

# FÉDÉRATION FRANÇAISE DES SOCIÉTÉS D'ASSURANCES

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LE DÉLÉGUÉ GÉNÉRAL

Mr Hans Hoogervorst  
Chairman  
International Accounting Standards Board  
30 Cannon Street  
EC4M 6XH London  
United Kingdom

October 24, 2013

**Re: IASB ED/2013/7 Insurance Contracts**

Dear Mr Hoogervorst,

The Fédération Française des Sociétés d'Assurances (FFSA) welcomes the opportunity to comment on the IASB's Exposure Draft ED/2013/7: Insurance Contracts (ED). Our members represent most of the French insurance and reinsurance undertakings, constituting over 90% of the insurance market in France. Accordingly it represents the consensus view of a significant element of the European insurance industry.

**We welcome the progress that the IASB has made in addressing some of our concerns with regard to the 2010 ED**

We support the IASB decisions regarding the adjustment of the contractual service margin (CSM) for changes in estimates of expected cash flows related to future coverage and other future services. We also welcome the introduction of other comprehensive income (OCI) for changes in market interest rates on insurance liabilities, the top down approach for discount rate and the revised transition proposals.

**The re-introduction of a FV-OCI<sup>1</sup> measurement in IFRS 9 and the requirement to present in OCI the changes in market interest rates on insurance liabilities that reverse over time are a very positive step in taking into account the overall linkage between insurance liabilities and their backing assets. However, the FV-OCI measurement category is too restrictive. It should be expanded to all categories of assets backing insurance liabilities, including portfolios of derivatives**

As consistently expressed in our comment letters to the 2010 ED and IFRS 9, the interaction between insurance liabilities and their backing assets is the core of the insurance activity and its performance, and is illustrated through the asset liability management (ALM) strategies. A consistent measurement of the insurance liabilities and their backing assets is fundamental to reflect their overall linkage.

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<sup>1</sup> "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.

In the IASB general model, financial assets and insurance liabilities are considered in isolation and are not measured on a consistent basis, irrespective of the ALM strategies. Limiting the FV-OCI measurement category as proposed in IFRS 9 to only simple debt instruments is too restrictive. It would impede insurers to reflect the performance of their ALM strategies. Those strategies are not limited to investment in simple debt instruments but involve diversified categories of assets including derivatives hedging, for example, interest rate risks or credit exposures. Therefore, the FV-OCI measurement category should be expanded to all categories of assets backing insurance liabilities. Similarly, the restriction on the recycling of gains and losses in profit and loss (P&L) for equity instruments is not consistent with the nature of the backed insurance liabilities. This is particularly so for participating contracts (but not only), where the assets returns, including gains and losses, are passed to the policyholders.

**An appropriate accounting standard for insurers should reflect the long term nature of insurance activities in the P&L. The impact of short-term market fluctuations that reverse over time should not obscure the long-term operating performance of insurance activities. The ED fails to meet this objective particularly with regard to participating contracts. It should be revised to ensure that the performance of all insurance contracts is appropriately reflected in the financial statements**

Consistently with the views expressed by the European insurance industry, we believe that an appropriate accounting standard for insurance contracts should be based on the following principles:

- Where an insurer's asset and liability cash flows are economically matched, no accounting volatility should be reported in P&L nor in 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 P&L account should reflect a measure of result that is relevant to the operating performance of the insurer.

In this context, our main concerns with regard to the current proposals of the ED are the following:

**The ED's proposals result in an inappropriate measurement of participating contracts as they do not reflect the economics of these products nor their performance. To address these concerns, we support the development of an alternative approach for these contracts, based on a consistent set of principles**

Participating contracts represent a significant portion of the French life business. As such, it is essential that the economics of these products and their performance are appropriately represented in the final standard.

The asset dependency of the participating contracts fulfilment cash flows is a key feature of these contracts. In this respect, we support the ED's requirement to use a discount rate that reflects this asset dependency.

