L'assureur de toute une vie

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

Paris, October 25th 2013

Re: IASB ED / 2013 / 7 Insurance Contracts

Dear Mr. Hoogervorst,

CNP Assurances welcomes the opportunity to comment on the IASB's Exposure Draft ED/2013/7: Insurance Contracts. Since the publication of 2010 ED, the group and its representatives, have been participating to public hearings, field-tests and outreaches related to this project. We have also been regularly and constructively exchanging with the staff and some Board members or other stakeholders (EFRAG, users, actuaries, local regulator and standard-setter); this helped us to develop an alternative approach consistent with our understanding of key principles of the Board.

Consistently with the key messages of the CFO-Forum and of the French insurance trade association (FFSA), CNP Assurances has developed an alternative approach that is based on the following principles:

- Reflect the assets and liabilities dependency through an alternative approach that satisfies to the key objectives of the "mirroring approach" for participating contracts;
- Unlock the contractual servicing margin (CSM) for all changes arising from the insurance contract, including those related to changes in assets returns for participating contracts. A full unlocking of the CSM better reflects the contractual asset dependency of both the services credited to the policyholders and of the unearned profit of the issuer of such participating contracts in line with our business model;
- Use of a current – i.e. recomputed at each closing of the accounts – discount rate that is based on asset returns to calculate the interest expense in the statement of profit or loss (PoL), while the unwinding of the insurance liability in other comprehensive income (OCI) is determined at current market rates consistently with the ED proposals. Accounting changes between the current market rate and our suggested current book yield in OCI allows to segregate the effects of the underwriting performance from the effects of market rates volatility and to obtain a consistent measurement of asset returns and insurance liabilities unwinding expense in PoL;

- Account the effect of market rates changes on time value of options and guarantees in OCI consistently with the ED proposals for market fluctuations that are expected to unwind over time. The time value of options and guarantees as initially priced is accounted for progressively in PoL through the amortization of the CSM.

In line with our previous presentations[1], this alternative approach, tested in practice with the support of the Deloitte France actuarial team[2], is an operational instance of “an industry alternative approach” for all participating contracts that does not introduce undue complexity and unbundling of rights and obligations towards policyholders.

Our main added value to other comments is to comprehensively present this alternative method (please refer to the supporting slides and their extensive Q&A) that is consistent with the following principles or standards:

- Application of the building block approach with an insurance liability that is measured at current fulfilment value on the face of the balance-sheet;
- Accounting of economic assets & liabilities mismatches, without creating any accounting mismatches;
- Use of OCI consistently with “IFRS 9 limited amendments” and with any possible suggestions to extend the measurement at FV-OCI;
- Accounting of the effects on expected cash-flows of options and guarantees;
- Accounting of time-value of options and guarantees consistently with the requirements of “IFRS 9 hedging” for assets.

We are convinced that this alternative approach will help your future standard to tell to the pilot, passengers and observers of the plane where the latter is heading and will be landing, if one wants to refer to your speech of 9 April 2013 about accounting of long term investments.

The appendix to this letter sets out our views on the detailed questions posed in the exposure draft. We believe that two additional steps should be performed before finalizing the insurance standard and suggest an immediate action if the Board concurs:

- a comprehensive field-test of the alternative solution; and
- an educational process in order to develop from this proposal of measurement of insurance liabilities, on the one hand, an understandable income statement based on an extended summarized margin and, on the other hand, key performance indicators on which management and users could rely to base and analyse key managing decisions of insurers.

We are prepared to work constructively with the Board and the staff to reach these challenging goals.

Please feel free to contact me to discuss any matters raised in this letter.

Yours sincerely,

Jean-Michel Pinton (jean-michel.pinton@cnp.fr)

Group Accounting Officer

[1] Notably presentations to the Board in March 2011, to the CFO Forum’s Insurance Accounting Group in October 2012 and to the French Institute of Actuaries in May 2013.

[2] The views expressed in this letter only reflect the ones of CNP Assurances.

