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25 October 2013

Dear Ms Flores,

EFRAG Comment Letter on IASB's Revised Exposure Draft: Insurance Contracts

This letter has been drafted by the European Insurance CFO Forum, a body representing the views of 21 of Europe's largest insurance companies and Insurance Europe, representing 95% of the premium income of the European insurance market. Accordingly it represents the consensus view of a significant element of the European insurance industry.

The development of comprehensive IFRS accounting standards for insurance contracts and related financial instruments is of significant importance to us and hence we see the recent publication of the revised insurance contracts exposure draft ("ED") as an important step in the development process. Given the importance of this standard, we appreciate the opportunity to provide you feedback on your draft comment letter to the IASB.

We have also prepared a response letter to the IASB setting out our views on the IASB ED. A copy of our response letter, which we refer to throughout, is attached in Appendix 5 to this letter for reference.

Key principles for an insurance contracts accounting standard

As a matter of principle, we believe that an insurance contracts accounting standard should recognise the following basic principles:

- where an insurer's asset and liability cash flows are economically matched, no accounting volatility should be reported in profit or loss nor in Other Comprehensive Income ("OCI");
- when there are cash flow mismatches over the long-term duration of the contracts, short-term market fluctuations in the value of assets and liabilities may be disclosed transparently in the balance sheet, but must not obscure the long-term operating performance in the P&L;
- the profit or loss account should reflect a measure of result that is relevant to the operating performance of the insurer.

We acknowledge the IASB's objective to provide a fully transparent current measurement of insurance liabilities in the balance sheet. Such measurement reflects a current view on all relevant assumptions and current interest rates for discounting of the insurance liability in the balance sheet.

We share many of the same concerns you have expressed in your draft comment letter

Like EFRAG, we welcome the IASB's decision to re-expose the ED and share many of the same concerns you have expressed in your letter. There are a number of significant issues in the ED that must be addressed to ensure the final principles are appropriate for our insurance business. We highlight these issues in our response letter to the IASB, namely:

- **No consistency between measurement of assets and liabilities**: There is a mandatory requirement to reflect all changes in discount rates for liabilities in OCI, whereas IFRS 9 restricts fair value through OCI ("FVOCI")[1] to simple debt securities. There is no ability to apply fair value through P&L ("FVPL")[2] for liabilities even when that provides better information about performance. OCI must not be mandatory.

[1] "Fair value through OCI" or "FVOCI" means fair value measurement in the balance sheet with unrealised gains reported in OCI for assets; and current fulfilment measurement in the balance sheet with changes in discount rate reported in OCI for insurance liabilities.

[2] Fair value through P&L" or "FVPL" means fair measurement in the balance sheet and unrealised gains reported in P&L for assets; and current fulfilment measurement in the balance sheet with changes in discount rate reported in P&L for insurance liabilities

- **Participating and unit-linked contracts**: The application of the proposed mechanics of "mirroring" is unclear and highly complex, resulting in bifurcation of cash flows which does not result in an appropriate profit recognition pattern.
- **Unlocking of the contractual service margin ("CSM")**: We welcome the decision to unlock the CSM for changes in estimates relating to future coverage and future services. However, there is limited unlocking of the CSM for participating contracts because the principle has not been fully developed for such contracts. A fully unlocked contractual service margin should be adopted.
- **Treatment of options and guarantees**: The treatment of changes in the value of options and guarantees is unclear in the ED and has not yet been adequately addressed in the proposals as short-term market fluctuations affecting their value are not representative of the long-term operating performance of the insurer.
- **Presentation and disclosure:** Premiums and claims are reported in the P&L on a "notional" earned premium basis which is complex and of little relevance to users of life insurer financial statements. The disclosure requirements are overly burdensome.
- **Reinsurance contractual service margin:** Measurement of the CSM of reinsurance contracts held does not always reflect the economics of the transaction.
- **Some proposals are overly complex**: For example, the bifurcation of cash flows and the requirement to disaggregate investment components will result in significant implementation time, with the cost exceeding the associated benefits.

We also agree with EFRAG that the effective date of IFRS 4 and IFRS 9 should be aligned for insurers so that they are not required, but are permitted, to adopt IFRS 9 before the mandatory effective date of IFRS 4.

We believe your draft comment letter reflects a number of our key principles; however, we believe both FVOCI and FVPL applications are needed.