However,

- It is essential that the asset dependency feature is appropriately reflected in the accounting treatment of all participating contracts. Participating contracts with similar economic characteristics should be treated in a consistent manner. There should be no arbitrary distinction between contracts based on a requirement to hold underlying items as proposed in the ED;

- The “mirroring” approach as proposed in the ED does not achieve the objective of reflecting the asset dependency principle. The requirement to bifurcate cash flows is arbitrary and overly complex. It contradicts the key principle of the ED to consider the insurance contract as a bundle of rights and obligations. It is also not consistent with how participating contracts are managed operationally;
- For those options and guarantees that are not separated according to the requirements of the ED, the recognition of changes in their current value through P&L is not appropriate. It would result in recognising in the P&L short-term market fluctuations that are not representative of the long-term operating performance of the insurer;
- The scope of changes adjusting the CSM should be revised to ensure that the characteristics of the participating contracts are appropriately addressed, through the full unlocking of the CSM. When a contract requires that the amounts paid to policyholders vary with the returns on underlying items, the profit that results from the insurance contract cannot be considered in isolation from those returns. Changes in the expected returns modify the insurer expected profit according to the terms of the contract. As drafted, the ED’s proposals do not allow to reflect the whole of the unearned profit arising from the participating contracts.

We consider that the IASB should reconsider how the asset dependency of the participating contracts fulfilment cash flows should be measured and presented in the financial statements. This feature must be fully reflected in the accounting treatment of all participating contracts. Otherwise, financial information provided to users will neither reflect the economics of the participating contracts nor their performance.

To address these concerns and to ensure an effective accounting treatment of all participating contracts, we support the following set of principles that should be considered comprehensively:

- The measurement model for all participating contracts should be consistent with the general principles of the ED that apply to other contracts under the building blocks approach;
- Participating contracts should be measured at current fulfilment value on the face of the balance sheet without bifurcation of cash flows;
- Asset dependency should be reflected through the use of a discount rate that is derived from the assets to recognise the effect of the unwinding the insurance liabilities in the P&L. Consistently with the general principles of the ED, the difference between the interest rate expense calculated at this rate and the effect of unwinding the insurance liabilities at a current discount rate should be recognised in OCI;
- The CSM of participating contracts should always represent the unearned profit associated with these contracts. It should be determined on a fully unlocked basis, including the changes in assets returns that impact the insurer’s share in expected profits. In other words, the CSM should be adjusted for differences in the cash flows due to changes in financial assumptions, except for short term fluctuations that reverse over time. These short term fluctuations, including those that affect the time value of options and guarantees, should be recognised in OCI.

An approach that combines these key principles would respond to our main concerns with regard to participating contracts. It will result in relevant performance in the P&L and reflect the long-term nature of insurance activities as:

- It will distinguish between earned profit that would be recognised in the P&L as services are provided to the policyholders and changes in future expected profits that would be recognised against the CSM;
- Short-term fluctuations that reverse over time, including those that affect the time value of options and guarantees, would be presented in OCI. Presenting in OCI the impact of market rate changes on the time value of options and guarantees is appropriate because those changes are not representative of the current or future performance of the insurer, they are not part of the service to the policyholders and they are expected to reverse over time.

This set of principles is consistent with that used by the European insurance industry to develop an “industry alternative proposal” for participating contracts. We are in the process of assessing its application to our participating products. Sufficient time is needed for this testing to ensure that the application mechanisms work appropriately for various products under different economic scenarios.

**The decision to introduce the unlocking principle for the CSM is a positive step. However further changes are needed to ensure that the unlocking principle is applied consistently to all contracts**

As stated above, we welcome the decision of the IASB to introduce the principle of unlocking the CSM.

However, further changes to the ED’s proposals are needed to ensure that the unearned profits of the insurance contracts are consistently reflected at initial recognition and at subsequent measurement:

- The unit of account used for the release of the CSM should be the portfolio. It would be consistent with how insurers manage their contracts and with the unit of account used for the initial measurement of the CSM;
- The CMS should be adjusted for changes in the risk adjustment that relates to future coverage and other services;
- The favorable changes in expected profit after the CSM has been exhausted should lead to rebuilding the CMS only when all prior losses that have been recognized in the P&L are reversed;
- The CSM should be released over both the period of coverage and the settlement period as the insurer continues to provide services to the policyholders after the end of the coverage period. For accounting purposes, considering that no services are provided to the policyholders after the end of the coverage period neither reflect the economics of the insurance contracts nor the obligations of the insurer towards the policyholders.

