CFO FORUM | CEA Insurers of Europe

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
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29 November 2010

Dear Sir David,

Exposure Draft: Insurance Contracts

We welcome the opportunity to comment on your Exposure Draft – Insurance Contracts (the "Exposure Draft" or "ED"). This letter has been drafted jointly by the European Insurance CFO Forum, which is a body representing the views of 20 of Europe's largest insurance companies, and the Comité Européen des Assurances ("CEA"), representing 94% of the European insurance market. The letter represents a consensus view on issues specifically impacting the European insurance industry.

Summary comments

We are fully committed to the development of a comprehensive insurance contracts accounting standard. A key objective of such a standard should be that it results in a lowering of the cost of capital for insurance companies relative to competing sectors. We do not believe that this objective will currently be met by the ED on the basis that it fails to achieve comparability across sectors, particularly with banks, in a number of respects. Furthermore, we are of the opinion that, as currently drafted, the measurement model set out in the ED is not sufficiently advanced to provide relevant information that will help users make economic decisions. The ED reflects many steps in the right direction, especially when compared to the 2007 Discussion Paper, but needs to be further advanced in terms of clarity and content in several areas. We discuss those areas in the responses to the detailed questions and suggest changes to the model where appropriate. Furthermore, the measurement model can only be properly assessed in conjunction with proposals to present the performance of insurers to users of financial statements. We do not believe that sufficient consideration has been given to the presentation model included in the ED.

As a result of the limitations of the ED we believe that further time is required to reconsider the relevant aspects of the ED and to re-expose them for comment. Given the importance of the impact that this standard will have on the industry, it is fundamental to dedicate sufficient time to elaborating a complete and robust model, both in terms of measurement and of presentation, coupled with an appropriate framework for consultative due process.

We support many aspects of the Exposure Draft and welcome many of the changes that have been made since the 2007 Discussion Paper

We have endeavoured to maintain a constructive dialogue with the IASB during the development of the Insurance Contracts project and we are pleased that a number of aspects of the ED reflect views that we have previously supported as part of this dialogue. We are pleased that the Board have developed a fulfilment value model as opposed to the exit value model proposed in the Discussion Paper. In this regard we also support the reflection of entity specific assumptions rather than an over-reliance on market assumptions. The measurement of insurance contracts utilising a "whole contract" approach which encompasses revised contract boundary criteria and inclusion of expected cash flows associated with participating contracts, is also welcomed. We also support the inclusion of acquisition costs within the cash flows albeit we believe the scope should be wider than incremental at contract level.

We support the reflection of the specific characteristics of the liability, including liquidity, in the discount rate and we strongly support the need for an explicit risk adjustment and the deferral of initial profits as a residual margin. We would, however, reiterate the view expressed in our Discussion Paper response that the deferred initial profit does not represent part of the liability to the policyholder and hence should represent a separate liability beyond that of the insurance contract.

In addition we are fully supportive of the need to develop a separate accounting standard for insurance contracts rather than rely on other accounting standards, such as those for financial instruments, revenue recognition or IAS 37 which have not been developed with the particular considerations of insurance in mind.

There are, however, some fundamental aspects of the Exposure Draft that are not clearly articulated or that we disagree with

We believe that the IASB needs to reconsider several aspects of the ED, either as a result of the proposals lacking clarity, not being appropriate for our business or subject to interpretation as to the intent of the Board. The most significant of these issues are set out below.

Sufficient field testing of the proposals is required before a final standard can be issued

The European insurance industry is fully committed to the need for a comprehensive accounting standard for insurance contracts. We acknowledge the fact that this project has a long history and the difficulty the Board faces in trying to satisfy a variety of constituents with differing objectives. We believe that, prior to its issue, it is essential that the final standard is tested as being fully fit for purpose as a robust high quality standard providing decision-useful information to users of financial statements. In order to meet such an objective the proposals in the final standard must be subjected to field testing by preparers in conjunction with detailed assessment by users. We acknowledge the outreach activities put in place by the Board but the comprehensive nature of the proposals requires sufficient time for assessment of the whole model, including presentation of performance, from accounting, business and operational perspectives.

The timetable for the issue of a final standard in June 2011 is a challenging objective requiring resolution of a number of key issues

For the reasons referred to above we believe that June 2011 represents a challenging timeframe to further develop the proposals in the ED and issue a robust final standard. However, we remain committed to assist you in addressing technical issues as you work towards the deadline but are concerned that time required to resolve some of these issues

may, in reality, make the proposed deadline difficult to achieve. We feel that it is necessary to provide for re-exposure of certain aspects of the proposals, including time to develop an appropriate performance reporting framework, and sufficient field testing of the model, both in terms of measurement and presentational aspects.

IFRS 9 has allowed banks to reflect their business models in their accounting; insurers should be provided with the same ability

Some insurers will manage their business on a current value basis and the proposals in the ED and IFRS 9 allow accounting that reflects the "current current" nature of that business model. Others, however, adopt a different business model, at least for parts of their business, which reflects the long term stable nature of the liabilities. In such cases the assets held to match their liabilities would be debt instruments often held to, or close to, their maturity, with the objective to hold those assets in order to collect contractual cash flows. IFRS 9 requires such assets to be carried at amortised cost based on a business model criterion and on the characteristics of the asset. However, whilst many of the assets held to back certain portfolios of insurance business would be expected to meet the relevant criteria for measurement at cost, the ED will require a "current" measure for the related insurance liabilities. Accordingly, insurers will be unable to utilise the cost classification for their assets without suffering a significant accounting mismatch.

Financial liabilities held by banks, such as deposits, are able to be carried at cost under the proposed IFRS 9 changes. Banks are therefore able to account for some or all of their activities in accordance with their business model on a "cost: cost" basis, with no disclosure of duration mismatches, whereas insurers will be required to use a "current: current" basis for all aspects of their business. Banks, with whom insurers compete for investor capital, are therefore able to avoid accounting volatility in their financial statements, presenting stable earnings patterns irrespective of market "noise" in their core business. We believe that this approach places insurers at a considerable disadvantage to banks.