We agree with your view that the classification and measurement of both insurance liabilities and the assets backing those liabilities are an integral part of an insurer's long-term business model that must be considered together to ensure accounting mismatches are minimised.

From your draft comment letter, we believe that EFRAG's views on the objectives for accounting for insurance contracts appear to reflect some of our key principles, which we have noted above, for an insurance contracts accounting standard. However, we believe that both FVOCI and FVPL applications are appropriate measurement bases for insurers. Hence, although we support EFRAG's proposal to expand the scope of FVOCI in IFRS 9, we strongly disagree to mandatory FVOCI measurement. We believe that mandatory FVOCI would give rise to unclear performance reporting for certain types of insurance business.

Accounting should reflect the linkage between assets and liabilities and hence the insurance contracts accounting model should be suitable for both FVOCI and FVPL applications depending on the measurement environment for backing assets and the way the related businesses are managed. Consequently, we believe that FVOCI should not be mandatory and that insurers should have the ability to present changes in the insurance liability arising from changes in the discount rate in the P&L using a current discount rate if and when that is a better reflection of the relevant portfolios.

Under both the FVOCI and FVPL applications there will be current measurement in the balance sheet. Insurers should then have the ability to apply the FVOCI or FVPL presentation approach that reflects the nature of the insurance products and the related assets.

Accounting for participating contracts must adequately reflect the nature of these products

We note that EFRAG has not yet formed a view on the proposal described in Appendix 5 to your draft comment letter. We describe our alternative proposal for a fully unlocked contractual service margin in our comment letter to the IASB. We fully support not requiring the bifurcation of cash flows nor a separate exception for mirroring as set out in our industry proposal described in our comment letter. We believe it would simplify the accounting requirements for participating contracts, be consistent with the overall building block approach and produce a more faithful representation of performance.

We describe our industry proposal in detail in our IASB comment letter (see Appendix 5 to this letter). We would be pleased to meet with you further to provide you further information and assistance in understanding the merits of our alternative proposal.

We believe the principles of our industry proposal would address our key concerns. We acknowledge that the application of our industry proposal for participating contracts set out in our IASB comment letter (see Appendix 5 to this letter) will need further development and wider testing on a variety of different insurance products.

We would like to thank EFRAG for including in your Draft Comment Letter your Appendix 5 which contains many of the key principles that the insurance industry is advocating. This was important to support a constructive discussion on the important topic of accounting for participating contracts.

Appendices to this letter

In Appendix 1 we have provided our comments on both your draft comment letter to the IASB and the specific questions you have raised in your Appendix 1 “EFRAG’s responses to the questions raised in the exposure draft”.

In Appendix 2 we have provided you with feedback on your Appendix 2 “Additional Comments” to your draft comment letter to the IASB.

Although the CFO Forum itself has not taken part in EFRAG’s field-testing activities, a number of our members have taken part and have provided their feedback separately to EFRAG. Whilst we consider the outreach activities helpful, we would like to highlight that in our response letter to the IASB we say that obtaining meaningful results from field testing within the limited time available in the current ED comment period is not possible. The proposals represent a fundamental change in accounting for insurance companies. It is therefore essential that a comprehensive understanding of the proposals is gained, to ensure that these will not have unintended consequences and are workable operationally. Extensive testing, beyond that currently proposed, is necessary. This should not be confused with either the IASB field testing currently proposed or the three year period between issuing the standard and its effective date. Testing should only take place once the proposals in IFRS 4 and IFRS 9 have been changed to address the issues presented above. We also refer to this in Appendix 3.

In Appendix 4 we comment on the request to provide views about the clarity of drafting in the ED.

In Appendix 5 we have provided you with a copy of our comment letter to the IASB. This comment letter contains a summary of our alternative industry proposal for participating contracts.

We would like to again thank EFRAG for the opportunity to share our comments with you as well as for considering our alternative industry proposal. Please feel free to contact us to discuss any matters raised in this letter.

Yours sincerely,

Gerald Harlin
Chair,
European Insurance CFO Forum

Olav Jones
Deputy Director General
Director Economics & Finance, Insurance Europe

Appendix 1 – CFO Forum and Insurance Europe response to EFRAG's draft comment letter

ADJUSTING THE CONTRACTUAL SERVICE MARGIN

We support the principle of the CSM in the ED to defer profits at inception in order to recognise profit over time as services are provided. However, we believe the ED has not sufficiently developed this principle as there should be a single principle of CSM for all insurance contracts. We welcome the introduction of the unlocking principle, which is consistent with the principle that the CSM represents a current estimate of remaining profits to be recognised in future periods. As such, we agree with the comments in the EFRAG draft response around the benefits from unlocking the CSM for both changes in future coverage or services and for changes in the risk adjustment. Further details on our views in this area can be found in our answer to Question 1 in Appendix 1 of our response letter to the IASB.