**The ED’s proposals for the presentation of revenue and expenses for life insurance activities will not provide useful information to users. The summarised margin approach that was proposed in the 2010 ED, together with volume information in the notes, will better achieve this objective**

The earned premium revenue as set out in the ED is not an appropriate measure for life insurance business. We are also convinced that insurance analysts and other users of financial statements will neither understand nor rely upon such a presentation. Users will continue to request existing volume measures such as gross written premiums and new business premiums which are key performance indicators for the life insurance industry today.

We consider that these proposals will introduce undue complexity and result in significant implementation costs for insurers without providing any additional benefits to users.

The summarized margin approach, as proposed in the 2010 ED, coupled with the disclosure of volume information in the notes (similar to the volume information that is provided today to users) will better achieve the objective of providing meaningful information to users for life insurance activities. We urge the IASB to reconsider its decision to abandon the summarized margin presentation.

In addition, the requirement to disaggregate ‘non-distinct’ investment components for the P&L presentation is contradictory with the ED principle to separate only those elements of insurance contracts that are distinct. This requirement is complex to implement as it would imply to separate interrelated cash flows and arbitrarily allocate them between the different “components”.

**Sufficient time should be given to constituents, particularly insurers, to assess the revised proposals of the IASB through extensive testing prior to their finalisation**

As stated above, we have significant concerns with some of the ED’s proposals. We believe that these ED’s proposals should be revised to ensure that appropriate financial information is provided to users. The most critical areas that need to be addressed are the treatment of participating contracts (including the treatment of options and guarantees and the unlocking of the CSM), the interaction between IFRS 4 and IFRS 9 (including the necessity to expand the FV-OCI measurement category to all assets backing insurance liabilities including portfolios of derivatives) and the presentation in the P&L. We acknowledge that these changes are significant. However, such changes are necessary to produce final standards that are workable and relevant for the insurance activities.

Therefore, it is crucial that the IASB takes sufficient time to revisit its proposals. Similarly, it will be necessary for constituents, particularly insurers, to gain a comprehensive understanding of the revised proposals through their extensive testing. In order to facilitate this testing there should be a review draft setting out the revised proposals. The objective of this extensive testing will be to ensure that these revised proposals do not have unintended consequences and are workable operationally prior to their finalisation.

**The mandatory effective date of IFRS 9 must be aligned with IFRS 4 for insurers**

As we have consistently highlighted, IFRS 9 and IFRS 4 projects are of crucial importance for insurers as they are complementary to reflect the fundamental interaction between the insurance liabilities and their backing assets. They must be finalised on a consistent basis. As such, we do not believe that the revised IFRS 9 can be finalised before the insurance standard is also finalised. We also consider that insurers should not be required (but permitted) to adopt IFRS 9 before the mandatory effective date of IFRS 4. Otherwise, the usefulness of the financial reporting for users in the period between IFRS 9 and IFRS 4 adoption would be put into question, as users will experience two major changes in insurers’ financial statements in short period of time.

If the effective dates were not aligned and insurers were required to adopt IFRS 9 in advance of IFRS 4, it would be critical to include sufficient provisions in IFRS 4 to permit insurers to fully reconsider designations and classifications of their financial assets when adopting IFRS 4.

Appendix 1 to this letter sets out our views on the detailed questions posed in the exposure draft.

We encourage the IASB to pursue its active dialogue with the insurance industry to produce high quality IFRSs for both financial instruments and insurance contracts that allow insurers to reflect their business models so as to provide decision-useful information to users.

Please feel free to contact Bertrand Labilloy at +33 1 42 47 93 58 to discuss any matters raised in this letter.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'J. Lequoy', with a horizontal line extending from the end of the signature.

Jean-François Lequoy

## Appendix 1

### Question 1—Adjusting the contractual service margin

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

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

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

**The decision to introduce the unlocking principle for the CSM is a positive step. However further changes are needed to ensure that the unlocking principle is applied consistently to all contracts**

We welcome the decision of the IASB to introduce the principle of unlocking the CSM. We believe that unlocking the CMS is essential to ensure the future unearned profits of the insurance contracts are consistently reflected at initial recognition and subsequent measurement. This is a significant improvement on the 2010 ED proposals.