About us : CNP Assurances; protecting People against Risks for 160 Years

For 160 years, CNP Assurances has been protecting people against the risks of everyday life. France's leading personal insurer, CNP Assurances also has operations in other European countries and in Latin America, with a significant presence in Brazil. It serves 27 million insureds under personal risk and protection contracts worldwide and 14 million savings and pensions policyholders.

The Group designs and manages life insurance, pension, personal risk and protection (term creditor insurance and health insurance) products.

- *In France, CNP Assurances distributes its insurance products through La Banque Postale and the Caisses d'Epargne, as well as through its own CNP Trésor network. In Brazil, its second largest market, the Group's partner is Caixa Econômica Federal, the country's second biggest state-owned bank.*
- *In group insurance, CNP Assurances crafts tailor-made personal risk, pension and term creditor insurance products that are aligned with the needs of companies, local authorities, mutual insurers, non-profit organizations, and banks in Europe and Latin America.*

CNP Assurances is a public sector company 40%-owned by Caisse des Dépôts et Consignations.

Its net profit rose by 9.1% in 2012, to €951 million.

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 a difference 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?

We welcome the new proposals of unlocking the Contractual Service Margin (CSM) for changes in cash flows that relate to future coverage and other future services and believe it is a positive step that the IASB has made with regard to 2010 ED. ***Nevertheless, additional changes to the current proposals are needed in order to transparently reflect the unearned profit of participating contracts consistently with the definition of CSM presented in Appendix A of the ED*** *("A component of the measurement of the insurance contract representing the unearned profit that the entity recognises as it provides services under the contract").*

We believe the principle of unlocking the CSM should be consistently applied to all insurance contracts. This objective is not achieved under the current proposals of the ED where the effects of changes in cash flows that arise from changes in the returns of underlying assets are excluded from the factors that would adjust the CSM.

From our point of view, the CSM should be fully unlocked for any changes in estimated cash flows as long as they have an effect on the expected future profit of the insurer. This is particularly true for participating contracts where the asset returns are not totally distributed to policyholders, for these contracts, the CSM should be adjusted to reflect the effects of changes in underlying assets returns to the extent to which they impact the unearned profit of the insurer.

Under our alternative proposal for a fully unlocked CSM, the unearned profit of the insurer will be transparently reflected in the CSM at initial recognition and at subsequent reporting periods, consistently for all types of participating contracts consistently with rights and obligations towards policyholders *(For more details, please refer to the Q&A in appendix 1).*

In addition to our main concern with regard to the scope of changes adjusting the CSM as described above, there are other areas where the current proposals need further consideration:

- *Interest accretion: we agree that interest accretion on the CSM is conceptually required to maintain consistency with the revenue recognition proposals. However, the use of a locked-in discount rate at contract inception is not appropriate for the reasons developed in our alternative approach. Also, under our proposal for a fully unlocked CSM, the insurer indirectly account for interest accretion because the calculation of the CSM would include the projected future allocations of asset returns to the insurer discounted at a rate that reflects the asset dependency and based on the underlying contractual or regulatory participating mechanism.*

- *Reinstatement of the CSM: our understanding from the current proposals is that the favourable changes in expected profits after the CSM has been fully exhausted would lead to rebuilding the CSM immediately. We believe that the CSM should be rebuilt only when all previous losses that have been recognized in the statement of profit or loss are reversed in order to reflect a more appropriate representation of the future performance of the contracts*

- *Risk Adjustment: the current proposals of the ED require to account for any changes in Risk Adjustment in P&L, including those that relate to future coverage and other future services. We think that it would more appropriate, from a conceptual point of view, that the CSM be also adjusted for changes in Risk Adjustment that relate to changes in Risk for future periods.*

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

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

(a) Measures the fulfilment cash flows that are expected to vary directly with returns on underlying items by reference to the carrying amount of the underlying items?

