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Ref.: INS/HvD/LF/ID

Dear Ms. Flores,

**Re: FEE Comments on EFRAG's Draft Comment Letter on IASB Exposure Draft  
*Insurance Contracts***

- (1) FEE (the Federation of European Accountants) is pleased to provide you with its comments on the EFRAG Draft Comment Letter on the IASB Exposure Draft *Insurance Contracts* (the "ED").
- (2) We acknowledge, in common with EFRAG, that a number of concerns raised in respect of the Discussion Paper issued in 2007 have been addressed. We encourage the IASB to continue to work towards developing a comprehensive high quality International Financial Reporting Standard on insurance contracts.
- (3) We agree with the main concerns highlighted by EFRAG over the proposals, i.e. the residual margin, financial statement presentation and transitional requirements. Our concerns are elaborated in detail in our responses to the questions in the ED.
- (4) In addition, we have a general concern regarding the clarity of how the ED is worded, in particular whether a future standard based on this ED would give sufficient, clear and effective guidance to ensure consistent application. In our view, there will be a significant number of items open to interpretation. The measurement requirements for participating features and the proposed requirements on unbundling where there appears to be contradictory or unclear guidance are illustrative examples.
- (5) Furthermore, we would encourage field testing for the main products to assess what the impact of the proposals is likely to be in practice and to ensure that the outcome is as intended. The main aim of such field tests should be to assess whether the proposed guidance is sufficiently robust to support consistent application.
- (6) Moreover, consistent with EFRAG, in our opinion the Board has not sufficiently explained the interaction between the proposals in the ED and IFRS 9 Financial Instruments. For good reasons, and as a consequence of the Financial Crisis, the IASB has refrained from pursuing a full fair value model for financial instruments but provided a mixed measurement model with the option of an amortised cost model to bring the accounting in line with an entity's business model, especially that of banks. We recommend that the IASB gives further consideration to how such an approach could apply to insurance contract liabilities.

- (7) Under many insurers' business model financial instruments are held for collecting contractual cash flows rather than for sale or settlement with a third party. We are particularly concerned that the measurement model of the ED would *de facto* preclude insurers measuring financial instruments with basic loan features at amortised cost in accordance with such a business model because of the resulting accounting mismatches, while entities from other industry sectors (such as banks) would be able to do so.
- (8) The IASB ought to consider as one alternative to the proposed model, a model for insurance contract liabilities based on the expected value of future cash flows that will arise as the insurer fulfils the insurance contract, but using a locked-in interest rate for discounting. Such an approach would be broadly consistent with the amortised cost model for financial liabilities. The use of that model could be based on an assessment of an insurer's business model, which would need appropriate disclosure.
- (9) As another alternative the IASB may consider the use of Other Comprehensive Income (OCI) to reflect changes in financial assumptions to eliminate volatility in profit or loss arising from short term fluctuations in discount rates. Depending on what elements of volatility would be reflected in OCI, a change of IFRS 9 would be necessary to avoid an accounting mismatch.
- (10) However, in our view, the question as to what elements should be recognised in profit or loss or recognised in OCI, should be addressed in a more general and principal discussion on "recycling". Therefore, in our view, there is a necessity for the Board to initiate a comprehensive debate on the question of recycling in order to decide which items should be recycled into the income statement and which should remain in OCI. As noted in previous FEE letters on IFRS 9 related issues, we fully support EFRAG's view that the Board should work to ensure consistency and to better define the use and purpose of OCI.
- (11) In addition, we support the proposal by EFRAG of using the residual margin as a buffer. We believe there is a need to look at the practical considerations of such proposal and we suggest achieving this through appropriate field testing.

Our responses to the questions in the Invitation to comment of the ED are included as an Appendix to this letter.

For further information on this letter, please contact Leyre Fuertes, Project Manager, at the FEE Secretariat on +32 2 285 40 76 or via email at [leyre.fuertes@fee.be](mailto:leyre.fuertes@fee.be).

Yours sincerely,



Hans van Damme  
President

## Measurement Model

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

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

- (12) We agree with EFRAG that the measurement model proposed in the ED would be a step forward in accounting for insurance contracts compared to the current IFRS 4 through eliminating the diversity of approaches allowable.
- (13) Whereas we expect that the introduction of the fulfilment model will make the financial statements more relevant, more consideration should nevertheless be given to the degree that measurement will be subject to judgment in the absence of clear guidance (e.g. participating features, unbundling, application of modified approach, reinsurance).
- (14) A key area of concern is that the proposals on the valuation of financial instruments and the measurement of insurance contracts will lead to short-term fluctuations in reported profitability. Such volatility is arguably unrelated to the long-term business model of some insurers and would mean that reported results would offer limited benefits in predicting long-term performance. It could also result in distorted perceptions of the insurance sector as a whole relative to other sectors, such as banking, where significant portions of both assets and liabilities may be reported using an amortised cost model.
- (15) In line with EFRAG, other concerns relate specifically to subsequent measurement of the residual margin, presentation in the statement of income and the proposed transitional rules.