We raise other issues on the treatment of the CSM in our response to the IASB where we believe the unlocking principle requires further changes, notably:

- The CSM principle has not been fully developed for participating contracts and hence fundamental changes are required to the current proposals. We believe such concerns can be addressed by our industry proposal for a fully unlocked contractual service margin, described in our comment letter to the IASB (see Appendix 5 to this letter);
- The unit of account is overly restrictive at both initial measurement and subsequent recognition. Setting the unit of account at too granular a level, as suggested in the ED, is inconsistent with the portfolio level applied elsewhere in the ED and will cause greater complexity;
- We believe that it would be a more faithful representation for prior losses to be reversed through profit or loss when reinstating the CSM;
- Interest should be accreted on the CSM using the discount rate used to unwind the insurance liability in profit or loss which is not always the locked-in rate from inception; and
- We believe that gains or losses on reinsurance contracts held on an individual loss basis ought to be immediately recognised by the ceding party and not deferred in a CSM for reinsurance contracts held.

In our response letter to the IASB we have expressed support for the current principles-based approach adopted by the IASB for the release of the CSM.

Additional question raised by EFRAG

- *Paragraph 14: Do you believe that the distinction between changes in estimates relating to future coverage or other future services and experience adjustments would involve a significant amount of judgement? If so, do you believe that the proposed guidance provides sufficient explanation on how entities make this distinction?*

  As noted above, we welcome the decision to unlock the CSM. Whilst unlocking introduces some complexity, this is considered acceptable given the benefits of having a strong principle for the CSM. We believe the unlocking proposals can be made operational as insurers will seek to develop a practical approach to determining which changes in cash flows should be taken to the CSM. To make the unlocking proposals manageable, however, it is imperative that such unlocking takes place using an appropriate unit of account. Setting the unit of account at too low of a level will increase complexity due to the system architecture that will be needed. We also think that the standard should remain principles-based and would object to any further prescriptive guidance being included.

CONTRACTS THAT REQUIRE THE ENTITY TO HOLD UNDERLYING ITEMS AND SPECIFY A LINK TO RETURNS ON THOSE UNDERLYING ITEMS

We welcome the introduction of the concept to reflect the asset dependency of participating contracts but we do not support the ED's application of 'mirroring'. We consider the requirement to bifurcate cash flows to be arbitrary and overly complex and believe there should be no requirement to bifurcate cash flows. It may result in the inconsistent measurement of the insurance liability and will distort performance reporting. This is a critical issue because participating insurance contracts account for a significant proportion of the contracts written by the European insurance industry.

As an alternative for participating contracts, the industry has developed a proposal for a fully unlocked CSM which would not require bifurcation of cash flows nor a separate exception for mirroring. We believe our industry proposal as set out in our letter to the IASB would simplify the accounting requirements for participating contracts, be consistent with the overall building block approach and produce a more faithful representation of performance. Our industry proposal would also apply to insurance contracts for which there are no requirement to hold the underlying items. This ensures that there is a consistent accounting model for all participating contracts with similar economic characteristics. The application of 'mirroring' in the ED is too restrictive in the types of participating contracts that can use this approach.

The key principles of our industry proposal are summarised as follows:

- No exception for the measurement of participating contracts. Instead our industry proposal defines how to apply the general principles of the ED to all contracts with a link to underlying items;
- All insurance contract liabilities would be measured at current fulfilment value on the face of the balance sheet without the bifurcation of cash flows;
- The CSM should always reflect the unearned profit arising from the insurance contracts and be determined on a fully unlocked basis. For participating contracts, an intrinsic element of the unearned profit is the investment return arising from the contracts;
- Profit would be recognised in accordance with the fulfilment of the contract as services are provided, in accordance with general revenue recognition principles; and
- An OCI solution within the ED (in combination with IFRS 9) is needed but OCI must not be mandatory. We believe there needs to be both FVOCI and FVPL applications available.