However, further changes to the ED's proposals are needed to fully meet this objective:

- The unit of account used for the release of the CSM should be the portfolio. We agree with paragraph B37a that the portfolio is the appropriate unit of account for measuring the CSM at the initial recognition. Concerning the release of the CSM, we note that BCA 113 states that the ED does not specify the level of aggregation for this purpose. However, B37d and BCA113 refer to a very low level in the aggregation of the contracts for the release of the CSM (refer to references made to the "contract", the contracts with "similar contract inception dates, coverage periods and service profiles" and even the "individual contract level"). Releasing the CSM at a lower level than the portfolio would not be consistent with the level of granularity at which the insurers manage their contracts, nor with the unit of account used to measure the CSM at initial recognition;
- The CSM should be adjusted for changes in the risk adjustment that relates to future coverage and other services. The risk adjustment reflects the uncertainty about the amount and timing of cash flows arising as the entity fulfils the insurance contracts. As such, the changes in the risk adjustment should be accounted similarly to the changes in the estimates of those future cash flows. Obtaining the necessary information would not create a significant burden for insurers;
- The favorable changes in expected profit after the CSM has been exhausted should lead to rebuilding the CSM only when all previous losses that have been recognized in the P&L are reversed. It appears that paragraph 30 intends that in such a case, these favourable changes would have to be added to the CSM. It would result in an overstated CSM compared to the future expectations of profits on the related contracts. Tracking the relevant data will not be overly burdensome for insurers. It will result in a more appropriate representation of the future performance of these contracts. Therefore, we recommend the IASB to modify paragraph 30 in this respect;

- The CSM should be released over both the period of coverage and the settlement period as the insurer continues to provide services to the policyholders after the end of the coverage period. The insurance coverage is described in BC 26 as the main service provided. We understand that it leads the IASB to the conclusion that the CSM should only be released over the coverage period. We do not consider that this conclusion is appropriate. Indeed, the price charged by the insurer to the policyholder is not covering only the services provided during the coverage period but also the claims handling period that are an integral part of the services provided to the policyholder. For accounting purposes, considering that no services are provided to the policyholders after the end of the coverage period neither reflect the economics of the insurance contracts nor the obligations of the insurer towards the policyholders. We consider that profits should be allocated to both the coverage and the settlement periods as they relate to core activities in the insurance business;
- The scope of changes adjusting the CSM should also be revised to ensure that the characteristics of the participating contracts are appropriately addressed, through the full unlocking of the CSM. Please refer to Question 2.

**The benefits of the information provided by the accretion of interest on the CSM should be reconsidered**

We note that the IASB considers that accreting interest is necessary to maintain consistency with the revenue recognition project. However, in our view, the CSM represents the unearned profit of the contract (“a deferred credit”). Therefore, we do not see the IASB’s argument persuasive from a conceptual point of view. In addition, we question the usefulness of the resulting information for users.

**The treatment of the CSM for reinsurance contracts held should be reconsidered to ensure that the link between the underlying insurance contracts and the reinsurance contract held is appropriately taken into account**

For the cedant, the function of reinsurance is to mitigate losses resulting from insurance contracts. Therefore, from an economic perspective, both contracts are linked. Depending on the type of reinsurance contracts, the extent of the mitigation of risk varies. Anyway, the cedant is no more subject to the risks covered under the reinsurance contract.

We are not convinced that the outcome of the ED’s proposals appropriately portrays the economics of these transactions in all cases. We recommend that the IASB reassesses the impact of the link between the underlying insurance contracts and the reinsurance contract held on the treatment of the CSM to avoid any unintended or counterintuitive effects of the ED’s proposals.