It is essential that the final standard incorporates a measurement basis that more accurately reflects the business model

We believe that the final standard should provide a clear communication tool to investors of our business performance. In this respect it is essential that the interaction of assets and liabilities that underlies our business is fully considered in the development of the standard. Accordingly, short term market movements that are not representative of long term performance should not be presented as key performance indicators. In this regard, we believe that there has been insufficient focus placed on the implications of IFRS 9 from both presentation and measurement perspectives in the ED proposals. In this context, we also consider that further investigation is required by the IASB into how the price of credit is reflected in the discount rate when valuing insurance contracts. Recent market conditions showed widening credit spreads to be an important issue. The recent Insurance Working Group ("IWG") meeting highlighted several potential solutions to the issue of determining the most appropriate discount rate. There appeared to be widespread support amongst the IWG for the need for further work in this area which we would fully endorse.

The CFO Forum published their Elaborated Principles for an insurance accounting model in 2006 based around an assumption that financial assets would be measured on a fair value basis. On that basis we supported a wholly current basis of measurement for insurance contracts with the proviso that the treatment of changes in financial assumptions underlying the valuation of those contracts mirrored that for the related assets. The 'Available for Sale' ("AFS") category for assets and the introduction of a similar ability to use OCI for changes in liabilities would therefore have allowed the underlying performance of some insurers to be

presented in net income whilst maintaining current measurement of assets and liabilities in the balance sheet. The removal of the AFS category in IFRS 9, and the related requirement to take all changes in insurance liabilities through profit or loss, therefore significantly change the perspective under which we look at the ED proposals.

We believe that there are a number of solutions available to the Board to address the issue of asset liability matching for insurers and provide a measurement model, and accompanying presentation requirements, that are in line with insurers' business models. We note that the Board refer to solutions based on presentation in profit or loss in the Basis For Conclusions to the ED (BC183). However, we believe that it is necessary to consider a number of other solutions which we would like to explore further with you, including the following:

- Allowing an "OCI solution" whereby elements of the changes in the value of insurance liabilities are taken to Other Comprehensive Income rather than taking all such changes to net income. This approach would ensure that key performance indicators are not overshadowed by short term market volatility.
    - Such a solution may involve the re-opening of IFRS 9 to re-introduce an OCI accounting model akin to the Available for Sale classification to address asset liability matching issues.
    - Alternatively, consideration should be given to developing an OCI model that does not necessitate re-opening of IFRS 9. Under such a model underlying operating performance would be shown in net income separately from short term market movements that are not representative of long term performance related to both assets and liabilities, which would be disclosed in OCI.

  In both cases, keeping the option in IAS 1.81 for two separate statements (income statement and statement of OCI)

- Where insurers are carrying their assets at amortised cost then the matching liabilities should be measured generally using a locked in discount rate to reflect their business model. This is consistent with IFRS 9 and the mixed measurement model applied by banks. In this regard IFRS 4 should reference back to the business model in IFRS 9 in order to ensure appropriate asset liability matching.

In all cases, insurers would be able to default to a current value option applicable for both assets and liabilities, including an appropriate presentation of operating performance, in cases of a different business model.

We would note that it is essential that this issue is addressed through initial focus on all potential solutions, rather than just one at this stage, and we would like to work with you to develop a basis that enables insurers to measure and present their business in a meaningful and effective manner.

Significant areas of the ED are lacking in appropriate clarity to enable a proper assessment of the proposals to be made

In attempting to assess the proposals in the ED we have encountered a number of significant areas where the ED is lacking in clarity as to the intent of the Board and hence significantly differing interpretations can be placed on the wording in the ED. In order to properly assess these proposals we require some clarification of the intent of the Board in these areas. We understand that others share our concerns in this respect and believe that the provision of such clarity is an essential aspect of the standard setting process. Without the provision of

further clarity we believe that many constituents will not be in an informed position to respond with a definitive view to the ED.

The most significant area of uncertainty is in relation to the unbundling proposals in the ED which are unclear in their objective and appear to reflect elements of US GAAP without full analysis having been carried out as to their application in the context of IFRS. We are aware that a number of constituents are placing different interpretations on the wording provided which, given the extent to which the level of unbundling is likely to influence views on other aspects of the model, may have significant implications for the quality of responses received by the Board in many areas of the ED.

As acknowledged by the IASB the transition requirements in the ED are not fit for purpose and require considerable revision

We do not believe that the ED proposals for transition are fit for purpose. The proposals will see the whole industry portrayed as start up businesses with post-transition profit emergence from existing business severely curtailed. The proposals would create inconsistent accounting models for existing and new contracts for a significant period of time after transition date. The transition adjustment under the ED proposals would be a significant amount for our members. Based on a high level estimation exercise carried out by a number of our member companies, initial estimates indicate that the aggregate adjustment would be in the region of €70bn for 12 life businesses and €20bn for seven non-life businesses. The direct release of such a significant sum to retained earnings on transition will distort users' assessments of capital and dividend paying ability as well as diluting future earnings. Our analysis suggests that large elements of insurers' earnings will never be shown through profit or loss under the current proposals. In addition, key performance indicators such as return on equity will be completely distorted. We do not believe that this approach would provide a faithful view of our industry's performance and we are aware that analysts share our views in this area.

We believe that the most appropriate conceptual approach to transition is a full retrospective application of the new accounting model, in line with IAS 8 and such an approach should not be prohibited. However, we acknowledge that this approach is likely to introduce some significant practical issues for many entities. Accordingly, we support the development of an alternative simplified approach for those companies that are unable to apply the full retrospective approach which could represent a suitable proxy. We believe it is important to try to understand the difference between existing GAAP and the ED proposals and hence are exploring a simplified approach that would adjust the difference on transition such that it is a suitable proxy for a fully retrospective determination of the residual margin on our existing business. Further time is needed to explore this proposal further and we are keen to work with you to develop an appropriate approach.

Further consideration must be given to the development of an appropriate presentation model

As evidenced by our points above about presentation of underlying performance versus short term market movements and our confusion over the interaction between the building blocks and premium allocation approaches in terms of presentation, we do not believe that the current presentation proposals have received enough attention from the IASB and hence are not appropriately reflective of our business. Whilst life companies and many composite insurers are supportive of a margin type approach to presentation, many non-life companies do not believe that this approach is appropriate for their business. We are supportive of the development of a single presentation model for all types of insurance to ensure that users are not confused by performance reporting and we believe that the Board should continue to work towards an effective solution in this light.