We believe the principles of our industry proposal would address our key concerns. We acknowledge that the application of our industry proposal for participating contracts set out in our comment letter to the IASB (see Appendix 5 to this letter) will need further development and wider testing on a variety of different insurance products.

There are some other aspects of the IASB measurement model for participating contracts which we support, but on balance, the proposals are too complex and do not provide an appropriate basis for reporting performance from these contracts. Our views in this area are described in detail in our answer to question 2 in Appendix 1 of our response letter to the IASB. In summary:

- We agree with EFRAG that the criteria for the mirroring approach in paragraph 33 of the ED, which "requires the entity to hold underlying items" and "specifies a link between the payments to the policyholder and the returns on those underlying items", is too narrowly defined to capture a significant number of participating contracts.
- We support the use of the discount rate set out in the ED for participating contracts. This approach better aligns the consistent measurement of assets and liabilities.
- We believe the requirement to bifurcate the cash flows must be removed from the final standard. This requirement is arbitrary, overly complex and may result in the inconsistent measurement of the insurance liability, which would distort performance reporting.

We believe these concerns can be addressed through our industry proposal.

In addition, we are of the view that the treatment of changes in the value of options and guarantees has not yet been adequately addressed in the proposals, as short-term market fluctuations affecting their value are not representative of the long-term operating performance of the insurer. We describe our views below in our response to your question in paragraph 115.

Additional questions raised by EFRAG

- *Paragraph 56: Do you believe the alternative approach described in Appendix 5 will lead to financial statements that provide relevant information that faithfully represent the entity's financial position and performance for contracts with asset dependent cash flows? Why or why not? If not, what would you recommend and why? Please consider whether the alternative approach eliminates or reduces accounting mismatches while reporting consistently contracts with similar economic features (i.e. contracts with asset dependent cash flows). Do you support the alternative approach wholly or partly? Please explain, which parts you support and which you do not?*

  As explained above, we fully support our industry proposal for participating contracts for a fully unlocked CSM as described in our comment letter to the IASB. We believe our industry proposal would simplify the accounting requirements for participating contracts, be consistent with the overall building block approach and produce a more faithful representation of performance. We acknowledge that the application of our industry proposal for participating contracts set out in our letter to the IASB will need further development and wider testing on a variety of different insurance products.

- *Paragraph 57: Do you believe that for contracts with asset dependent cash flows, the effect of changes in financial assumptions should be accounted for in the contractual service margin resulting in a fully prospective contractual service margin? If so, why and how this should be done?*

  We believe it is appropriate to account for the effect of changes in investment returns in the CSM. This is a feature of our industry proposal as described in our comment letter to the IASB. The sharing of investment returns between shareholders and policyholders is a key feature of participating contracts. Consequently, we consider this treatment to be more consistent with the definition of the CSM as the unearned profit for providing services under the insurance contract. As such, a fully unlocked CSM will be more understandable and meaningful to users of the financial statements. (We note that the distinction between shareholders and policyholders is not relevant for mutual insurance companies).

- *Paragraph 58: Do you agree that interest expense should be recognised in Profit or Loss based on a yield as proposed in the alternative approach (please refer to paragraphs 21 – 25 of Appendix 5 for a description of the yield curve under the alternative approach)? Why or why not?*

  Consistent with our response above to your Paragraph 56, we support the approach set out in our industry proposal as described in our comment letter to the IASB.

  We believe that both an FVOCI and FVPL application should be available for the treatment of changes in discount rate. Under the FVOCI application, the discount rate applied to the fulfilment cash flows to measure the liability is the current market rate. To determine interest expense presented in profit or loss, the discount rate is effectively an amortised cost based rate which is unlocked where there are changes in the expected future cash flows under the contract. The difference between this rate and the current market rate would be recognised within OCI. Under the FVPL application, the discount rate used to measure the liability and determine the interest expense presented in P&L is a current market rate.

- *Paragraph 59: What should be the pattern of release of the contractual service margin for contracts with asset dependent cash flows?*

  Under our industry proposal the CSM reflects the unearned profit arising from the insurance contracts and is updated each period to be determined on a fully unlocked basis. We believe this treatment is more consistent with the definition of the CSM as the unearned profit for providing services under the insurance contract and applies the unlocking principle to participating contracts in a more consistent manner with non-participating contracts. Profits would be recognised in accordance with the fulfilment of the contract as services are provided, in accordance with general revenue recognition principles. This approach is, therefore, both more understandable and more meaningful to users of the financial statements.