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

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

- measures the fulfilment cash flows that are expected to vary directly with returns on underlying items by reference to the carrying amount of the underlying items?*
- measures the fulfilment cash flows that are not expected to vary directly with returns on underlying items, for example, fixed payments specified by the contract, options embedded in the insurance contract that are not separated and guarantees of minimum payments that are embedded in the contract and that are not separated, in accordance with the other requirements of the [draft] Standard (ie using the expected value of the full range of possible outcomes to measure insurance contracts and taking into account risk and the time value of money)?*



(c) *recognises changes in the fulfilment cash flows as follows:*

- (i) *changes in the fulfilment cash flows that are expected to vary directly with returns on the underlying items would be recognised in profit or loss or other comprehensive income on the same basis as the recognition of changes in the value of those underlying items;*
- (ii) *changes in the fulfilment cash flows that are expected to vary indirectly with the returns on the underlying items would be recognised in profit or loss; and*
- (iii) *changes in the fulfilment cash flows that are not expected to vary with the returns on the underlying items, including those that are expected to vary with other factors (for example, with mortality rates) and those that are fixed (for example, fixed death benefits), would be recognised in profit or loss and in other comprehensive income in accordance with the general requirements of the [draft] Standard?*

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

**The ED's proposals for participating contracts are overly complex. They result in an inappropriate measurement of participating contracts as they do not reflect the economics of these products nor their performance. To address these concerns, we support the development of an alternative approach for these contracts, based on a consistent set of principles that should be addressed comprehensively**

Participating contracts represent a significant portion of the French life business. It is essential that the economics of these products and their performance are appropriately represented in the final standard.

The asset dependency of the participating contracts fulfilment cash flows is a key feature of these contracts. In this respect, we support the ED's requirement to use a discount rate that reflects this asset dependency.

However,

- It is essential that the asset dependency feature is appropriately reflected in the accounting treatment of all participating contracts. Participating contracts with similar economic characteristics should be treated in a consistent manner. There should be no arbitrary distinction between contracts based on a requirement to hold underlying items as proposed in the ED;
- The "mirroring" approach as proposed in the ED does not achieve the objective of reflecting the asset dependency principle. The requirement to bifurcate cash flows is arbitrary and overly complex. Paragraph B86 shows that there are different possibilities to bifurcate cash flows out of which the IASB has required one to be applied mandatory. It is unclear how entities will apply this proposal in practice. In addition, bifurcating cash flows only for presentation purposes contradicts the key principle of the ED to consider the insurance contract as a bundle of rights and obligations. It is also not consistent with how participating contracts are managed operationally;
- For those options and guarantees that are not separated according to the requirements of the ED, the recognition of changes in their current value through P&L is not appropriate. It would result in recognising in the P&L short-term market fluctuations that are not representative of the long-term operating performance of the insurer;

- The scope of changes adjusting the CSM should be revised to ensure that the characteristics of the participating contracts are appropriately addressed, through the full unlocking of the CSM. When a contract requires that the amounts paid to policyholders vary with the returns on underlying items, the profit that results from the insurance contract cannot be considered in isolation from those returns. Changes in the expected returns modify the insurer expected profit according to the terms of the contract. If the CSM is not adjusted for these changes, the CSM will not reflect the whole of the unearned profit arising from these contracts and will fail to represent their economics.

We consider that the IASB should reconsider how the asset dependency of the participating contracts fulfilment cash flows should be measured and presented in the financial statements. This feature must be fully reflected in the accounting treatment of all participating contracts. Otherwise, financial information provided to users will neither reflect the economics of the participating contracts nor their performance.

To address these concerns and to ensure an effective accounting treatment of all participating contracts, we support the following set of principles that should be considered comprehensively:

- The measurement model for all participating contracts should be consistent with the general principles of the ED that apply to other contracts under the building blocks approach;
- Participating contracts should be measured at current fulfilment value on the face of the balance sheet without bifurcation of cash flows;
- Asset dependency should be reflected through the use of a discount rate that is derived from the assets to recognise the effect of the unwinding the insurance liabilities in the P&L. Consistently with the general principles of the ED, the difference between the interest rate expense calculated at this rate and the effect of unwinding the insurance liabilities at a current discount rate should be recognised in OCI;
- The CSM of participating contracts should always represent the unearned profit associated with these contracts. It should be determined on a fully unlocked basis, including the changes in assets returns that impact the insurer's share in expected profits. In other words, the CSM should be adjusted for differences in the cash flows due to changes in financial assumptions, except for short term fluctuations that reverse over time. These short term fluctuations, including those that affect the time value of options and guarantees, should be recognised in OCI.