### Question 2 – Fulfilment cash flows (paragraphs 17(a), 22-25, BC37-B66 and BC51)

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

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

- (16) We agree with EFRAG in its support for a measurement approach for insurance contract liabilities that is based on the expected present value of the fulfilment cash flows.
- (17) We also believe that the portfolio is in most cases the appropriate level of measurement for the probability weighted cash flows of insurance contracts. We understand that most insurers manage and measure their insurance contracts at the portfolio level and this is therefore an appropriate approach.

Appendix - Comments on the EFRAG draft comment letter including the responses to the questions in the Invitation to comment of the IASB Exposure Draft *Insurance Contracts*

- (18) However, for the initial determination of the residual margin and acquisition costs, we understand that the IASB is proposing the use of different levels of aggregation on the basis that this offers a simplification compared to a contract by contract approach. We question whether this represents a real simplification in practice, as we would expect that determining the residual margin at a contract-by-contract level should not create a major problem in practice, assuming that for short-duration contracts the modified approach applies.
- (19) Regarding EFRAG's remark that portfolios are also a level of measurement in other standards, notably IAS 39 and IFRS 9, we do not feel that there is a need for the IASB to ensure consistent interpretation of portfolios between standards. Insurance contracts are a separate class of contracts that are distinctive from financial instruments and service contracts. Hence, portfolios may be defined as appropriate for the specific circumstances in insurance business.
- (20) Unlike EFRAG, in our view, the definition of portfolio might be too narrow. The portfolio has been defined as a group of "contracts" subject to broadly similar risks and managed together as a single pool. However, individual contracts may include different risks. In this case, the risks and not the contracts should be grouped as a portfolio. For example, multiline reinsurance contracts may not be managed as a portfolio *per se* but be split according to the risks covered for risk management purposes. Another example is a life contract with a separate disability coverage, which is priced and managed differently from the life part of the contract.
- (21) In addition, while in some cases the portfolio is the correct level of measurement, because pricing, risk management and performance management takes place at that level, in other cases the specific characteristics of an individual contract (like technical characteristics of insured objects or individual pricing) may need to be considered. We would be in favour of a stronger link to the business model and "the eyes of management" in order to address the unit of account in the final standard.
- (22) We agree with EFRAG that the guidance regarding the definition of future cash flows is at the right level of detail. We support EFRAG's recommendation to include guidance on the treatment of taxes in future cash flows.

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

- (a) Do you agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability? Why or why not?
- (b) Do you agree with the proposal to consider the effect of liquidity, and with the guidance on liquidity (see paragraphs 30(a), 31 and 34)? Why or why not?
- (c) Some have expressed concerns that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts. Are those concerns valid? Why or why not? If they are valid, what approach do you suggest and why? For example, should the Board reconsider its conclusion that the present value of the fulfilment cash flows should not reflect the risk of non-performance by the insurer?

Appendix - Comments on the EFRAG draft comment letter including the responses to the questions in the Invitation to comment of the IASB Exposure Draft *Insurance Contracts*

*Question 3(a) – Discount rate reflects the characteristics of the liability*

- (23) We agree with EFRAG in that the discount rate should, in principle, reflect the characteristics of the liability.
- (24) We note that paragraph 32 of the ED (providing that where the amount, timing and uncertainty of cash flows arising from an insurance contract depend wholly or partly on the performance of specific assets, the measurement of the insurance contract shall reflect that dependence) could be interpreted as applying to unit-linked contracts and also to contracts with participating features. However, the measurement in the case of unit linked contracts and contracts with participating features is not necessarily done through a discount rate.
- (25) We therefore agree with paragraph 34 of EFRAG's draft comment that the current placement of paragraph 32 of the ED under the sub-heading "Time value of money" is confusing, in other words that requirements relating to cash flows that relate to the return on assets, should not be addressed in the paragraphs that address discounting.
- (26) According to paragraph 32 of the ED, the measurement of the insurance contract should reflect the dependence on the performance of specific assets if the cash flows arising from an insurance contract depend wholly or partly on the performance of such assets. According to BC 97, this is the case for unit linked contracts and *some* participating contracts. We suggest to clarify, that it allows two approaches:
- i) measuring the guarantees separately and determining the participation rights on a consistent basis, or
  - ii) measuring the total probability-weighted cash flows in one stochastic model (which then automatically includes the options and guarantees) and apply a discounting technique that is consistent with the cash flow projections (risk neutral or "real world").

*Question 3(b) – Liquidity adjustment*

**Question to Constituents**

*The majority of members of EFRAG's Insurance Accounting Working Group (IAWG) supported the ED's proposal to consider the effects of liquidity in determining the discount rate when measuring an insurance contract. In their view, the risk-free rate does not faithfully represent the characteristics of the insurance contract.*

*EFRAG would be particularly interested in understanding constituents' views on whether and why the effects of liquidity should or should not be considered when determining the discount rate to be used in measuring an insurance contract.*

- (27) The fact that in certain circumstances a policyholder may not surrender his policy because of economic disincentives (e.g. surrender penalties or reduced surrender values) means that those contracts expose an insurer to liquidity risk, that creates a lower economic burden compared to a situation where for example deposits can be withdrawn in any point of time. We believe the relative illiquidity of its cash

Appendix - Comments on the EFRAG draft comment letter including the responses to the questions in the Invitation to comment of the IASB Exposure Draft *Insurance Contracts*

flows is a key characteristic of the fulfillment value of insurance contracts and should be reflected in the financial statements.