- *Paragraph 60: Do you believe the alternative approach is operationally more or less complex than the IASB's 'mirroring approach'?*

  We believe that our industry proposal for a fully unlocked CSM is less complex compared to the IASB proposal in the ED. It has no requirement to bifurcate cash flows and also benefits from applying the general building block model to the measurement of participating contracts. Furthermore, it applies a single yield curve to the measurement of all cash flows. These changes simplify the accounting requirements for participating contracts and provide a more faithful representation of the performance from these contracts.

- *Paragraph 61: Do you believe that the alternative approach, or a variant thereof, would be conducive to understandable and useful information for investors and their advisors?*

  Yes, we believe our industry proposal will provide a more faithful representation of performance from participating contracts and will be easier for users to understand as it applies the general requirements of the buildings block model. By removing the need to bifurcate cash flows, our industry proposal will increase the consistency in the measurement of participating contracts between insurers, thereby aiding comparability. In addition, the ability to use both FVOCI and FVPL applications for presenting the effect of changes in the discount rate will reduce the frequency and severity of accounting mismatches, which makes the financial statements more meaningful.

PRESENTATION OF INSURANCE CONTRACT REVENUE AND EXPENSE

Our detailed view on insurance contract revenue and expense is set out in our answer to Question 3 in Appendix 1 of our response letter to the IASB.

We do not believe that the earned premium revenue proposals in the ED for the presentation of earned premium revenue and expenses under the building block approach will provide a clear communication tool to investors on the performance of our business. The proposal will also introduce more complexity without providing significant additional benefits.

Whilst the presentation of a premium revenue number is an important metric for non-life insurers, earned premium revenue, as set out in the ED, is not a measure used by the life insurance industry. As such we believe insurance analysts and other users of financial statements will neither understand nor rely upon earned premiums as proposed in the ED. Instead, they are likely to continue to request existing volume measures such as gross written premiums and new business premiums. Insurers that only have life insurance products would prefer a summarised margin approach to be available.

Earned premium revenue may also create an inconsistency with both the overall model and the premium allocation approach as it uses claims incurred as the main driver of premium revenue. This may not be in line with the transfer of services as incurred claims are not always the main service provided by the insurer, even for non-life insurers.

We also oppose the requirement to disaggregate premiums for 'non-distinct' investment components. Disaggregation is conceptually inconsistent with the ED's proposal not to unbundle 'non-distinct' elements of an insurance contract for classification and measurement purposes. Additionally:

- It is likely to be very costly to implement because the data is not readily available and is inherently difficult to obtain. Consequently, allocation of some of the investment components would be highly arbitrary and would not provide comparable information; and
- The definition of an investment component is very broadly defined and we believe the disaggregation requirements will be more complex than the IASB may have envisaged.

Additional questions raised by EFRAG

- *Paragraph 87: Do you believe that the investment component amounts would be difficult and costly to* *compute because they are not distinct and are highly interrelated with the insurance component?*

- *Paragraph 88: Do you believe that additional application guidance is necessary to determine these amounts on a portfolio level?*

  The data required to disaggregate the investment components is neither readily available nor easy to obtain. As such, we envisage it to be unduly costly to obtain. We do not believe that additional guidance is needed because we object to the requirement itself.

- *Paragraph 89: Do you believe that preparing and presenting revenue under the ED proposals would be difficult and costly?*

  Yes, as explained in our response to the IASB, we believe that the earned premium revenue in the building block approach introduces more complexity without providing significant additional benefits.

INTEREST EXPENSE IN PROFIT OR LOSS

We welcome the Board's decision to introduce an OCI model in IFRS 4 and reintroduce FVOCI in IFRS 9 as we see OCI as a vital element to adequately reflect the performance of certain insurance products in a current measurement environment. Accounting should reflect the linkage between assets and liabilities and hence the insurance liability accounting model should be suitable for both FVOCI and FVPL applications depending on the measurement environment for backing assets. Consequently, we believe FVOCI should not be mandatory and that insurers should have the ability to present changes in the insurance liability arising from changes in the discount rate in P&L using a current discount rate.