As the premium allocation approach is a simplification of the building block model it should not be mandated for particular types of contract

We support a single measurement model for all types of insurance business and, notwithstanding specific comments made in this letter around aspects of the proposals, we believe that the building block model set out in the ED is an appropriate basis for that single model. We believe that, under a principles-based standard, it is appropriate to introduce a simplification of the single model that allows insurers with relatively straightforward contracts to avoid detailed building block determination. Whilst there are aspects of the premium allocation approach that do not perhaps represent a simplification, such as the accretion of interest, we support the concept of an allowance to apply that model as a proxy for the full measurement model. It follows therefore that a simplified approach should be available to assist preparers and should not be mandated for certain types of contracts. Mandation suggests that the premium allocation approach is being seen as an alternative model rather than a simplification which we do not believe was the intention of the Board.

We have set out our detailed comments under the relevant questions posed in the ED in the appendix to this letter.

As from the beginning of this project, we support the elaboration of a high quality standard for insurance contracts. Therefore, we remain committed to pursue an active dialogue and cooperation with the Board and its staff, including assisting you in developing a revised timetable and workplan that will facilitate the development of such a standard on a timely basis.

Yours sincerely

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Chair, European Insurance CFO Forum

Michaela Koller
CEA, Director General

APPENDIX 1

Question 1 – Relevant information for users

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

We support the development of a comprehensive accounting standard for insurance contracts. We acknowledge the issues that the Board has had in developing that standard and the need to instigate a two-phase process beginning with the publication of IFRS 4 in 2004. IFRS 4 allows the perpetuation of existing GAAP for insurance contracts and hence allows significant diversity in reporting which is clearly not sustainable. Accordingly, we support the current project to develop a "Phase 2" standard to introduce consistency amongst insurers.

We believe that, whilst many aspects of an insurer's activities are similar to elements of other businesses, the combination of all those features (often pushed to an extreme) in one business makes the overall nature of insurance business unique and therefore warrants a separate accounting standard in order to provide decision useful information. Accordingly, we are supportive of the decision to exclude insurance contracts from the scope of other standards such as revenue recognition, financial instruments and liabilities (IAS 37). We believe that those standards do not appropriately reflect the specific aspects of insurance.

We are supportive of many aspects of the measurement model as outlined in the responses to the following questions, particularly the use of a fulfillment approach that uses entity specific assumptions, expected cash flows with a contract boundary that includes participating features, discounting for the time value of money and a rate that reflects liquidity, an explicit risk margin, and the deferral of initial profit, However, we do have significant concerns around some aspects of the model, including the interaction with the valuation of assets and liabilities, and also around the presentation proposals which, in our view, should form an integral part of the overall financial reporting model. In addition to those aspects of the proposals that we fundamentally disagree with such as the transition requirements and the mandation of the premium allocation approach, we are also concerned with the lack of clarity and hence scope for interpretation that there is around several areas of the ED, notably unbundling.

Accordingly, we are of the opinion that, as currently drafted, the measurement model is not sufficiently advanced to provide relevant information that will help users make economic decisions. The ED reflects many steps in the right direction, especially when compared to the 2007 Discussion Paper, but needs to be further advanced in terms of clarity and content in several areas. We discuss those areas in the responses to the following questions and suggest changes to the model where appropriate.

Furthermore, the measurement model can only be properly assessed in conjunction with proposals to present the performance of insurers to users of financial statements. As stated above, we do not believe that sufficient consideration has been given to the presentation model included in the ED.

Question 2 - Fulfilment cash flows

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

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

(a) Yes, we believe this measurement principle is in line with the "market-consistent fulfilment cost" approach that the CFO Forum and the CEA have previously advocated.

We welcome the changes made from the Discussion Paper ("DP") published in 2007 notably the reflection of entity specific costs, the removal of the guaranteed insurability criteria around future premiums and the inclusion of expected payouts on participating contracts.

We consider the revised principle to reflect much better the economic value of the cash flows related to an insurance contract.

Our rationale is set out in our previous letters to the IASB including our joint response to the DP and the CFO Forum's letter on Measurement Attribute dated 25 July 2008 (www.cfoforum.eu/letters/CFOF-Measurement_Attribute_paper.pdf).

(b) Yes, consistent with a principle based standard, we do not believe that the guidance should be any more prescriptive than that currently detailed in Appendix B.

We do have a number of concerns around certain elements of the guidance, notably:

- We believe that paragraphs B45-47 place undue emphasis on the use of the replicating portfolio technique. We acknowledge that this is a valid technique in certain circumstances (but we do not believe it is commonly used in practice given that the insurance products for which a replication technique can be used are limited). Therefore, we do not believe that insurers should be required to demonstrate that there is no material difference between the technique employed and a replicating portfolio technique and propose that paragraph B46 and the fourth sentence of paragraph B47 are deleted;
- We believe that the current wording in paragraph B61 (j) is inconsistent with the definition of discretionary participation features on page 45. It is missing the third element in the definition of DPF in (c) (iii) "that are contractually based on the profit or loss of the company, fund or other entity that issues the contracts". Without this third element being included in the application guidance, an unintended consequence could occur whereby cash flows associated with contracts where the policyholder participates in the profit or loss of the company would be excluded from the first building block;
- We are concerned about the treatment of general overheads as B62 (f) states that these should be excluded. We believe that cash flows should include both overhead expenses and expenses which are directly assignable to individual claims, policies or transactions. For example, this would include an allocation of overheads such as costs of an insurance company's finance department but not wider corporate overheads or one-off project expenditure. Not to do so would understate the policyholder liability and overstate the residual margin as premiums are set up to recover such expenses. Not to include them may also encourage outsourcing of activities due to accounting reasons not necessarily on the basis of sound economics;
- Paragraph B62 (g) excludes tax cash flows that are within the scope of IAS 12. In certain jurisdictions this will result in taxes paid on behalf of policyholders being excluded. Further consideration needs to be given to the treatment of such taxes to ensure the liability is not misstated; and
- We are concerned around which cash flows arising between different components of the reporting entity are expected to be excluded in paragraph B62 (h). For example, we believe that an allocation of rent relating to property owned by policyholder funds should be made to shareholders and therefore included in the cash flows but are concerned that this paragraph would exclude this.