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

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

(i) changes in the fulfilment cash flows that are expected to vary directly with returns on the underlying items would be recognised in profit or loss or other comprehensive income on the same basis as the recognition of changes in the value of those underlying items;

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

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

We understand and agree with the intention of the IASB when proposing a "mirroring approach" that reflects the assets dependency of insurance contracts that specify a link to underlying items. ***Nevertheless, we believe the measurement model that is proposed for the "mirroring approach" as set in the ED is:***
- Overly complex;
- Not consistent with the simplified example provided by the IASB (although we understand the educational aim of the description);
- Requires arbitrary choices when bifurcating the cash flows; and
- Results in instable decomposition of the cash flow between the three components (fixed, direct and indirectly linked cash flow)
Consequently, The mirroring approach would result in inappropriate measurement and reporting performance of the contracts included in the scope of this exception.

Also, the scope of contracts for which the mirroring principles would apply, as required in the ED (paragraph 33) is too narrow and would result in excluding contracts where the fulfilment value of the insurance contract depend on the returns of underlying items. ***The measurement model that will be developed in the final standard needs to apply consistently to all contracts with participating features***

As part of our field testing activities, we analyzed how the "mirroring approach" could be implemented for our French participating contracts (Please refer to appendix 2 for more details on the analysis performed). Our main conclusions are the following:

- *The example provided in the ED for bifurcating cash flows of a contract is too simplified and not applicable to French participating products considering their contractual features:*
  - *Profit sharing mechanism is based on statutory returns instead of market returns*
  - *Bifurcating cash flows of contracts where the minimum guaranteed rate exceeds 0% would be overly complex*
  - *The obligations of the insurer are increased by allocated profits that accumulate through periods. Those shared profits result in higher guaranteed amounts on the following years.*

- *In other words, the separate measurement of the "Indirectly linked component" as required is the ED is not practicable considering the options and guarantees that are embedded in our participating contracts*

- *Under our tentative implementation of the "mirroring approach", it was necessary to take some assumptions in order to perform the bifurcation as described in appendix 2 (i.e. an insurance liability that equals the stochastic[3] BEL and an "indirectly linked component" that corresponds to the time value of options and guarantees "TVOG"). The results we obtained were instable and their volatility significantly increased in stress scenarios. This instability is mainly explained as follows :*
  - *The "directly linked" cash-flows can't be expressed as a fixed portion of the asset returns and are not stable over time, because the asset dependant components also vary with parameters other than the asset returns (surrenders, discretionary profit sharing, interest rates and other macro-economic variables…)*
  - *The "indirectly linked" cash flows (TVOG in our tentative implementation) are the most volatile component of the Best Estimate and are very sensitive to market rates changes. The accounting of changes in the "indirectly linked component" in P&L results in an inappropriate measurement of the performance of the contracts because changes due to market rates fluctuations are expected to reverse over time and to not affect the long term underwriting and investing performance of the insurer*

For our point of view, the objectives of the mirroring approach (i.e., to reflect the assets and liabilities dependency and avoid accounting mismatches when cash flows are economically matched) can be achieved through the use of an alternative approach that results in a more faithful representation of underlying economics and performance of participating contracts with less undue complexity. The key principles of this alternative approach (CBY-OCI) would apply to all participating contracts:

- ***The measurement of the insurance liability in accordance with the general principles and measurement model of the ED*** *(building block approach) with a current value of the liability in the face of the balance sheet;*
- ***The use of an asset based discount rate "current book yield" to determine the interest expense that is booked in P&L****. This "current book yield" (CBY rate) reflects the asset returns considering the measurement of underlying items and takes into account differences in assets and liabilities durations through the use of*

[3] Explicit, unbiased and probability-weighted estimate of the present value of future cash flows considering a range of scenarios that reflect the full range of possible outcomes.

reinvestment assumptions for the unmatched period. This rate is "current" because it is recalculated at each period closing to incorporate the latest market rates and book returns in its computation;