We believe that both FVOCI and FVPL applications are appropriate measurement bases for insurers and hence we do not agree with EFRAG'S proposal to mandate FVOCI measurement for all assets backing insurance contracts and insurance liabilities. We agree that the OCI model as currently proposed in the ED will result in many possible accounting mismatches. Although we support the solution proposed in the EFRAG response to expand the scope of FVOCI in IFRS 9 to reduce such accounting inconsistencies, we believe that the use of OCI to reflect the effect of changes in the discount rate should not be mandatory and consider it essential for the IASB to permit insurers to elect to apply a current measurement through the P&L. We envisage the final standard could include guidance about factors that can be considered in determining the application, and that the application of either FVOCI or FVPL could be irrevocable in the absence of a significant change in the insurer's business model. We describe our suggested approach in more detail in our answer to Question 4 in Appendix 1 of our response letter to the IASB.

Additional questions raised by EFRAG

- *Paragraph 103: Under the IASB's proposals, the difference to be reported in OCI is determined by comparing the discount rate to measure the liabilities and, depending on the type of cash flows, the locked-in discount rate at inception of the insurance contract or an updated rate. Under IAS 19 Employee Benefits, the difference is determined by comparing the discount rate at the beginning of the reporting period and the rate at the end of the reporting period. Some, including IASB Board member Stephen Cooper, hold the view that only the latter difference (i.e. the effect of changes in discount rates in the period of the change) provides relevant information (as is described in paragraphs AV5 and AV6 of the Basis for Conclusions), and that, therefore, only this difference should be reported in OCI.*

  We support the application of the OCI model in the ED. However, we do not agree with the mandatory application of OCI which will create accounting mismatches and give rise to inappropriate performance reporting for certain types of insurance business. Accounting should reflect the linkage between assets and liabilities and hence the insurance liability accounting model should be suitable for both FVOCI and FVPL applications depending on the measurement environment for backing assets. To ensure meaningful performance reporting, we consider it essential that the IASB develops an accounting model suitable for both FVOCI and FVPL applications.

- *Paragraph 104: Do you support the approach in the ED or should the interest expense recognised in profit and loss be based on a current discount rate for all type of cash flows? If so, should the discount rate be the rate at the beginning of the period, as in IAS 19, or that at the closing date?*

  Yes, we support the application of the OCI model in the ED and the introduction of FVOCI in IFRS 4 and IFRS 9. However, we believe both FVOCI and FVPL measurement should be available. We do not support applying a model similar to that in IAS 19; instead, insurers should have the ability to use either the locked-in discount rate approach set out in the ED or to apply a current measurement through the P&L using end-of-period discount rates.

- *Paragraph 108: Do you believe the suggested approach described above will lead to financial statements that provide relevant information that faithfully represent the entity's financial position and performance for contracts? Please consider whether the suggested approach eliminates or reduces accounting mismatches in Profit or Loss and OCI.*

  We acknowledge the intention of EFRAG's proposal to avoid accounting mismatches. However, it is our view that a faithful representation of an entity's financial position and performance can only be obtained if both FVPL and FVOCI applications are available. This approach would make it possible to avoid accounting mismatches even with a mixed measurement basis under IFRS 9.

- *Paragraph 109: Are you aware of any circumstances in which, from your point of view, measurement of both insurance liabilities and the related financial assets at FV-PL might be needed instead of, or combined with, measurement at FV-OCI? If so, please provide a description of the portfolios of insurance contracts concerned and how the asset-liability management strategy differs from other portfolios.*

  Yes, we believe FVPL measurement for assets and current measurement through P&L for liabilities should be available in addition to FVOCI in order to be consistent with the differing types of products, business models and the ALM of insurers. The application of FVOCI and FVPL should not be dependent on detailed rules based criteria. Instead we envisage the final standard could include guidance on the types of factors that can be considered in determining the application of FVOCI and/or FVPL. For example, characteristics of the insurance liability/product and the way the corresponding assets and insurance liabilities are managed. The application of either FVOCI or FVPL could be irrevocable in the absence of a significant change in the insurer's business model.

- *Paragraph 110: Do you believe that EFRAG should suggest how the assets related to insurance liabilities should be identified? If so, what would you recommend and why?*
- *Paragraph 111: Do you believe that derivatives should also be accounted for using OCI? If so, how could objective evidence be gathered in respect of derivatives that only play a role in matching insurance liabilities?*
- *Paragraph 112: Should any other assets apart from those included in paragraph 105 be measured at FV-OCI? Please explain why.*

  As set out above, we believe that both FVOCI and FVPL applications should be available. In the FVOCI application, FVOCI should be available for both the insurance liability and all related assets. Hence, although we support EFRAG's proposal to expand the scope of FVOCI in IFRS 9, we strongly disagree to mandatory FVOCI measurement. We believe that mandatory FVOCI would give rise to unclear performance reporting for certain types of insurance business.