An approach that combines these key principles would respond to our main concerns with regard to participating contracts. It will result in relevant performance in the P&L and reflect the long-term nature of insurance activities as:

- It will distinguish between earned profit that would be recognised in the P&L as services are provided to the policyholders and changes in future expected profits that would be recognised against the CSM;
- Short-term fluctuations that reverse over time, including those that affect the time value of options and guarantees, would be presented in OCI. Presenting in OCI the impact of market rate changes on the time value of options and guarantees is appropriate because those changes are not representative of the current or future performance of the insurer, they are not part of the service to the policyholders and they are expected to reverse over time.

This set of principles is consistent with that used by the European insurance industry to develop an "industry alternative proposal" for participating contracts. We are in the process of assessing its application to our participating products. Sufficient time is needed for this testing to ensure that the application mechanisms work appropriately for various products under different economic scenarios.

### Question 3—Presentation of insurance contract revenue and expenses

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

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

**The ED's proposals for the presentation of revenue and expenses for life insurance activities will not provide useful information to users. The summarised margin approach that was proposed in the 2010 ED, together with volume information in the notes, will better achieve this objective**

The earned premium revenue as set out in the ED is not an appropriate measure for life insurance business. We are also convinced that insurance analysts and other users of financial statements will neither understand nor rely upon such a presentation. Users will continue to request existing volume measures such as gross written premiums and new business premiums which are key performance indicators for the life insurance industry today.

We consider that these proposals will introduce undue complexity and result in significant implementation costs for insurers without providing any additional benefits to users.

The summarized margin approach, as proposed in the 2010 ED, coupled with the disclosure of volume information in the notes (similar to the volume information that is provided today to users) will better achieve the objective of providing meaningful information to users for life insurance activities. We urge the IASB to reconsider its decision to abandon the summarized margin presentation.

In addition, the requirement to disaggregate 'non-distinct' investment components for the P&L presentation is contradictory with the ED principle to separate only those elements of insurance contracts that are distinct. This requirement is complex to implement as it would imply to separate interrelated cash flows and arbitrarily allocate them between the different "components".

### Question 4—Interest expense in profit or loss

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

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

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

**The re-introduction of a FV-OCI<sup>2</sup> measurement in IFRS 9 and the requirement to present in OCI the changes in market interest rates on insurance liabilities that reverse over time are a very positive step in taking into account the overall linkage between insurance liabilities and their backing assets. However, the FV-OCI measurement category is too restrictive. It should be expanded to all categories of assets backing insurance liabilities, including portfolios of derivatives**

As consistently expressed in our comment letters to the 2010 ED and IFRS 9, the interaction between insurance liabilities and their backing assets is the core of the insurance activity and its performance, and is illustrated through the asset liability management (ALM) strategies. A consistent measurement of the insurance liabilities and their backing assets is fundamental to reflect their overall linkage.

The re-introduction of a FV-OCI<sup>3</sup> measurement in IFRS 9 and the requirement to present in OCI the changes in market interest rates on insurance liabilities that reverse over time are a very positive step in taking into account the overall linkage between insurance liabilities and their backing assets.

However, in the IASB general model, financial assets and insurance liabilities are considered in isolation and are not measured on a consistent basis, irrespective of the ALM strategies.

Limiting the FV-OCI measurement category as proposed in IFRS 9 to only simple debt instruments is too restrictive. It would impede insurers to reflect the performance of their ALM strategies. Those strategies are not limited to investment in simple debt instruments but involve diversified categories of assets including derivatives hedging, for example, interest rate risks or credit exposures.

Therefore, the FV-OCI measurement category should be expanded to all categories of assets backing insurance liabilities, including portfolios of derivatives.

Similarly, the restriction on the recycling of gains and losses in profit and loss (P&L) for equity instruments is not consistent with the nature of the backed insurance liabilities. This is particularly so for participating contracts (but not only), where the assets returns, including gains and losses, are passed to the policyholders.