- (28) We therefore support the ED's proposal to take illiquidity into account in discounting the expected cash flows in order to reflect the characteristics of insurance contracts liabilities.
- (29) According to paragraph 31 of the ED, the discount rate should reflect the yield curve in the appropriate currency for instruments that expose the holder to no or negligible credit risk, with an adjustment for illiquidity. We note that depending on the degree of market efficiency, more than one class of instruments may be found with the same (negligible) credit risk that match the maturity of the insurance cash flows, but with different interest rates given the same market value because one instrument can be more readily traded in the market than the other. The difference in those par yields may be identified as illiquidity premium. In such a scenario the entity should be able to select the highest par yield as a basis for discounting. We expect that other methods will emerge that provide a proper valuation of the corresponding effect.

*Question 3(c) – Impact on long-duration insurance contracts*

- (30) We agree with EFRAG that the effects of an entity's own credit risk should not be included in the measurement of an insurance liability.
- (31) For long-term business the use of current risk free rates causes short-term volatility which means that results as reported may offer limited benefits in predicting long-term performance. It may also result in distorted perceptions of the insurance sector as a whole relative to other sectors, such as banking, where significant portions of both assets and liabilities may be reported using an amortised cost model. The IASB therefore ought to consider better alignment with IFRS 9's amortised cost model, which could be achieved through a lock-in of discount rates.
- (32) For discounting cash flows with a duration for which discount rates are unobservable in active markets, we suggest reference to methods that are considered sufficiently robust by qualified institutions, like regulators.

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

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

- (33) We agree with EFRAG and support the proposal for separate recognition of a risk adjustment and a residual margin and do not support the recognition of a single composite margin.
- (34) We believe that the risk adjustment can be sufficiently and reliably measured and therefore can be explicitly included as a separate building block. We believe this is relevant in capturing the inherent uncertainty in, and risk of deviation of, future cash flows.

- (35) We do not believe that a clear distinction can be made between the risk adjustment on the one hand, and coverage for sunk costs (like marketing) and profit margin on the other within the residual margin. In subsequent measurement, more quantifiable information on risks may become available, which may lead to changes in the risk adjustment without affecting the total position of a portfolio of contracts. In such a situation, changes in the risk adjustment should be recorded as change in the residual margin, to the extent available for that portfolio of contracts.

**Question 5 – Risk adjustment (paragraphs 35-37, B67-B103 and BC105-BC123)**

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

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

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

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

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

*Question 5(a) – Definition of the risk adjustment*

- (36) We agree with EFRAG that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected.
- (37) Having said this, there might be some concerns about the subjectivity in practically assessing this. Requiring a “Use Test” like in Solvency II could address this concern, but IFRS rarely includes requirements on control over financial reporting (hedge documentation requirements may be an exception). Therefore, we recommend reinforcing the explanation of the relationship between risk factors, risk management and risk adjustment in the note disclosures.

*Question 5(b) – Techniques for estimating the risk adjustment*

- (38) In common with EFRAG, we believe that the methods that may be used to measure the risk adjustment should not be limited. We support EFRAG's suggestion that a principle should be developed that drives the selection of an appropriate measurement methodology. It is appropriate that the application guidance provides some preferred methods, but these should not be limited to the choice of techniques as is done in paragraph B73 of the ED.
- (39) We also believe that the method used should be properly disclosed and that it should be properly explained as to why it is the most appropriate method.

*Question 5(c) – Confidence level disclosure*

**Question to constituents**

*Do constituents think that confidence level information provides useful information or do constituents think that other disclosures could provide equal information?*

- (40) We have some practical concerns in requiring disclosure of the confidence level to which the risk adjustment corresponds, regardless of the method for measuring the risk adjustment. Our principal concern is that requiring this could represent a burden for preparers with no clear benefit for users.
- (41) We understand that the proposed calculation would be at an entity level. If calculation is proposed to be done at a disaggregated level this should be clarified and guidance would be helpful on the level of disaggregation (portfolio, segment or entity) and how to deal with correlations.