Question 3 – Discount rate

(a) Do you agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability? Why or why not?

(b) Do you agree with the proposal to consider the effect of liquidity, and with the guidance on liquidity (see paragraphs 30(a), 31 and 34)? Why or why not?

(c) Some have expressed concerns that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts. Are those concerns valid? Why or why not? If they are valid, what approach do you suggest and why? For example, should the Board reconsider its conclusion that the present value of the fulfilment cash flows should not reflect the risk of non-performance by the insurer?

(a) Yes. We agree that the future cash flows should be adjusted for the time value of money and that the discount rate should be consistent with observable current market prices for cash flows whose characteristics match those of the insurance liability.

We believe that it is fundamental to include factors such as timing, currency and liquidity in the discount rate as these are relevant characteristics of the liability that reflect the economic substance of the contract.

In relation to discount rates for contracts where the cash flows depend wholly or partly on the performance of specific assets, we understand from discussions with the IASB staff that the overall objective of the Board was to achieve a "market consistent" approach. We support this approach and propose that this is clearly stated in paragraph 32 as the wording is currently open to interpretation.

A fundamental aspect of insurers' business models is the matching of assets and liabilities. IFRS 9 allows entities to carry assets at amortised cost where certain criteria pertaining to the nature of the asset and the business model are met. Given that insurers manage assets and liabilities together the business model approach of IFRS 9 is equally relevant in determining the measurement approach to insurance liabilities. However, the basis of valuation of insurance liabilities as set out in the ED effectively precludes insurers from using the amortised cost category for their assets even where this would be the most appropriate valuation in terms of their business model. The implications are that assets matching insurance liabilities would have to be measured at fair value.

Where insurers are carrying their assets at amortised cost we propose that the standard should allow the matching liabilities to be measured using a locked in discount rate to reflect their business model. We therefore propose that IFRS 4 should reference back to the business model in IFRS 9 in order to ensure an appropriate asset liability matching.

We are continuing to develop our proposals in this area, including whether additional criteria may be required, and will be happy to work with the IASB to develop an effective solution. We have begun to consider specific aspects of the alternative model. For example, we believe that expected cash flows and the risk adjustment elements of the model should be remeasured as set out in the ED, even if the locked in discount rate approach is applied. Thus the expected cash flows associated with options and guarantees that are not closely related to the underlying contracts would be accounted for as required by the ED. This would include both their intrinsic and time values.

(b) Yes. We believe that it is wholly appropriate to allow for an illiquidity premium adjustment in the estimation of discount rates as stated in (a).

The illiquidity spread, highlighted in the recent financial markets turmoil, is reflected in the market valuation of assets and we believe it should also be appropriately reflected in the measurement / valuation of insurance liabilities to faithfully represent the characteristics of the liability. Any buyer of a financial instrument would place a value on the degree of liquidity in their investment. Similarly, a potential policyholder would differentiate between two similar products with varying degrees of liquidity. To this end, liquidity is an important market consistent valuation aspect and provides a consistent measurement of assets and liabilities which is particularly important in a dislocated market.

We believe that the inclusion of an illiquidity premium is consistent with the fulfilment objective. Insurance liabilities are generally retained by the insurance company and are not transferred to a third party and therefore it is appropriate that the discount rate reflects the certainty of timing of fulfilment cash flows where applicable. We believe that the illiquidity premium can be reliably measured as we already use it in the context of our internal risk management, in our embedded value reporting and soon in solvency reporting and there are a number of techniques already in existence to do this.

(c) The CFO Forum and CEA have always stated that own credit standing of an insurance contract should not be considered in the valuation of insurance liabilities. We continue to support this view on the basis that introducing own credit standing into liability valuation would result in a misleading accounting profit in the event of a downgrade to an insurer. However, we believe that further investigation is required by the IASB into how the price of credit, and changes therein, are reflected in the valuation of insurance contracts. This issue is particularly relevant at times of widening credit spreads, as evidenced in the recent financial crisis where changes in the price of credit became dislocated from the risk of default. IFRS 9 takes account of credit risk for financial liabilities.

Question 4 – Risk adjustment versus composite margin

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

We reiterate our support for a separate explicit risk margin (or “adjustment”) and residual margin as previously stated in our May 2010 letter to the IASB regarding the need for separate risk and residual margins.

We believe an explicit risk adjustment presents an economic valuation of the insurance contract liability and explicitly identifies the risk and uncertainty in the discounted probability weighted cash flows underlying that liability. We believe that a model incorporating separate risk and initial profit (“residual”) margins is significantly more appropriate than one aggregating these two elements together in a single composite margin.

We believe that the residual margin represents an element of the profit expected to be generated by the contract over its lifetime. Given the long term nature of insurance it is appropriate that this gain is not recognised at inception but deferred reflecting the provision of insurance coverage. Without explicit separation of the risk and residual margin, the total margin may have to be recognised over a period through to ultimate settlement, thus delaying profit recognition, particularly in many non-life contracts. Our views around the residual margin are further expanded in Q6.

The key reasons we support an explicit risk adjustment over a composite margin are set out below. Further detail is included in the May 2010 letter (www.cfoforum.eu/letters/Letter_to_IASB_risk_v_composite_margins.pdf).

- An explicit risk adjustment provides greater transparency over the true position of the contract;
- There is a considerable weight of opinion behind the need for a separate risk margin, including from regulators and users;
- Risk margins are determined for several other purposes, both in relation to external reporting and internal management of the business;
- Consistent application will develop through market practice aided by an appropriate disclosure regime;
- Excluding a risk adjustment raises issues around the liability adequacy test;
- The composite margin model gives rise to complicated issues around the period and pattern of recognition and would inhibit transparent reporting; and
- The lack of remeasurement of the composite margin will result in no consideration of changes in risk over a contract's life.

