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THE CHAIRPERSON

Hans Hoogervorst
Chairman
International Accounting Standard Board
30 Cannon Street
London EC4M 6XH

25 October 2013

Exposure Draft: Insurance Contracts

Dear Mr Hoogervorst

The European Banking Authority (EBA) welcomes the opportunity to comment on the IASB's Exposure Draft ED/2013/7 Insurance Contracts (ED). The EBA has a strong interest in promoting sound and high quality accounting and disclosure standards for the banking and financial industry, as well as transparent and comparable financial statements that would strengthen market discipline.

The EBA reviewed the ED from a banking supervisory perspective and was focused predominantly on the issues which could have an impact on banking groups which include insurance entities and for which an overall supervisory assessment of the group's financial position and risk profile is necessary to be performed.

We welcome the efforts of the IASB to develop proposals in order to improve the transparency of the effects of insurance contracts on an entity's financial position and financial performance and to reduce the diversity in accounting for insurance contracts. Overall, the EBA would reiterate its support of consistent accounting requirements for transactions with similar economic substance and which are relevant to more than one industry, in order to eliminate potential differences in outcomes and thus the scope for arbitrage.

In the Annex, we discuss certain aspects of the ED that could be further improved together with more general concerns that the IASB should consider. We have not explicitly addressed the specific questions raised in the ED.

If you have any questions regarding our comments, please feel free to contact Mr Colinet (+32.2.220.5247) in his capacity as Chairman of the technical group that coordinated this comment letter.

Yours sincerely

(signed)

Andrea Enria

CC: Mr Michel Colinet, Chairman of the Technical Group

Appendix: detailed comments on the Exposure Draft

Annex

Scope of application

The ED's requirements would apply to insurance and reinsurance contracts issued by an entity, reinsurance contracts held by an entity and investment contracts issued with a discretionary participation feature provided that the entity also issues insurance contracts (paragraph 3). Nevertheless, the proposals do not provide enough guidance on how the requirements would apply to a group including banks with insurance subsidiaries, which might include a bank selling investment contracts with a discretionary participation feature (but not issuing insurance contracts) and an insurance entity selling insurance contracts. The ED does not clarify whether the bank shall apply the proposals of the ED to these contracts (considering that the bank is part of a group which includes entities issuing insurance contracts) or account for these contracts under IAS32/ IFRS7 and IFRS 9 requirements (considering that the bank does not issue insurance contracts at its own level). Thus, there might be arbitrage opportunities within the group of entities by applying different accounting standards to similar transactions so as to achieve a more favourable outcome.

The EBA is concerned that in the absence of enough clarity on the scope of application of the ED requirements, the scope for judgement could increase and financial information might become less comparable across entities. Thus, we would suggest that the IASB provides additional guidance and clarifies the appropriate accounting treatment of such transactions in the consolidated accounts, so as to ensure that transactions with similar economic substance are accounted for consistently.

Financial guarantee contracts

In paragraph 7(f) of the revised ED, it is explicitly stated that an entity shall not apply the requirements of the Standard to financial guarantee contracts, unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting that is applicable to insurance contracts. The ED explains that the same contract could be accounted for either using the proposed ED's requirements or the IAS32/ IFRS7 and IFRS9 requirements, depending on the accounting choice an issuer makes.

As such, the EBA is concerned that within a group including banking and insurance entities there could be inconsistent accounting treatment applied for similar transactions depending on the issuer's industry. More specifically, it might be the case that financial guarantee contracts issued by banks are accounted for differently from similar contracts which are issued by insurance entities, although a consistent accounting treatment should be applied for transactions with similar economic substance irrespective of the issuer's industry. Additionally, the ED does not provide guidance on the appropriate accounting treatment of financial guarantees at the consolidated level, when there is different accounting treatment of financial guarantees between a bank (i.e. applying IAS32/ IFRS7 and IFRS9 requirements) and an insurance entity (i.e. applying ED Insurance Contracts) in the group of entities for consolidation purposes.