- ***The accounting in OCI of** :*
  - ***the difference between BEL unwinding at Current rate and BEL unwinding at CBY rate;***
  - ***the effect of market rates changes on time value of options and guarantees in OCI,** with the time value of options and guarantees as initially priced accounted for progressively in P&L;*
- ***The unlocking of the CSM for all changes arising from the insurance contract when related to future coverage and other services,** including those resulting from changes in assets returns for participating contracts.*

We believe that our alternative is the most appropriate and comprehensive proposal for participating contracts because it achieves the objectives of the mirroring approach without the undue complexity of the current proposals and is based on a set of principles that are consistent with the conceptual framework of the IASB:

- ***Insurance liabilities are measured in the balance sheet under a unique model that applies to all contracts**, i.e. the building block approach;*
- *The interaction between assets returns and liabilities interest expense is transparently reflected in P&L and **no accounting mismatch is generated when assets and liabilities cash flows are economically matched;***
- *Changes accounted for in OCI are those resulting from market rates changes that are expected to unwind over time: **the statement of profit or loss only captures the underwriting and investing performance of the insurer and is not obscured by market fluctuations**, consistently with our long term business model;*
- *The unearned profit of the insurer is measured and presented in the CSM for all contracts and at any point of time. **For participating contracts, the CSM will consequently reflect the contractual asset dependency of unearned profit of the insurer;***
- *The proposal of accounting the effects of market rates changes on TVOG in OCI reduces the volatility in the statement of profit or loss and **is consistent with the accounting treatment of TVOG for hedged assets under IFRS 9 Phase III "hedging"**;*
- *The accounting requirements are simplified under our alternative approach because the bifurcation of cash flows is not needed: **the current book yield applies to all cash flows arising from participating contracts and not only those varying directly with underlying items;***
- *The alternative approach is consistent with the current requirements of IFRS 9 Phase I "classification and measurement" because **the CBY is adjusted to reflect the asset returns depending on the underlying assets classification** (Please refer to appendix XX for more details on the CBY computation methodology).*

The appendix 2 includes the results of field testing our alternative approach which confirmed that the benefits expected are those obtained when we applied key principles of the approach to one of our most significant participating portfolio.

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?

We don't support the "earned premium approach" that would apply under the current proposals for presenting the insurance contract revenue and expenses; we believe such approach doesn't achieve the objective of providing a clear communication tool to investors of our business performance. In addition, the current proposals disaggregating the investment component from premiums and claims is overly complex and not consistent with the ED proposals to not unbundle "non distinct" elements of the insurance contracts.

The earned premium revenue approach as set out in the ED will not provide relevant information for life insurance activity. It is very likely that investors and other users of the financial information will continue to request existing "volume" measures (such as gross written premiums and new business premiums…) to have a clear understanding of the performance and activity of the company.

Also, the requirement to disaggregate "non distinct" investment component will be unduly costly to implement as the data required is not readily available and inherently difficult to obtain. Allocation of some of these components would be unduly arbitrary and would not provide comparable information.

The costs that will be needed to implement the current proposals for the "earned premium approach" significantly outweigh the benefits from presenting a revenue measurement.

***We believe that the "summarized margin" presentation as set in 2010 ED is more appropriate for life insurance activities** because the presentation of "margins" for this business activity is more relevant and is consistent with the current performance measurement model that is communicated to users (although slight adjustments to align the key performance indicators will be needed).*

We do think that much remains to be developed to produce an understandable statement of profit or loss that could be useful for users of the accounts and on which one could elaborate key performance indicators to assess the impacts of management actions and of changes of hypotheses in the economic, technical, administrative and financial inputs for accounting for insurance contracts.

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?

We welcome the introduction of OCI in the current proposals and fully support the principle of segregating the effects of the underwriting performance from the effect of changes in discount rates. We agree the current proposals for calculating the interest expense in P&L at a locked in interest rate at inception would provide useful information for non participating contracts if the FV-OCI category in IFRS 9 is extended to all assets backing insurance contracts.