*Question 5(d) – Risk adjustment: Level of aggregation and diversification*

- (42) We agree with EFRAG and support measuring the risk adjustment at a portfolio level. However, see also our response to Question 2 on our view that the definition of portfolio might be too narrow.
- (43) We also agree with EFRAG that diversification between portfolios should be taken into account under specific circumstances. Under the ED the risk adjustment shall be the maximum amount the insurer would rationally pay to be relieved of the risks. It is meant to represent the insurer's view of the economic burden imposed on it by the presence of risk. Since the economic burden would not be determined by pooling effects solely within a portfolio, we believe it would be inconsistent with the principle as expressed in paragraph 35 of the ED not to reflect those effects.
- (44) We believe that the impact of diversification should be reflected in consolidated financial statements. Similar discussions for other purposes (e.g. in the context of Solvency II) should not prejudice the treatment in financial reporting, since they are aimed to fulfill different objectives. Nevertheless, we would not consider it appropriate to consider those effects that result from pooling or diversification with risks that are assumed by entities outside the reporting entity level (e.g. in case of single financial statements or sub groups).



*Question 5(e) – Level of detail of application guidance*

- (45) We agree with EFRAG and consider that the application guidance in Appendix B on risk adjustments is at the right level of detail.

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

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

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

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

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

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

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

*Question 6(a) – No gain at initial recognition*

- (46) We agree with EFRAG that an insurer should not recognise any gain at initial recognition of an insurance contract. We understand that this position is consistent with the ED on revenue recognition. However, we see an inconsistency here with the treatment of the residual margin in subsequent measurement. A lock in of the residual margin at inception would mean that any unquantifiable uncertainties and subjectivities would affect income at the first remeasurement date after initial measurement. The same reasons as at initial recognition apply to recognising any gain from changes in estimate of future cash flows. The arguments in BC77 of ED/2010/6 apply equally to initial and subsequent measurement.

*Question 6(b) – Losses recognised at initial recognition*

- (47) We agree with EFRAG that a loss at initial recognition of an insurance contract should be recognised immediately in profit or loss.

*Question 6(c) – Level of aggregation*

- (48) Regarding the proposal that an insurer should estimate the residual margin at a level that aggregates insurance contracts, we question whether the proposal really represents a simplification compared to a determination on a contract-by-contract basis. We suggest this is made subject to the field test.
- (49) In addition, one unintended consequence of grouping contracts together when determining their initial value may be cross subsidisation of individual contracts within the same portfolio that are issued at different prices.

*Question 6(d) – Release of the residual margin*

- (50) Regarding the proposals concerning the pattern of release of the residual margin, we support EFRAG's view that the residual margin should be adjusted to offset the changes from remeasurement of the present value of the fulfilment cash flows.
- (51) In principle, we disagree that all changes in remeasurement should go directly to profit or loss. If the changes relate to the future they should be recognised in the period in which the related cash flows occur or the risk is crystallised, and this approach could be simplified by allocating those changes over the remaining life of the contract. Any differences between estimates and actual cash flows should be recognised in profit or loss. Such an approach would be consistent with the accounting treatment of changes in estimates as under IAS 8.
- (52) In addition, we note that the proposed model, which reflects any change in estimates, including discount rates, in profit or loss immediately, will be more volatile. We suggest that the IASB request users to comment on whether they believe that such a model will result in more useful information.
- (53) We do not believe that adjusting the residual margin would be unduly technically complex. The effect of changes of assumptions for future periods is to be identified in any case in accordance to IAS 8. The consequently identified amount would simply be added or deducted from the residual margin associated with the contract or portfolio, as long as positive.
- (54) Furthermore, since changes of the value of a replicating portfolio are not changes in an accounting estimate, they are not included in the amount to be disclosed under IAS 8 and should not be off-set against the residual margin, since there is no estimate but a measurement consistent with matching instruments, regardless of whether those are held by the insurer or not.
- (55) Regarding the proposed starting point for recognising the residual margin in profit or loss, we wonder whether the deferral period in case of annuities is meant to be also included in the coverage period or not. In some cases, during the period up to the point where the annuity payments start, services are already being provided. In our view, if services are provided before the coverage period, some part of the residual margin should be released during this period, if this has a significant impact. Alternatively, the final standard could opt for a principles based approach, requiring release "in accordance with services provided".

**Question to constituents**

With respect to accounting for changes in estimates we refer to Appendix 2, which provides a summary of possible accounting mismatches caused by the interaction between IFRS 9 and the proposals in the ED. EFRAG asks constituents' input on this issue.

(56) Please refer to our comments on this issue in the cover letter.

*Question 6(e) – Release of the composite margin*

(57) As noted in our response to Question 4, we favour the proposed separate recognition of a risk adjustment and a residual margin and do not support the recognition of a single composite margin.

*Question 6(f) – Accretion of interest on the residual margin*

(58) We agree with EFRAG and do not support the accretion of interest on the residual margin. While it might appear conceptually appropriate, we believe that in practice this requirement may add complexity without a clear benefit. However, if our proposal to recalibrate the residual margin is accepted, interest, on a current basis, should be accredited.

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

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

(59) We agree with EFRAG and support the proposal that incremental acquisition costs should be included in the initial measurement of the insurance contract as cash outflows.

(60) In addition, we agree with EFRAG and support the proposal that all other acquisition costs should be recognised as expenses when incurred.

(61) However, EFRAG is proposing to consider acquisition costs at a portfolio level. We support EFRAG's comments to bring the levels of aggregation for acquisition costs and other cash flows in line.