#### **Question 5—Effective date and transition**

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

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

#### **Sufficient time should be given to constituents, particularly insurers, to assess the revised proposals of the IASB through extensive testing prior to their finalisation**

As stated above, we have significant concerns with some of the ED's proposals. We believe that the ED's proposals should be revised to ensure that appropriate financial information is provided to users. The most critical areas that need to be addressed are the treatment of participating contracts (including the treatment of options and guarantees and the unlocking of the CSM), the interaction between IFRS 4 and IFRS 9 (including the necessity to expand the FV-OCI measurement category to all assets backing insurance liabilities including portfolios of derivatives) and the presentation in the P&L. We acknowledge that these changes are significant. However, such changes are necessary to produce final standards that are workable and relevant for the insurance activities.

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<sup>2</sup> "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.

<sup>3</sup> "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.

Therefore, it is crucial that the IASB takes sufficient time to revisit its proposals. Similarly, it will be necessary for constituents, particularly insurers, to gain a comprehensive understanding of the revised proposals through their extensive testing. In order to facilitate this testing there should be a review draft setting out the revised proposals. The objective of this extensive testing will be to ensure that these revised proposals do not have unintended consequences and are workable operationally prior to their finalisation.

#### **The mandatory effective date of IFRS 9 must be aligned with IFRS 4 for insurers**

As we have consistently highlighted, IFRS 9 and IFRS 4 projects are of crucial importance for insurers as they are complementary to reflect the fundamental interaction between their insurance liabilities and their backing assets. They must be finalised on a consistent basis. As such, we do not believe that the revised IFRS 9 can be finalised before the insurance standard is also finalised. We also consider that insurers should not be required (but permitted) to adopt IFRS 9 before the mandatory effective date of IFRS 4. Otherwise, the usefulness of the financial reporting for users in the period between IFRS 9 and IFRS 4 adoption would be put into question, as users will experience two major changes in insurers' financial statements in short period of time.

If the effective dates were not aligned and insurers were required to adopt IFRS 9 in advance of IFRS 4, it would be critical to include sufficient provisions in IFRS 4 to permit insurers to fully to fully reconsider designations and classifications of their financial assets when adopting IFRS 4.

#### **Question 6—The likely effects of a Standard for insurance contracts**

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

*Please describe the likely effect of the proposed Standard as a whole on:*

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

We believe that the final insurance standard should provide an appropriate basis for insurers to report financial information that reflects the long-term nature of insurance business and the overall linkage between the insurance liabilities and their backing assets consistently with their ALM strategies. If this objective is met, the final standard would have benefits as it would result in more useful and relevant information for the users, as and such, contribute to increase transparency in the financial statements.

However, at this stage, as stated above, although the IASB has made progress in addressing some of our concerns with regard to the 2010 ED, this objective has not been met. We are concerned that there are a number of critical issues that still need to be addressed, specifically:

- The IASB's decision to restrict the FV-OCI measurement category to simple debt instruments instead of expanding it to all assets backing insurance liabilities, including portfolios of derivatives;
- The necessary changes to ensure that the unlocking principle is applied consistently to all contracts;
- The proposals for the treatment of participating contracts including the arbitrary distinction between contracts based on a requirement to hold the underlying items as proposed in the ED, the requirement to bifurcate cash flows, the treatment of options and guarantees and the limited unlocking of the CSM;

- The presentation of revenue and expenses for life insurance business.

As regards the compliance costs for preparers, we believe that these costs will be significant in any case. These costs will relate to the development of new IT systems and training of specialised resources in order to produce the necessary information not only at the date of implementation but also an on-going basis.

It is crucial that these costs are outweighed by the improvement in the information provided to users. As stated above, we believe that the ED's proposals do not achieve this objective. There are a number of critical areas that need to be revised so as to make them workable for insurers and to ensure that they provide appropriate financial information for users. Refer to Question 5 as regards the need of an extensive testing of the future revised proposals.

Consequently, at this stage, we do not see any benefits from implementing the ED as currently drafted.

#### **Question 7—Clarity of drafting**

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

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

In this comment letter, we have raised some comments on the lack of clarity of some of the ED's proposals such as:

- The unit of account for the release of the CSM;
- The requirement to reinstate the CSM;
- More generally in relation to the proposals for the treatment of the participating contracts.