Our alternative approach for participating contracts is quite consistent with the general approach measurement principles because ***the proposed "Current Book yield" is updated at each closing to reflect the asset dependency of these contracts as requested in paragraph 60(h).*** *The use of a locked-in discount rate that doesn't take into account the asset dependency would result in increased volatility in stress situations and unmatched periods because the insurance liabilities would be measured at a rate that doesn't reflect their interaction with assets.*

Also, ***the Current Book yield resolves the issue of accounting mismatches that could result from asset classification restrictions under IFRS 9 because the calculation methodology of the CBY provides consistency between the classification of the assets – which reflects the underlying business model of asset and liability management – and asset returns that are captured in the CBY computation*** *(for instance, if the CBY will not capture the changes in unrealized gains and losses of assets classified at the FV-OCI category). Also, in situations where the assets backing the portfolio are measured at FV-PL, the current book yield will tend to reflect a current market rate with no changes accounted for OCI (as the difference with current rate will be close to nil), consequently,* ***the concern of some constituents that request a FV-PL option is also addressed under our alternative proposal*** *without requiring an explicit option in the final standard.*

Under our proposal, the current book yield rate is consistently applied to all cash flows arising from the contract and not only to those that vary directly with underlying asset returns. Otherwise, the bifurcation of cash flows would result in undue complexity with no significant differences in the outputs as most of the cash flows in participating contracts are varying with underlying assets returns.

In addition, we don't understand why the IASB proposals for accounting the effects of changes in discount rates in OCI are not applied consistently to the TVOG. *We think that the requirement for accounting the changes in TVOG fully in P&L are not consistent with the principle of accounting market rates changes in OCI, especially, when considering the volatility of this component and its sensitivity to market rates changes.*

We believe that the performance of insurance contracts would be more faithfully reflected in financial statements if the changes in TVOG due to market rates fluctuations are accounted in OCI *and that the TVOG calculated according to the assumptions at the inception of the contract (that correspond to part of the services that have been priced to the policyholder) be accounted progressively in P&L through the CSM release.*

Finally, we find this suggested accounting model more in line with the current proposals within IFRS 9 for time-period hedging of an asset: although our concern deals with the natural hedging of O&G within an insurance liability by an asset, the analogy with what is proposed in IFRS 9 or what could be developed in Macrohedging is obvious from a practical point of view.

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?

We strongly support the IASB's decision to introduce a retrospective application of the insurance contracts standard. *We acknowledge that a retrospective application is more complicated to apply in practice, but we believe that the benefits of this approach far outweigh the costs of implementation.* ***Without retrospective application, inconsistent accounting models would be introduced for existing contracts and new business issued after transition.***

We believe the simplifications introduced by the IASB in transitional requirements achieve a good balance *between reducing complexity and also ensures an appropriate valuation of the insurance liability on transition.*

We believe that the effective dates of new IFRS 4 and IFRS 9 should be aligned. *Otherwise, the usefulness of financial reporting for users in the period between IFRS 9 and new IFRS 4 adoptions could be put into question, as users will experience two major changes in an insurer financial statements in short succession.*

If IFRS 9 effective date was, despite our requests, set before the effective date of IFRS 4 Phase 2, it would be important to consider simplified transition requirements for companies that will consider an early application of IFRS 4 Phase 2 (comparative period,..) in order to avoid maintaining dual accounting for of their assets (one according to IAS 39 for their own financial communication, one according to IFRS 9 for their reporting purposes towards consolidating shareholders that are not insurance companies) or massive reclassifications of the assets which possibilities are so far too limited if IFRS9 was applied in advance of IFRS 4 Phase 2.

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.

Our views are consistent with those expressed in the CFO Forum and Federation Française des Sociétés d'Assurance "FFSA" (French trade insurance association) comment letters, please refer directly to their comments on this question.

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?

Our views are consistent with those expressed in the CFO Forum and Federation Française des Sociétés d'Assurance "FFSA" (French trade insurance association) comment letters, please refer directly to their comments on this question.

Annexes:
Appendix 1 – CNP Assurances Alternative approach – Q&A
Appendix 2 – CNP Assurances Alternative approach – Key principles & field testing results (slides)