Question 5 – Risk Adjustment

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

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

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

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

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

(a) Yes. We support the objective as stated.

As stated in Q4, we believe an explicit risk adjustment is an important component in presenting an economic valuation of the insurance contract liability. In our view, the objective is consistent with a fulfilment model as it represents the amount an insurer would pay to be relieved of risk rather than the market price that would be charged. The economic cost of the liability is the amount an entity will actually ultimately pay to settle the obligation over the life of the contract and this is the most likely option that will be utilised by the entity to fulfil the obligation. The use of terms "rationally pay" and "maximum amount" are important components of the objective as they reflect the economic nature of the valuation.

(b) We do not believe the proposals should be restricted to three techniques as this is not consistent with a principles based standard and would restrict the inclusion of improved actuarial techniques as these are developed. We reiterate our view set out in the recent letter to the IASB regarding measurement of risk adjustments in June 2010 where we stated that the determination of a consistent risk adjustment is not achieved by any particular methodology but through the application of a single measurement objective with due

consideration for the characteristics of risk. This approach is consistent with the IASB's stated objective of principle-based financial reporting standards.

We welcome the inclusion of the cost of capital method as a permitted technique for estimating risk adjustments as we believe that there is considerable evidence that the cost of capital method is currently the most appropriate method for assessing risk and evaluating a risk adjustment.

(c) No, we do not agree that the insurer should disclose the confidence level to which the risk adjustment corresponds if either the cost of capital or CTE method is used.

We do not believe that the disclosure of confidence levels would provide decision useful information to the users and consider that it may be misleading as it would not provide a consistent comparison between companies. The confidence level method is not reliable when the probability distribution is skewed and varies significantly over time as the Board themselves concluded in paragraphs B67-102 of the Application Guidance in Appendix B of the ED. As such we do not understand why the single required disclosure in this area would be based on the least appropriate of the prescribed methods.

In our letter to the IASB referred to in (b) above, we also set out why we believe the cost of capital method is more appropriate than the confidence level technique as the cost of capital method ensures that insurers consider the shape of the distribution whereas no such consideration is given in percentile approaches where the confidence level is just selected. For example, determination of a risk adjustment based on, for example, as 75% confidence interval may underestimate the risk adjustment for highly skewed risk with a mean, for example, in excess of 65% and may overestimate the risk adjustment for a risk with a mean close to 50%.

Notwithstanding the basis of the prescribed disclosure, we do not believe that the Board should permit one method then prescribe the disclosure of a second as this creates an additional workload for companies that we do not believe adds any benefit to the user and is not in line with a principle based standard approach. We believe that the disclosures required around the technique employed in terms of measurement and the sensitivity analysis should provide sufficient transparency to the users.

(d) No, we do not agree that the risk adjustment should be measured at portfolio level as we do not support the level of diversification benefit taken into account being restricted to portfolio level. We reiterate our views expressed in response to the DP that further allowance should be made for diversification up to a group level. The benefits of diversification between lines of business are an integral part of an insurer's business model and it is therefore fundamental that accounting reflects these benefits when valuing together a number of portfolios of insurance contract liabilities.

For example, we would highlight the negative correlation between term assurance and annuity books. An entity that writes both term assurance and annuity contracts will be able to offset the impact of any mortality changes between these portfolios. This should be reflected in a lower risk adjustment as the uncertainty is effectively reduced and (consistent with the measurement objective for the risk adjustment) this reduces the amount the insurer would rationally pay to be relieved these portfolios. The current proposals in the ED would potentially result in an overstatement of realistic liabilities as a result of this negative correlation not being considered for these books of business.

We do not believe that the concept of fungibility that is referred to in the Basis of Conclusions as part of the rationale behind the Board's proposals in this area is an appropriate one to consider in relation to accounting. We see fungibility as a capital management and regulatory issue.

In addition, diversification at a group level is also relevant to the measurement of the risk margin as this reflects the economics of the business as evidenced in pricing decisions. Further, there are widespread actuarial techniques that are used by the insurance industry to reflect diversification effects in their capital management models. Overall, we believe that the benefits of diversification (and negative correlation) between portfolios up to a group level should be reflected in risk margins on the basis that this approach is reflective of the business model applied.

(e) We believe the Board should not provide detailed guidance on how the risk margin should be calculated in line with principle based approach.

Question 6 – Residual/composite margin

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

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

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

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

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

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

(a) Yes. As stated in Q4 and Q5, we fully support the concept of a residual margin and agree with the principle that an insurer should not recognise any gain at initial recognition of an insurance contract.

In addition to the rationale set out in support of the residual margin in Q4, we agree with the Board's views in paragraph BC121 of the Basis for Conclusions. The deferral of a day 1 gain or "deferred profit margin" is consistent with revenue recognition proposals as, at inception, the insurer has not satisfied any of its performance obligations.

We would note that, in practice, the gain at inception would be measured at portfolio level and allocated at cohort rather than contract level as stated in the question, consistent with our proposals regarding the level of measurement of the residual margin proposed in (c).

(b) Yes. We agree that a loss at initial recognition of an insurance contract should be recognised immediately in profit or loss.

We believe that recognising a loss at inception is appropriate to reflect the economic substance of the contract where the amount paid by the policyholder is insufficient to cover the expected present value of the policyholder benefits and claims.

(c) Yes. We believe that the determination of the residual margin can be operationalised. Further prescription of the basis of that determination is not necessary.

(d) No. We do not agree with the proposed method of releasing the residual margin.

We agree with the concept that insurance coverage is an appropriate basis of release as set out in paragraph BC 127 in the Basis for Conclusions. However we do not believe the proposals in paragraph 50 are consistent with this concept. There is disproportionate emphasis on the pattern of incurred claims and benefits which appears to override the concept of insurance coverage as a key profit driver. For example, where there is a significant delay in the payment of the claim e.g. whole life contracts, the profit recognition would be delayed if the pattern of claims and benefits is the default basis.

We propose that sub-paragraphs 50(a) and (b) should be deleted and paragraph 50 changed so that it ends with "... in a systematic way that best reflects the exposure from providing insurance coverage, which may be on the basis of the passage of time".