We have also identified the following other issues for which clarification is needed:

#### **Grandfathering of the definition of an insurance contract**

We understand that the intention of the IASB in the ED, when specifying the manner in which the notion of insurance risk is applied for reinsurance contracts was to address the unintended consequences of the changes made to the application guidance, inspired by US GAAP. Therefore, it appears that there is no need to reassess whether contracts that met the definition of insurance contracts in IFRS 4 would meet the definition in the future standard.

In January 2013, the Board discussed this topic and decided not to create specific guidance on grandfathering the definition of an insurance contract. However, we recommend the IASB to include an explicit statement in the future standard that "because there was no intention to change existing practice, insurers do not need to do this exercise again at the transition date". Such a clarification would have the benefit to avoid insurers to do a "formal" burdensome exercise of their existing insurance contracts at the transition date.

#### **Financial guarantees contracts**

It is currently unclear whether an entity that issue financial guarantee contracts for the first time can has the choice offered for the treatment of financial guarantees contracts. We believe that the IASB should clarify this topic.

#### **Separation of components**

As stated in our comment letter on the 2010 ED, we believe that the separation of the components (unbundling) should not be required as contracts should be measured as a bundle of rights and obligations, consistently with the manner in which they are managed, except in limited circumstances when these components are separately managed.

In this respect, we welcome the ED's revised proposals in the ED as we understand that the IASB shares the same view, e.g that unbundling should remain uncommon. However, we have concerns that the illustrative example 1 may be interpreted as requesting a more frequent separation of the asset management services component, which we do not agree with. Therefore, we recommend the IASB to revise this example to state clearly that separation of asset management services should only occur in rare circumstances or to remove this example from the future standard.

#### **Top down discount rate**

We support the principle in the ED for determining the discount rate. As stated in our cover letter, we welcome the possibility to use a top-down approach in determining the discount rate, in addition to the bottom-up approach. In addition, we also support the principle in the ED that the discount rate for participating contracts should reflect the asset dependency of these contracts.

Concerning the application, we note that paragraph B74 should be clarified to be put in line with paragraph B70a (iii) so as to avoid any misinterpretation of how to apply the top down. Paragraph B74 states that as regards debt instruments, the market premium for liquidity should be eliminated. This is not consistent with paragraph B70a (iii) that describes how the top down approach is to be applied and states that "the entity needs not make adjustment to eliminate remaining differences between the liquidity characteristics of the insurance contract and the liquidity characteristics of the assets in the portfolio".

## **Appendix 2 – Additional comments**

We understand that the IASB is primarily seeking feedback from the constituents on the specific areas that are covered by the ED's questions. However, we would like to take the opportunity of this letter to comment on the following other elements in the ED:

### **Scope of the ED – Fixed fee contracts**

We support the scope of the ED. We welcome the decision of the IASB to include the investment participating contracts that we strongly supported in our comment letter on the 2010 ED.

However, we believe that the requirements to account for fixed-fee contracts either as insurance contracts or services contracts based on the conditions that are set out in paragraph 7e may be unduly complex for entities that also issue insurance contracts (with little benefit in terms of information provided). Therefore, we believe that the entities that issue insurance contracts should have the choice to apply the insurance standard to its fixed fee contracts similarly with the treatment of financial guarantee contracts;

### **Disclosures**

#### **Disclosure of confidence level**

We welcome the IASB decision to not limit the techniques that can be applied in practice to determine the risk adjustment.

However, we note that the IASB has retained in the ED its requirement to disclose the confidence level where an insurer uses a technique other than confidence level to determine the risk adjustment. We do not agree with this requirement as it will not provide useful information to users. In addition, it would be burdensome to apply (for further comments, please refer to our comment letter on the 2010 ED).

We believe that adequate disclosures on the methodologies and assumptions used to determine the risk adjustment will provide useful information to users and achieve the IASB's objective of transparency.

#### **Disclosures about the effects of each regulatory framework in which the entity operate**

We believe that the requirement to disclose information regarding the regulatory framework in which entities operate should be deleted. Regulatory capital is not part of the financial statements of an entity.

#### **Volume of disclosures**

More generally, we are concerned about the volume and level of detailed and prescriptive disclosures requirements. We believe that the right balance between volume e.g. costs for preparers and usefulness of information for users has not been achieved. Therefore, we recommend the IASB to reconsider the proposed disclosures to simplify and improve these requirements.