- *Paragraph 113: Do you agree that following EFRAG's approach, the IASB would need to develop an impairment model for debt instruments that do not meet the contractual cash flow characteristics assessment and investments in equities that would be measured at FV-OCI and potentially other assets? If so, what impairment model would you recommend and why?*

  In our March 2013 letter to the IFRS 9 Classification & Measurement ED we said that FVOCI measurement should be available for a wider scope of asset classes that back insurance contracts liabilities that are measured at FVOCI. We also stated that the contractual cash flow characteristics test is too narrow to identify all debt instruments that should be eligible for FVOCI measurement. Furthermore, in our response to the IFRS 9 Impairment ED we have expressed a strong preference for one impairment model for all assets in scope of IFRS 9.

- *Paragraph 114: Do you see any problems in recycling realised gains and loss on investments related to contracts with asset-dependent cash flows (that are not under the scope of the IASB's measurement and presentation exception as discussed in Question 2)? If so, what solutions would you recommend? Please explain your answer.*

  If and when IFRS 9 requires realised gains and losses on investments related to contracts with asset dependent cash flows to be recognised immediately in P&L, it is important that IFRS 4 deals correctly and consistently with the related impact on insurance liabilities. Our industry proposal would adequately deal with this issue for all contracts with participating features.

- *Paragraph 115: Where should changes in the time value of options and guarantees not separated from insurance liabilities be recognised? Please explain your answer.*

  Under the proposals in the revised ED, all options and guarantees, even those that are not unbundled, are measured separately at current value through profit or loss. We believe this treatment is inconsistent with the treatment of options and guarantees in financial instruments issued by other industries. We believe that options and guarantees that are not unbundled should be treated consistently with all other elements of the insurance liability for measurement and presentation as set out in our industry proposal. This means that changes in the value of options and guarantees are recognised based on the nature of the change and the measurement application followed (including the application of OCI and/or FVPL and the CSM) for other elements of the insurance liability and backing assets.

EFFECTIVE DATE AND TRANSITION

Transition

We agree with the EFRAG response in highlighting the improvements made to the approach for transition. We also support the need for alignment between the effective dates of IFRS 4 and IFRS 9. However, we do not believe it is possible to obtain meaningful results from field testing in the time available, particularly given the issues identified in response to the other questions raised by the IASB. We do not believe that extensive testing can take place until after the proposals in IFRS 4 and IFRS 9 have been updated and consider this an essential step in obtaining a comprehensive understanding of the requirements and their implications.

Effective date and implementation

In setting the effective date, it is important that the proposed three-year implementation period that has been discussed previously by the IASB is given. The standard will introduce fundamental changes to insurance accounting which have far reaching operational challenges. This means the two years usually applied to new standards will not be sufficient for insurers and at least a three-year period is needed.

It is also essential that in advance of finalising the proposals, a comprehensive understanding of the proposals is gained, to ensure that these will not have unintended consequences and are workable operationally. Extensive testing, beyond that currently proposed, is necessary. This should not be confused with either the IASB field testing currently proposed or the three year period between issuing the standard and its effective date. Testing should only take place once the proposals in IFRS 4 and IFRS 9 have been changed to address the issues presented above. In order to facilitate this testing there should be a review draft setting out the revised proposals.

Further detail on all these points can be found in our answer to Question 5 in Appendix 1 of our response letter to the IASB.

Additional questions raised by EFRAG

- *Paragraph 135: Considering EFRAG's recommendation for entities where insurance forms a significant part of their activities (i.e. the effective date of IFRS 9 should be deferred until the effective date of the new insurance contracts standard), do you believe that:*

  (a) Those entities should always be required to apply the impairment proposals earlier than the other parts of IFRS 9; or

  (b) Those entities should be allowed early implementation of the impairment proposals compared to the other parts of IFRS 9.

  We strongly believe that insurers should not be required, but should be permitted, to adopt IFRS 9 before the mandatory effective date of IFRS 4. This belief encompasses all aspects of IFRS 9, including the impairment proposals; hence we support statement (b) above.