We do not believe that an approach that locks in and amortises the residual margin after contract inception is consistent with the initial measurement model. That model does not allow day one gains to be recognised immediately and instead spreads those gains over the coverage period. However, all changes in assumptions subsequent to inception must be taken immediately to profit or loss.

Conceptually, we believe that the residual margin should be recalibrated to take account of the impact of changes in non-financial assumptions, such as mortality and lapses, on future expected cash flows and risk adjustment. Such recalibration would provide consistency in this respect between "day 1" and "day 2" accounting. We note that our views on the treatment of changes in financial assumptions will depend on the basis of resolution of the issues around the interaction of the measurement of assets and liabilities.

That said we recognise that there are some significant practical issues that must be overcome before such recalibration can be operationalised and we would be happy to work with the IASB to determine whether it is feasible to develop a practical and effective solution in this area without introducing undue complexity into the standard.

(e) N/A - as stated in our response to questions 5(a) above, we believe that an explicit risk adjustment and residual margin should be calculated as opposed to a composite margin. Notwithstanding this point we do not agree with the introduction of a rules-based amortisation pattern in a principles-based standard.

(f) Yes. Conceptually we believe that the accretion of interest concept is consistent with the measurement model. However, we believe that the complexity involved in practice outweighs the benefits of such an approach.

Question 7 – Acquisition costs

(a) Do you agree that incremental acquisition costs for contracts issued should be included in the initial measurement of the insurance contract as contract cash outflows and that all other acquisition costs should be recognised as

expenses when incurred? Why or why not? If not, what do you recommend and why?

(a) We welcome the inclusion of incremental acquisition costs in the contract cash flows, albeit we believe that the proposed definition is too narrow. We believe that acquisition costs are a fundamental part of the life cycle of an insurance contract despite not being legally part of the insurance contract itself. Pricing of insurance contracts takes into account acquisition costs and given that the residual margin is based on the premium less the building blocks, including the expected cash flows, it is appropriate to build the acquisition costs into the determination of that margin.

We believe that the proposed definition is too narrow and we are concerned about the definition of acquisition costs as incremental at contract level. This is inconsistent with the manner in which we price and manage our business and the general principle which allows for the inclusion of cash flows incremental at the level of a portfolio of insurance contracts. Limiting acquisition costs to those that are incremental at contract level may lead to a divergence in valuation of contracts sold through different distribution channels. An insurer who sells through a direct sales force may incur similar total acquisition costs to one selling through an agent yet the latter will incur incremental acquisition costs whereas the former will not. Accounting should not drive business practices and the restriction of acquisition costs to contract level may lead to inappropriate changes in business practice.

Question 8 – Premium allocation approach

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

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

(a) We support a single measurement model for all insurance contracts. However, we believe that, under a principles based standard, it is appropriate to introduce a simplification of the single model that allows insurers with relatively straightforward contracts to avoid detailed building block determination. In that regard we continue to support the Unearned Premium Reserve (UPR) model as a suitable proxy although there should be no compulsion to use any simplified approach.

Accordingly, we support view (ii) whereby an insurer is permitted, but not required, to apply such an approach. As the premium allocation approach (“PAA”) is a simplification of the building block model it should not be mandated for particular types of contracts. It is illogical that companies who would want to apply a full model would be precluded from doing so.

Further, an insurer can write contracts which include the same risks but the contract may have different coverage periods e.g. 1 and 3 years. It should be possible that the insurer can measure the same risk always with same methods in order to give consistent information.

(b) No. On the basis that the PAA is a simplified approach operating as a proxy for the full model then it should be available for use as required and no criteria for use are necessary.

We are concerned that the proposed criteria may have unforeseen consequences such as the mandation of the PAA for certain short term life contracts such as Group Life business or the exclusion from scope of certain longer non-life contracts such as professional indemnity and health insurance. We do not believe that insurers should be forced to apply, or prevented from applying, the PAA to contracts that fall within, or outside, these criteria. To require them do so would result in an additional workload for insurers, including a further classification exercise which is not consistent with a simplified measurement proxy.

Although we are concerned that there are certain aspects of how to apply the approach that do not perhaps represent a simplification such as the accretion of interest or onerous contract test using the full building block approach, we support the availability of the premium allocation model as a proxy for the full measurement. .

There are other areas of concern in relation to the PAA which we will raise in later questions in relation to presentation, reinsurance and transition.

Question 9 – Contract boundary principle

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

(a) Yes. We fully support the changes that have been made to the contract boundary principle proposed in the ED based on a whole contract approach including the removal of the guaranteed insurability criteria included in the Discussion Paper.

We strongly believe that insurance contracts should be valued in their entirety as we believe that once that boundary has been determined the expected value of all the cash flows falling within the existing contract should be included in the measurement of the liability.

We have extensively discussed and field tested the contract boundary proposals to establish suitable criteria to distinguish between existing and new contracts. We believe that the proposed principle clarifies when an existing contract ends and a new contract begins and that insurers should be able to apply this consistently in practice without any further guidance.

Question 10 – Participating features

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

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

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

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

(a) Yes. We agree that the measurement of insurance contracts should include participating benefits on an expected present value basis as we believe that this reflects the true economic value of such contracts. This is in line with the fulfilment value notion.

However, we note that participating contracts are significantly different in terms of contract and fund structures within different jurisdictions. In particular, there are significant differences in relation to how the excess over policyholder liabilities is treated. The Basis for Conclusions states that the Board decided not to address accounting for unallocated surplus in the ED and

we believe that further consideration is required in this area. In this regard, we recognise that one solution will not suit all types of contracts.

For example, the ED proposals do not adequately address UK-style with-profits funds from a shareholder perspective and in particular is silent on the treatment of unallocated surplus. These funds are ring-fenced in nature and we do not believe that the proposed accounting adequately reflects the shareholders perspective. Another example is the case of Swedish mutuals where unallocated surplus is utilised as risk capital and hence is more akin to equity.

We believe this topic requires further consideration and members who hold such funds would be happy to discuss this further with you.