(62) Furthermore, we note, that different use has been made of the concept of "incremental" costs. Whereas for administrative expenses allocations are accepted (B61 and B63), for those that relate to various portfolios, in the case of acquisition costs such allocations do not seem to be allowed in the ED.

### Short-duration contracts

**Question 8 – Premium allocation approach (paragraphs 54-60, 39 and BC145-BC148)**

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

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

- (63) We understand that the IASB is proposing a modified measurement approach on the basis that this offers a simplification. In common with EFRAG, we question whether such approach represents a real simplification as intended. For example, discounting expected future premiums appears to create unnecessary complexity given the fact that the approach is limited to short term contracts with a coverage period of no more than 12 months.
- (64) On the basis that the modified measurement approach is intended to be a simplification that should not result in a significantly different result to the full measurement model, we agree with EFRAG that the modified measurement approach should be permitted but not required.
- (65) We consider that the premium allocation approach is appropriate as a proxy for the full measurement model. On this basis we do not consider that a firm cut off should be applied to the duration of the contract, rather a principles-based approach of insurers being able to use the approach if it is materially consistent with the full model would seem appropriate.
- (66) Like EFRAG, we do not believe that the pre-claim liability should accrete interest for reasons of materiality and complexity.

**Question 9 – Contract boundary principle (paragraphs 26-29 and BC53-BC66)**

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

- (67) We agree with EFRAG and support the proposed boundary principle and we believe that insurers would be able to apply it consistently in practice. In our view, there is no need to provide more extensive application guidance on this proposal.

### Participating features

**Question 10 – Participating features (paragraphs 23, 62-66, BC67-BC75 and BC198-BC203)**

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

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

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

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

*Question 10(a) – Measurement of insurance contracts includes participating features*

- (68) We agree with EFRAG and the proposal that the measurement of insurance contracts should include participating benefits based on the expected value (i.e. both, legal obligatory and discretionary benefits) and not on a legal basis only. We would not interpret “expected” in a way such that “real world” estimates are required, but rather those which are consistent with the other components of the contract measurement. We believe that this should be clarified further.
- (69) However, we are not sure whether the most appropriate basis in all instances is “expected cash flows”. We refer to our response to Question 3 (a) (in paragraph 25 of this letter) where we discuss paragraph 32 of the ED and BC 97. In order to avoid accounting mismatch, the measurement of participating features should be based on the surplus as recognized in the IFRS financial statements.
- (70) To some extent, participation obligations refer to payments to future policyholders as required under current contracts. Since those cash flows are beyond the contract boundary, while the obligation is actually present, it might be necessary to clarify that such obligation needs to be measured without reference to the actual cash flows, but the nominal value is to be considered in measurement until it is expected to be moved from current policyholders to future policyholders.

*Question 10(b) – Financial instruments with discretionary participation features are in the scope*

- (71) We agree with the IASB and the proposal that financial instruments with discretionary participation features should be within the scope of the IFRS on insurance contracts if clients participate in the same surplus as do policyholders of insurance contracts, mainly for practical purposes. Any split of the participating feature for accounting purposes will create complexity and become unduly burdensome.
- (72) We support the argument that all financial instruments with discretionary participation features should be measured consistently. However, we wonder whether this should apply to *Discretionary* but all Participating Features. We suggest to consider a corresponding extension.

Appendix - Comments on the EFRAG draft comment letter including the responses to the questions in the Invitation to comment of the IASB Exposure Draft *Insurance Contracts*

*Question 10(c) – Investment contracts participate along with insurance contracts*

(73) We refer to our comment on Question 10(b).

*Question 10(d) – Modification of the measurement provisions for financial instruments with discretionary participating features*

(74) In relation to the proposed guidance where it is detailed how the residual margin for a financial instrument with a discretionary participation feature shall be recognised, and the specific reference to “the basis of the fair value of assets under management” (in paragraph 65(b) of the ED), we wonder why the ED specifically refers to the “fair value of assets” under management and what the implications are. We would recommend a principles-based approach by just referring to the rendering of services.

**Definition and scope**

**Question 11 – Definition and scope features (paragraphs 2-7, B2-B33 and BC188-BC209)**

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

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

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

**Question to constituents**

*The ED proposes to exclude fixed fee service contracts from the scope of the standard if the primary purpose of the contract is the provision of services. EFRAG supports the Board’s reasoning, however EFRAG does not find the criteria to assess whether or not a contract is in the scope of the standard to be clear enough.*

*Do you agree with the Board’s intent that contracts whose primary purpose is the provision of services should be out of the scope of the standard, even if they meet the definition of the insurance contract?*

*Do you share EFRAG’s concerns about the wording of the scope exclusion?*

**Question to constituents**

*The proposals in the ED will bring financial guarantee contracts that meet the definition of an insurance contract within the scope of the new insurance standard.*

*Do you think there could be a reason to exclude financial guarantees from the scope of the insurance standard?*