- *Paragraph 136: Do you believe the scope of the redesignations and reclassifications when the new insurance contracts standard is applied for the first time by entities for whom insurance forms a significant part of their activities, should be extended beyond IFRS 9 (e.g. investment properties)? If yes, please explain what items should be within that scope?*

  As explained above, we strongly believe that insurers should not be required to adopt IFRS 9 before the mandatory effective date of IFRS 4. In such case, the issue raised in paragraph 136 is not relevant.

THE LIKELY EFFECTS OF A STANDARD FOR INSURANCE CONTRACTS

We describe our views on the likely effects of the standard in our answer to Question 6 in Appendix 1 of our response letter to the IASB.

Additional question raised by EFRAG

- *Paragraph 139: Do you believe that the IASB's response to the comments on the 2010 Exposure Draft balance the costs of applying these proposals with the benefits of the resulting information provided?*

  A number of our key concerns have not been adequately addressed by the proposals in the ED. While we support certain of the IASB's responses to the comments on the 2010 Exposure Draft, we also believe that a number of the IASB's responses, such as bifurcation of cash flows and the required disaggregation of investment components will result in significant complexity and costs which outweigh the benefits of the resulting information provided.

  We believe the focus is now needed to make sure the proposals in the ED are amended such that they are appropriate for insurance business. The most critical areas are the interaction between IFRS 4 and IFRS 9 (including the limitation on the application of FVPL and the restrictive use of the FVOCI category in IFRS 9), the proposed measurement and presentation of participating contracts and the treatment of options and guarantees. As a next step, efforts are needed to translate these principles into high level and practical guidance, avoiding unnecessary complexity.

CLARITY OF DRAFTING

We outline our views on clarity of drafting in our response to Question 7 in our comment letter to the IASB. In our comment letter we have raised a number of significant conceptual issues with the underlying principles in the standard which need to be addressed. The current proposals in the ED do not yet adequately achieve their intended purpose in significant areas and important changes are needed. We believe focus should be given first to developing principles to be appropriate for insurance business before finalising the detailed wording and application guidance. Consequently, we feel it is premature to comment on detailed wording. We note, however, that the current draft wording can be unclear, confusing and even potentially contradictory at times.

Additional question raised by EFRAG

- *Paragraph 141: Do you agree with the areas/paragraphs identified by EFRAG in Appendix 4?*
- *Paragraph 142: Have you identified any other areas/paragraphs that need clarification? Please explain.*

  We do not consider it appropriate to comment at this time because focus should be given first to developing principles appropriate for insurance business before finalising the detailed wording and application guidance.

Appendix 2 – Comments on EFRAG's Appendix 2 "Additional Comments"

Additional question raised by EFRAG

- *Paragraph 17: Do you agree with EFRAG's conclusion that day one gains and losses on buying reinsurance should be recognised over the coverage period? If not, please explain how those should be accounted for and what the supporting arguments for a different accounting treatment are.*

  No, we believe that gains or losses on reinsurance contracts held on an individual loss basis ought to be immediately recognised in P&L. Further details can be found in our answer to question 1 in Appendix 1 of our response letter to the IASB.

- *Paragraph 23: Do you agree with EFRAG's recommendation that the requirement to disclose information about the effects of each regulatory framework in which entities operate should be deleted in the final standard? Please explain your answer.*

  We support EFRAG's response.

Appendix 3 – Field-testing activities

We do not believe it is possible to obtain meaningful results from field testing in the time available, particularly given the issues identified in response to the other questions raised by the IASB. We do not believe that extensive testing can take place until after the proposals in IFRS 4 and IFRS 9 have been updated and consider this an essential step in obtaining a comprehensive understanding of the requirements and their implications.

Appendix 4 – Suggestions for clarification in the drafting

We feel it is premature to comment on detailed wording in the exposure draft, although we do find the current draft wording can be unclear, confusing and even potentially contradictory at times.

In our response letter to the IASB we have raised a number of significant conceptual issues with the underlying principles in the standard which need to be addressed. We believe focus should be given first to developing principles to be appropriate for insurance business and addressing these conceptual issues before finalising the detailed wording and application guidance. We have, however, raised some comments on the wording and application guidance where we believe there is a lack of clarity or the words can be interpreted differently to how the IASB intended. These areas are highlighted in our response to Question 7 in our IASB response letter.

Appendix 5 – CFO Forum and Insurance Europe's response letter to the IASB

Please see attached document.