(b) We believe that financial instruments with discretionary participation features (DPF) should be within the scope of the IFRS on insurance contracts and hence accounted for on a consistent basis to insurance contracts. This will provide a single point of reference for how such features should be treated under IFRS. Such treatment reflects the fact that such contracts are economically similar and, in our view, applying a consistent and comparable measurement basis to both would provide decision useful information to the users. The Insurance Contracts project has specifically considered the basis of measurement for discretionary features whereas financial instrument accounting has not.

(c) No. We believe that the proposed condition would result in an arbitrary split for investment contracts with discretionary participation features with similar contracts being accounted for differently. We believe that all such contracts should be scoped into IFRS 4 as per (b) above. We do not agree with the proposed definition of discretionary participation features and believe that there should be no change to the current IFRS 4 definition. In particular, we do not support the new condition that the definition is only met where there are also insurance contracts that participate in the same pool of assets or the profit or loss of the same company, fund or entity.

This amendment to the definition could result in different accounting treatment for contracts with identical or very similar contract features. It is common to find investment contracts with discretionary participation features invested in segregated funds where no insurance contracts participate in the same pool of assets, the profit or loss of the same company, fund or other entity. Indeed certain jurisdictions require the use of a segregated fund without the participation of insurance contracts, for example in Italy. These contracts would be accounted for under IFRS 9 whereas similar contracts held by the same company where there are insurance contracts participating in the same pool of assets of profit or loss of the company would be accounted for under IFRS 4.

Another example is in Germany, where the regulator requires that products with discretionary features have to invest in segregated funds when they reach a certain threshold. This could result in contracts with the same characteristics written by two different companies in Germany, which look identical from the perspective of the policyholder, being accounted for differently. Or the situation could arise that the same policy could be treated as an investment contract with discretionary participating feature under IFRS 4 initially, then later have to be reclassified to IFRS 9 when the threshold is met. Similar examples can be cited for other countries such as Belgium, France and South Africa.

(d) We agree with the modifications to the boundary of the contract for investment contracts with DPF. We agree that with the principle that the residual margin shall be recognised over the life of the contract in a systematic way that best reflects the asset management services. However, we do not believe the proposed criteria for the pattern of release of the residual margin is necessary and propose that paragraphs 65 (a) and (b) are deleted.

Question 11 – Definition and scope

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

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

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

(a) We agree with the overall definition and welcome the fact that the existing IFRS 4 Phase I definition has been retained. We do not believe any changes should be made to the related guidance.

From our perspective the definition of an insurance contract in IFRS 4 Phase I has worked very effectively across all territories that have implemented IFRS to date. We do not believe any product reclassification exercise is required upon the introduction of Phase II.

We note that changes made to the guidance in B25 only import certain aspects of US GAAP that relate directly to reinsurance but not other elements that are an integral part of a reinsurance risk transfer test under US GAAP. Therefore, this additional guidance does not work in practice for certain reinsurance contracts. Some of our members have already engaged with the IASB staff on this issue.

As stated above, we do not believe any changes should be made to the existing IFRS 4 definition including the guidance and hence paragraph B25 should be deleted.

Another issue relates to paragraph B28 of the ED, which prescribes the risk transfer being assessed on a contract by contract basis, rather than by reference to the materiality to the financial statements. In parentheses, it also advises that for the purpose of assessing the risk transfer, "contracts entered into simultaneously with a single counterparty, or contracts that are otherwise interdependent, form a single contract".

In our understanding, this could imply that fronting, retrocession and reinsurance programs might be excluded from the scope of the future standard on insurance contracts. However, these are typical business activities of reinsurers by which the reinsurer transfers some of the assumed risks to another reinsurer, the retrocessionaire. From our communication with the IASB Staff we have understood that this potential scope exclusion has never been intended by the IASB.

Therefore, it should be made clear that fronting, retrocession and reinsurance programs are not "contracts that are otherwise interdependent" in the sense of paragraph B28 of the ED and consequently, the assumed contracts and the ceded contracts, respectively, shall be checked independently from each other for significance of risk transfer.

(b) No. We do not believe that fixed fee contracts that meet the definition of insurance should be specifically excluded from scope. As stated in (a) we support the definition of insurance contracts and believe that once it has been established that such contracts meet this high level principle, it is therefore appropriate to measure them within the insurance contracts proposals consistent with a principles based approach.

(c) We agree that it is appropriate to include trade credit insurance contracts that meet the definition of insurance contracts within the scope of insurance accounting.

Question 12 – Unbundling

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

(a) No. We do not agree with the requirement to unbundle as set out in the ED or the proposed criteria.

This is a critical area of the ED and has extensive implications for the industry particularly in terms of the significant practical effort potentially required in implementation of the proposals for no great benefit for users. As previously stated in our response to the Discussion Paper, we believe that unbundling should not be required because a contract should be recognised as a whole, rather than as component pieces, reflecting the basis on which the company manages it. We do not believe that the unbundling will provide meaningful and useful information to users of financial statements in most circumstances. We believe that the unbundling proposals introduce unnecessary cost and complexity into financial reporting. The time and costs required for insurers to analyse their underlying contracts should not be underestimated as was demonstrated by the work undertaken on product classification under Phase I. Significant systems changes will be required in many cases. Issues such as the allocation of charges and acquisition costs to unbundled component parts of contracts will require greater clarification. We strongly believe that unbundling is not necessary because the existing definition of insurance works well to determine what the measurement and boundaries should be.

In relation to the proposed criteria, we believe that the wording is unclear and is open to interpretation as it is not clear from the proposals what contract types would be required to be unbundled or not. In particular, the term "closely related" requires definition and the examples provided are also open to interpretation.

Question 13 – Presentation

(a) *Will the proposed summarised margin presentation be useful to users of financial statements? Why or why not? If not, what would you recommend and why?*

(b) *Do agree that an insurer should present all income and expense arising from insurance contracts in profit or loss? Why or why not? If not, what do you recommend and why?*

We believe that the final standard should provide a clear communication tool to investors of our business performance. In this respect it is essential that the interaction of assets and liabilities that underlies our business is fully considered in the development of the standard. Accordingly, short term market movements that are not representative of long term performance should be clearly distinguished such that underlying key performance indicators are not overshadowed by short term market volatility. In this regard, we believe that there has been insufficient focus placed on the interaction with IFRS 9 from both presentation and measurement perspectives in the ED proposals.