Thus, the proposed requirements might encourage inconsistency in the accounting methods used and reduce comparability of financial information for contracts with similar economic substance, which might be accounted for differently within groups of entities and across industries. The EBA would encourage the IASB to provide additional guidance on how the requirements would be applied in order to eliminate potential arbitrage opportunities and increase comparability of financial information. Additionally, the IASB could clarify further the major distinguishing features of the financial guarantee contracts (besides the definition in Appendix A in IFRS9) and under which circumstances such contracts need to be regarded as insurance contracts or financial instruments, in order to improve understanding and application of the ED's requirements.

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

Although this proposal could be further elaborated with issues specific to the insurance industry, from a banking supervisory perspective, the accounting treatment of such contracts could be seen as unclear and complex to be implemented, especially the application of the requirements for decomposing the cash flows from insurance contracts. Thus, the EBA suggests that the costs and benefits of this proposal to the preparers and users of financial information are assessed, in order to support the introduction of an exception to the general measurement requirements to the "building block approach", which seems overall as a robust accounting model.

Additionally, the EBA is concerned that the resulting financial information could be difficult to the users of financial statements to understand, as some of the liabilities will be measured using a different basis (being the measurement basis of the underlying assets) than the present value of the fulfilment cash flows, that the entity expects to pay to the policyholder. It is questionable whether this measurement approach will result in faithful representation of the entity's contractual obligations and rights for insurance contracts and if such financial information will be relevant to the users of financial statements.

Interest Expense and Discount Rate

The proposed approach permits an insurance entity to determine a discount rate using either a top-down or a bottom-up approach, in order to reflect the particular characteristics of the cash flows of the insurance contract with regards to timing, currency and liquidity, as explained in paragraph B69 of the Appendix B of the proposed Standard. However, such requirement might increase significantly the scope for judgement and inconsistency in the application of the requirements. The EBA is concerned that such accounting choice could reduce comparability of financial information and allow for earnings' management depending on the estimations of preparers, which might be subjective to a large extent. In addition, when determining the discount rate under the proposed top-down approach, paragraph B70 (a) requires that the discount rate should exclude factors that are not relevant to the insurance contract. Such factors include market risk premiums for credit risk included in the rates of return for a portfolio of assets. However, the EBA notes that in the draft general hedge accounting requirements that will be added to IFRS 9 Financial Instruments, it is considered that credit risk is not a separately identifiable risk component (see draft BC6. 382) and that it is difficult to adequately measure credit risk as a risk component on the basis of credit default swap prices.

Consequently, it seems that the proposed guidance on how to apply the top-down approach might be inconsistent with the Basis for Conclusions for general hedge accounting requirements and we question whether in practice it will be possible to identify and measure appropriately the factors that should be excluded from the discount rate (such as credit risk).

Finally, discounting is a common requirement in other Standards as well, thus we would suggest that the IASB develops a consistent and holistic approach on the methodology for estimating and applying discount rates (in our Comment Letter on the IASB's ED *Financial Instruments: Expected Credit Losses* we expressed also the concern about the lack of comparability due to the use of different discount rates). In this regard, we support the work of the IASB on its research project on discount rates.

Presentation of insurance contract revenue and expense

Under the proposed requirements for the presentation of the gross performance of insurance contracts in the financial statements, insurance contract revenue reflects the transfer of promised services arising from the insurance contract in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services. The EBA supports the IASB's efforts to align the proposed requirements to the core principle of the 2011 Exposure Draft *Revenue from Contracts with Customers*. Nevertheless, these are specific presentation requirements for insurance contracts and the ED does not provide clarity on whether the proposed requirements would have an impact on the financial statements of groups, which include both bank and insurance entities. Thus, the EBA believes that the impact of the proposed presentation requirements of the gross performance of insurance contracts needs to be assessed and analysed further, so as to avoid unnecessary complexity and ensure that the understanding of financial information will be improved under these proposals.