*Financial guarantees are currently in the scope of IAS 39, except for those contracts that are explicitly 'selected' and treated as insurance contracts. IAS 39 requires such contracts to be measured at the higher of the amount determined in accordance with IAS 37 and the initially recognised amount less cumulative amortisation.*

*The proposed amendments to IAS 39 mean that a financial guarantee contract that does not meet the definition of an insurance contract should be measured as a derivative in accordance with IAS 39. Do you agree with these classification and measurement requirements?*

- (75) Consistent with EFRAG, we agree with the definition of an insurance contract and the related guidance.
- (76) The ED incorporates additional guidance from US GAAP in the definition of insurance risk, as described in B25 and BC191(c), which would require the existence of a scenario with commercial substance in which the present value of cash outflows can exceed the present value of the premiums. These proposals could affect the treatment of reinsurance contracts. US GAAP (Codification paragraph 944-20-15-53 in Financial Services Insurance) provides that instances in which the insurance risk transferred is not significant, but substantially all of the insurance risk that relates to the reinsured portions of the underlying insurance contracts is transferred to the reinsurer, would be accounted for as an insurance contract. Since the ED proposals do not include a corresponding provision, perhaps unintentionally, some reinsurance agreements might no longer fit within the definition of an insurance contract. We suggest adding the guidance that exists in US GAAP for reinsurance contracts.
- (77) Regarding the scope exclusions in paragraph 4 of the ED, we note a resulting inconsistency with paragraph 5 of the ED. We understand that the ED is applicable to insurers that provide goods and services and to coverage on product warranties that are issued by insurers, despite the explicit scope out of product warranties issued by a manufacturer, dealer or retailer (in paragraph 4(a) of the ED). At the same time, paragraph 5 of the ED describes "any entity that issues an insurance contract as an insurer". We believe that the definition of "insurer" should be defined in a more refined way.
- (78) In our opinion, credit insurance contracts, but not credit derivatives, where the business model is the same as insurance contracts should be in the scope of the insurance standard. If certain products, that fall under the definition of insurance contracts are scoped out, a clear description must be developed, which may be based on a "business model" approach.

## Unbundling

### **Question 12 – Unbundling features (paragraphs 8-12 and BC210-BC225)**

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

- (79) In common with EFRAG, we agree that in principle unbundling some components of an insurance contract may be appropriate.

Appendix - Comments on the EFRAG draft comment letter including the responses to the questions in the Invitation to comment of the IASB Exposure Draft *Insurance Contracts*

- (80) However, as noted in our covering letter (paragraph 4), we have a general concern on the clarity of how the standard is worded in order to describe what the intention of the IASB is with respect to unbundling. We raise the question of whether the standard gives sufficient, clear guidance to ensure consistent application.
- (81) We would expect that any arbitrary combination of economically independent components in one formal contract would be required to be separated under the principle of “substance over form”. Another question is whether there is a need for the move from the unbundling rules as per current IFRS 4.
- (82) In paragraph 8 of the ED, unit-linked contracts are referred to as a common example of components that are not closely related to the insurance contract, hence that should be unbundled and accounted for within the scope of another relevant IFRS. However, there are dedicated paragraphs for unit-linked contracts in the ED (see paragraphs 71 and 78). We are not sure whether the IASB’s intention is that all unit-linked contracts are unbundled. If so, it might be necessary to explain further the reasoning of paragraph 32 of the ED together with the specific guidance on unit-linked contracts. We encourage the IASB to make their position clear with respect to the requirements of unit-linked contracts.
- (83) One interpretation is that the measurement requirements of unit-linked contracts be dealt with under IAS 39 and their presentation under the insurance standard. In our view, the resulting requirements on unbundling would not be sufficiently clear and bear the risk of not being consistently applied.
- (84) To avoid confusion, we think that the term “closely related” should not be used in the context of components, other than embedded derivatives, since it may be interpreted as requiring the same unbundling criteria for the other components as for embedded derivatives.
- (85) In addition, we think that it would be more helpful including the common examples presented in the application guidance and not in the standard. The examples presented should be in line with the principles of the requirements. As explained above, this is not the case for unit-linked contracts.

### Presentation

**Question 13 – Presentation (paragraphs 69-78 and BC150-BC183)**

- (a) Will the proposed summarised margin presentation be useful to users of financial statements? Why or why not? If not, what would you recommend and why?
- (b) Do agree that an insurer should present all income and expense arising from insurance contracts in profit or loss? Why or why not? If not, what do you recommend and why?

- (86) There may be merit in a margin-based approach for the statement of comprehensive income and we understand that this approach is consistent with the measurement model.



Appendix - Comments on the EFRAG draft comment letter including the responses to the questions in the Invitation to comment of the IASB Exposure Draft *Insurance Contracts*

- (87) However, users of financial statements should ultimately decide on whether the proposed margin presentation would be useful. If there is a margin approach, in our view it should be “expanded” to include a revenue number and claims and expenses for insurance contracts in order to provide requested information by users and provide consistency with other industries.
- (88) We are concerned that the “summarised” approach may not fulfil users’ needs and whether an “expanded” approach would be feasible in practice. This could be a subject for field tests.
- (89) An accounting mismatch would occur if under the terms of an insurance contract with participating features, the insurer recognised the change in those items in OCI, whereas the change in the liability for the participating feature will be recognised in profit or loss.
- (90) We believe that in all cases, where cash flows depend directly, by contract or law, on amounts reported in OCI, the related amounts should follow this presentation. We do not believe that such approach would add complexity, since it is already applied for deferred taxes.

