occur on the face of the income statement; if not, the

related disclosure might be not necessary und paragraph 79 of the revised ED should be deleted.

The proposed disclosures might even have unintended consequences; for example the mandatory disclosure of confidence level (*paragraph 84*) should be removed in the final standard. The required translation of results of other techniques used for risk adjustment determination into the confidence level effectively creates an implicit preference, an incentive for the confidence level technique which is not necessary the most appropriate approach in every circumstances. In addition, this is contrary to the conceptually right decision of the Board that no specific techniques should be prescribed. From GDV's perspective, only a disclosure about the methodology being used by the entity for risk adjustment determination is necessary and sufficient. Finally, even the confidence level disclosure would not provide a consistent comparison between companies. Therefore, the disclosure requirement introduces only additional workload for entities (i.e. effectively application of two techniques would be needed) without evident benefits for users. The confidence level disclosure can only create the illusion of precision which inherently does not exist. For these reasons we believe that the comparability argument is not valid here as entity specific methods used require entity specific information about the methods used, the underlying assumptions and the input parameters.

Similarly, the requirement in *paragraph 88* to disclose information about the effects of each regulatory framework in which the entity operates is disproportionate. Any potential disclosures about effects of the regulatory framework in which entity operates should be applied consistently for all entities/industries operating in a regulated environment. Therefore we strongly suggest deleting the paragraph 88 in the final standard. We believe our request is consistent and fully in line with Board's rationale as expressed in BCA232. Finally, we refer to the general requirement defined in paragraph 135 of IAS 1 *Presentation of Financial Statements*. And we believe that this general disclosures requirement is sufficient.

Interest expense presentation under the premium allocation approach

We heavily support the Board's decision to allow for optional use of premium allocation approach (PAA) as a simplified approximation of the general building blocks approach (BBA). This simplified approach for measuring the liability for remaining coverage allows insurers with

relatively straightforward contracts (e.g. p & c business) to avoid detailed building block determination; e.g. of the cash flow estimates. However, we would like to note that the accretion of interest in case of PAA could be designed in a more operational way. Although we understand the rationale for the Board's decision to require the recognition of interest expense on the basis of the discount rate *at initial recognition of the contract*, similar to the OCI decision for BBA, we would favour an operationally less challenging solution for the PAA. Therefore, we advocate for an optional use of discount rates at the date *the claim is incurred*. From our perspective, it would better fit into the current praxis of insurers where systems for the claims settlement are not the same as the contracts/policy administration systems. Usually, these systems run separately. To consider this fact and being aware that for PAA the contract inception and the appearance of claims, in general, do not dramatically fall apart, we recommend allowing for the optional use of the lock-in discount rate being valid when the claims arise. This flexibility would underline the simplified character of the optional PAA. In both cases the current value in the balance sheet would be the same as the lock-in discount rate has only relevance for the OCI presentation.

Question 7 - Clarity of drafting

Do you agree that the proposals are drafted clearly and reflect the decisions made by the IASB?

If not, please describe any proposal that is not clear. How would you clarify it?

We support the principle-based design of the standard. The application guidance is, in general, sufficient to apply the standard, with the exception regarding the provisions to decompose the contractual cash flows which we fundamentally oppose as such. Especially, we suggest deleting the related paragraphs 33-34, implementation guidance in paragraph B86, the explanations in BC59-BC61 and the Illustrative Example 11 *without replacement*. Irrespective of that critical issue, there are still further clarifications needed to clarify the intention of the Board's decisions. Although we are not advocating for new guidance, the wording of the revised ED needs to be improved. The following issues might demonstrate that there is a lack of clarity with regard to understanding of intended application of suggested principles.

The required treatment of options and guarantees embedded in insurance contracts is crucial, especially for extremely long-term life business models. We recommend to explicitly clarify the intended presentation of value changes in options and guarantees embedded in insurance contracts in the main text of the standard. We appreciate the consideration of the issue in BC127 (b); but the standard itself should contain clear provisions. With regard to our position on preferable treatment of options and guarantees we refer to our detailed answer to Question 2 and our support for the preferred application of the *alternative approach* for participating contracts.

Regarding the provision of paragraph 13 we encourage the Board to clarify the suggested treatment of pre-coverage cash flows (e.g. acquisition costs) in cases in which no portfolio exist the cash flows could be attributed to (e.g. new insurance products). We assume that in such cases a 'prepayment asset' should be recognised.

We are not clear about the objective of the application guidance defined in paragraph B61. In the first sentence *future events* have to be considered.

In last sentence indicates that *future events* shall not be taken into account. We encourage the Board to state the intended meaning more precisely.

The definition of 'portfolio' might need further clarification. E.g. in paragraph 15 the Board defines that testing for onerous contracts only has to be exercised when there are facts and circumstances indicating that the related portfolio might be onerous. This would imply a narrow understanding of portfolio. In other cases a broader understanding of 'portfolio' might be necessary. Does it imply that the portfolio term understanding can be different depending on the circumstances of its use as we would assume?

It might be not sufficiently clear if the disaggregation of investment components (paragraph 58) is also required in the scope of the premium allocation approach. However, we reiterate our strong objections regarding this requirement for income statement presentation purposes only.

Finally, it is unclear how the rebuilding of the contractual service margin should be interpreted. The paragraph 30 of the revised ED only defines the provision that the contractual service margin shall not be negative. In general, two interpretations are possible: fully prospective rebuilding of the contractual service margin after any subsequent positive reverse change in cash flow estimates (i.e. interpretation 1: 'rebuilding from zero on a fully prospective basis'). Or the rebuilding of the contractual service margin can only be presented in the balance sheet after the insurance contracts becomes profitable again (i.e. interpretation 2: 'rebuilding from the original loss'). The alternative 1 is operationally less burdensome because a prospective adjustment would not require tracking negative changes in cash flow estimates over time. However, only the interpretation 2 is conceptually consistent with the intended meaning of the contractual service margin as unearned profit.

The intended Board's interpretation might be contrary to the one we think is conceptually the right one as we would not favor a presentation of a positive contractual service margin on the face of balance sheet as long as the contract remains onerous. The positive change in cash flow estimates should be recognised in profit or loss *until the contract gets profitable again*. Thus, there is a different interpretation of paragraph 30 of the revised ED possible where only the provision has been laid down that

the contractual service margin shall not be negative. The answer to the question which interpretation above is the intended one might have material and operative consequences for entities. As stated above, we tent to the conclusion that an appropriate and consistent interpretation of the contractual service margin as future 'unearned profit' gives the answer that for an onerous portfolio of insurance contracts a positive contractual service margin is not reported. We request the Board for reconsideration of this issue and to add an appropriate clarification to paragraph 30 and/or BC32 (a) if assessed as needed.

Suggested treatment for segregated portfolios of assets

The GDV is aware that the proposals of the Financial Accounting Standards Board (FASB) for insurance contracts accounting include specific requirements and exemptions for segregated fund or separate account arrangements and the related segregated portfolios of assets (i.e. unit-linked contracts). Similar requirements were included in the initial IASB's ED/2010/8 but have been removed from the revised proposals in ED/2013/7 without providing explanatory arguments for this possibly significant change. The GDV would like to encourage the Board to redeliberate that decision and to consider that exemptions and requirements, for the reasons stated by FASB and in order to avoid divergences that may rise from different interpretation of IFRS 10 *Consolidated Financial Statements*.

Berlin, 18th October 2013