## Disclosures

### Question 14 – Disclosures (paragraphs 79-97, BC242 and BC243)

- (a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?
- (b) Do you think the proposed disclosure requirements will meet the proposed objective? Why or why not?
- (c) Are there any disclosures that have not been proposed that would be useful (or some proposed that are not)? If so, please describe those disclosures and explain why they would or would not be useful.

- (91) We agree with EFRAG and support the proposed disclosure principle requiring an insurer to explain the amounts recognised in the financial statements arising from insurance contracts and the nature and extent of risks arising from those contracts.
- (92) We share EFRAG’s concern in relation to the requirement in paragraph 83 of the ED that information relating to different reportable segments, as defined in IFRS 8 Operating Segments, shall not be aggregated, while this is not required in other IFRSs. The reasoning for this specific requirement in the standard for insurance contracts might need further clarification.
- (93) In line with EFRAG, we agree that the proposed disclosure requirements will meet the proposed objective of transparency.
- (94) Regarding the volume information on premiums, claims and expenses, see also our response to Question 13 where we agree with EFRAG that their presentation should be required on the face of the statement of comprehensive income.

Appendix - Comments on the EFRAG draft comment letter including the responses to the questions in the Invitation to comment of the IASB Exposure Draft *Insurance Contracts*

- (95) When considering the question on how to present economic volatility in a measurement model that is based on locked-in discount rates, special attention should be given to users' needs with respect to comparability and predictability of future cash flows in the context of disclosures.

### Unit-linked contracts

**Question 15 – Unit-linked contracts (paragraphs 8(a)(i), 71 and 78, Appendix C, and paragraphs BC153-BC155 and BC184-BC187)**

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

- (96) Regarding the proposals on unbundling that are relevant for unit-linked contracts and the presentation requirements for unit-linked contracts and related assets, we refer to our comments in the response to Question 12 on unbundling. As explained in more detail in paragraphs 80-83 of this letter, in summary we are not sure whether the IASB's intention is that all unit-linked contracts are unbundled. If so, it might be necessary to explain further the reasoning of paragraph 32 of the ED together with the specific guidance on unit linked contracts. We encourage the IASB to make their position clearer with respect to the requirements of unit-linked contracts.
- (97) We note that the ED addresses accounting mismatches that can occur under current accounting rules for unit-linked contracts. We agree, that in the case of insurer's own shares, it is appropriate to measure them at fair value through profit or loss to the extent the changes in the value of the pool of those assets relate to the interest of unit-linked contract holders (in paragraph 180(a) and 181 of EFRAG's draft comment letter).
- (98) In addition, we propose the IASB consider whether this requirement should be extended to bonds issued by other consolidated entities.

### Reinsurance

**Question 16 – Reinsurance (paragraph 43-46 and BC230-BC241)**

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

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

- (99) We agree with EFRAG and support in principle an expected loss model for insurance contracts.
- (100) We have concerns that the measurement as prescribed in paragraphs 43 and 44 of the ED will require that a cedant has to calculate building blocks for its gross business to determine the reinsurer's share in any case, including for short duration contracts. This may undermine the intended simplification by the modified approach. We assume this is unintended and propose a rewording that requires a measurement consistent with that of the underlying ceded business.

Appendix - Comments on the EFRAG draft comment letter including the responses to the questions in the Invitation to comment of the IASB Exposure Draft *Insurance Contracts*

- (101) We understand the intended consistency of the recognition of a residual margin for ceded reinsurance with the recognition of a residual margin on gross business is realised by calibrating the residual margin for reinsurance ceded to the reinsurance premium less ceding commission. We suggest that under this approach, the recognition of a gain at inception of a reinsurance contract should be limited to those cases where the ceded gross business is considered onerous with the objective to limit potential abuse.
- (102) In addition, we are not sure whether the ED proposals relating to the residual margin on ceded reinsurance contracts will always meet the IASB's intentions. We propose to include this matter in the field test that we suggest in paragraph 5 of this letter.
- (103) If the reinsurance premium paid (less ceding commissions) is higher than the reinsurer's share in gross cash flows and risk adjustment, the cedant may recognise within the reinsurance asset a residual margin that is higher than the corresponding share of reinsurer in the gross residual margin. This raises the question of what the capitalised residual margin is intended to present and whether the cash flows and risk adjustment for the primary contracts have been determined adequately.
- (104) If the reinsurance premium paid (less ceding commissions) is lower than the reinsurer's share in gross cash flows and risk adjustment, the cedant may carry forward a gross residual margin that partially relates to the cash flows and profits related to business ceded. This raises the question of what the residual margin within liabilities intends to reflect: If the residual margin represents uncertainty not covered in the risk adjustments or deferred profits, we would consider it consistent, that a corresponding cession to the reinsurer is reflected. Only if the intention of the residual margin was to reflect a service margin that covers overhead not considered in cash flows and not compensated by the ceding commission, we would understand that no corresponding reinsurer's share is reported in the assets.
- (105) Unless the purpose of the residual margin is clarified, we suggest that as a principle the reinsurers' share – and only that - in the residual margin is recognised within assets to reflect fully the reinsurers' share in the cedant's insurance obligation.

### Transition and effective date

**Question 17 – Transition and effective date (paragraphs 98-102 and BC244-BC257)**

- (a) Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?
- (b) If the Board were to adopt the composite margin approach favoured by the FASB, would you agree with the FASB's tentative decision on transition (see the appendix to the Basis for Conclusions)?
- (c) Is it necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9? Why or why not?
- (d) Please provide an estimate of how long insurers would require to adopt the proposed requirements.

*Question 17(a) – IASB's proposed transition approach*

- (106) We share EFRAG's concerns over the proposed transition requirements and effective date.
- (107) In common with EFRAG, we do not agree with the proposed transitional requirements. In particular, we note that the requirement in paragraph 100 of the ED will result in no residual margin being included in the insurance contract liabilities in the opening balance sheet. We disagree, and believe there should be some residual margin for contracts in force at transition. We support EFRAG's comments that such a treatment prevents insurers from reporting a potentially significant part of the profits on existing contracts through profit or loss and reduces comparability between the results on existing and new business.
- (108) In addition, we argue that the residual margin reflects to a large extent overhead and non-incremental acquisition costs not being considered in cash flows but in pricing. Under the proposed transitional rules the insurer will not be able to cover ongoing non-incremental acquisition cost and overhead, if there is no residual margin.
- (109) We are concerned that the proposed transitional rules may create an incentive to set the risk margin for in force business artificially high and as a consequence distort comparability further.
- (110) We agree with EFRAG that the proposed transition requirements should be required retrospectively as an option in accordance with IAS 8.

*Question 17(b) – FASB's proposed transition approach*

- (111) As noted in our response to Question 4, we support in the proposed separate recognition of a risk adjustment and a residual margin and not the recognition of a single composite margin. If the Board were to adopt the composite margin approach favoured by the FASB, we would have the same concerns as for the IASB's approach – see our response to Question 17(a).

*Question 17(c) – Interaction with IFRS 9*

- (112) We support the expressed intention to bring in line the mandatory first-time applications of IFRS 9 and the final standard for insurance contracts.
- (113) In the case that the measurement of insurance contracts provided a basis for measuring certain investments at amortised cost, further possibilities for reclassification should be provided to allow consistent measurement of assets and insurance liabilities.

*Question 17(d) – Expected period required for adoption*

**Question to constituents**

*We do not refer to a specific transition date as requested in question 17d.*

*Can you provide an indication of the time needed for changing insurance processes and policies and implementing the new requirements?*

*What is in your opinion a feasible transition date?*

(114) We recognise the time commitment involved in making such wide ranging changes and this should be considered in allowing for additional time for implementation. Based on the complexities of the proposals, we think the effective date will need to be extended significantly past 1 January 2013. In order for insurers to be able to develop the systems, test them and capture data by the beginning of the comparative year presented upon transition, we believe the effective date should be no earlier than 36 months after issuance of the final standard.

#### **Other comments**

##### **Question 18 – Other comments**

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

(115) With respect to recognition, in our opinion, there appear to be two different views on how to read the ED and some additional clarification should be given. Our understanding of paragraph 14 (b) of the ED (the date “when the insurer is first exposed to risk under a contract...”) is that this is at the beginning of the coverage period. However, some might interpret this paragraph as the possibility of referring to the date when the insurer makes an offer. It would be helpful to clarify whether it is the start of coverage period or at issue of a binding offer.

(116) Furthermore, we question the premise made in paragraph 21 of the ED. There may well be a significant time difference between becoming party to a contract and the beginning of the coverage period and for some long duration contracts the impact of changes in circumstances e.g. discount rates may have a material effect. We question whether it is intended by the IASB, that any change in value before provision of services has begun is reflected. This would be inconsistent with similar situations covered by the ED on revenue recognition.

## Benefits and costs

### Question 19 – Benefits and costs (paragraphs BC258-BC263)

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

(117) We agree with EFRAG's view that the standard on insurance contracts is very important. An evaluation of the benefits depends on how our comments and concerns are addressed in the final standard.

### Question to constituents

*In our response to question 17 we have stated that we believe IAS 8 should be required. IAS 8 requires retrospective application (unless impracticable). Could you provide an assessment of the benefits and costs of applying IAS 8?*

### Comments on EFRAG's Appendix 2 – accounting mismatch

(118) Please refer to our comments on this issue in the cover letter and in our response to Question 13 (paragraphs 89-90 of this letter).