In general terms, we do not believe that the presentation aspects of this project have been given appropriate attention by the Board to date given the focus on the measurement model. We would stress the need for an integrated presentation model that effectively communicates performance to users in the final standard. We will be happy to work with the IASB on presentation and performance reporting in the future.

(a) Conceptually we support a presentation model that reflects the measurement model and we accept that the current basis of reporting performance, particularly for life insurance, does

not provide decision useful information to users. Accordingly, in principle most life companies and many composite insurers would support a summarised margin approach as an attempt to improve on current reporting. However, more work need to be done on the margin approach for life as it raises some issues. On the contrary, there remain significant concerns amongst non-life insurers about the usefulness of a margin approach to properly disclose the key metrics of their business.

Furthermore, we believe that the board should clarify the relationship between the presentation proposals included in this ED and the ongoing Financial Statement Presentation project. For example, we are unclear which of the prescribed income statement line items under each project would take precedence or how other items on an insurers' income statement beyond insurance contracts should be accounted for. Furthermore, we would question why the board have chosen not to address the contentious issue of an insurer's cash flow statement in the Insurance Contracts project rather than dealing with it generically under the Financial Statement Presentation project.

(b) As we have already stated, we are supportive of an ability to use OCI to reflect aspects of the changes in insurance liabilities. As indicated above we believe that users of an insurer's financial statements want to understand the underlying long term performance of an entity's operations without "market noise" confusing the picture. The IASB has removed the option to account for assets using an Available for Sale categorisation under IFRS 9 and have mirrored this approach by excluding such an option from the ED. We believe that the objective of more effective performance reporting may be served by reinstating the AFS category for assets and by using OCI to reflect matching short term fluctuations in insurance liabilities.

Alternatively, consideration should be given to developing an OCI model that does not necessitate re-opening of IFRS 9. Under such a model underlying operating performance would be shown in net income separately from short term market movements that are not representative of long term performance related to both assets and liabilities, which would be disclosed in OCI.

As per our answer to 6(d), we have some issues around non-recalibration of the residual margin for changes in non-financial assumptions which require consideration in parallel with the points referred to with regards to OCI above.

Question 14 – Disclosures

(a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?

(b) Do you think the proposed disclosure requirements will meet the proposed objective? Why or why not?

(c) Are there any disclosures that have not been proposed that would be useful (or some proposed that are not)? If so, please describe those disclosures and explain why they would or would not be useful.

(a) Yes, we agree with the proposed disclosure principle which requires an insurer to explain the amounts recognised in the financial statements arising from insurance contracts and the nature and extent of risks arising from those contracts. We believe that this overall principle will provide decision useful information to the users of the financial statements. However, we have significant concerns around the underlying detailed disclosure requirements as set out below.

(b) No, we do not believe that the proposed disclosure requirements meet the proposed objective to help users of financial statements understand the amount, timing and uncertainty of cash flows arising from insurance contracts.

We believe that disclosure requirements should be principles based. We are concerned about the volume and level of detail in the disclosure requirements and do not believe that such prescriptive rules based requirements should be included.

We believe the disclosure requirements are not clear or even feasible to produce in practice in many cases as set out in (c) below and are concerned that they do not provide an appropriate reflection of the key aspects of the new measurement model.

(c) As stated above, we support the overall objectives in paragraph 79 but believe that if the disclosure requirements do not meet these objectives then an insurer should be able to provide alternative, not *additional,* information as stated in paragraph 80. If not, this will result in additional workload to produce boiler plate disclosures that have no benefit or relevance to the user.

We believe that the requirements around aggregation in paragraph 81 and 82 are helpful but are then contradicted by paragraph 83 and 84 which prescribe a level of aggregation which appears to be much more detailed. We suggest that a broader concept based on how management organises the business including the business activities in which it engages and the economic environments in which it operates might be a better starting point and paragraphs 83 and 84 should be removed.

We support the overall disclosure requirements in paragraph 85 and 91 but have concerns about the prescriptive detail in paragraphs 85-90 and 92 to 97. We have already set out our concerns in relation to paragraph 90(b) (i) regarding disclosures of confidence levels in question 5; however we have concerns in several other areas including the following:

It is not clear how the line items prescribed in the reconciliation of insurance contracts in paragraph 87 apply to the reconciliation of the risk adjustment and residual margin.

The lack of clarity around how the presentation of short duration contracts will operate is also applicable to the disclosure requirements in paragraphs 88 and 89. In particular, we are unsure how the claims development tables would be developed in practice for life contracts that may fall within the definition of short duration contracts.

Paragraph 90(d) requires a sensitivity analysis similar to that proposed in the Fair Value Measurement project. The detail likely to be required, particularly around the correlation of inputs, would be extremely onerous if not impossible to do in practice taking all scenarios into consideration. We are unsure conceptually why this would be required in a probability weighted measurement model which allows for uncertainty in best estimate liability and includes a risk adjustment. In addition, the sensitivity analysis wording from IFRS 7 has been pasted into paragraph 96(a) and the sensitivity to insurance risk requirements in paragraph 92(e) (i) have been retained from IFRS 4 although the option to disclose qualitative information as an alternative has been removed. We are unclear why this new disclosure requirement has been added and how it is linked to existing sensitivity requirements.

Paragraph 92(d) introduces new requirements to disclose information about the effect of the regulatory frameworks in which the insurer operates. This would appear to be an extremely onerous requirement given the multi-national frameworks that most of our companies operate in and we are unsure of what benefit this would provide to users or how this interacts with the existing disclosures regarding capital required in IAS 1.

Overall, we believe that existing IFRS 4 and IFRS 7 disclosures provide an ideal starting point to assess the disclosure requirements for insurance contracts on the basis of the new measurement model. However, the disclosure requirements included in the ED appear to be a combination of existing IFRS 4 requirements with a paste of IFRS 7 wording with some new requirements also added without consideration as to whether those requirements are relevant for the new measurement model. As noted in our response to the discussion paper, the level

of disclosures required by IFRS 4 is partly a reflection of the inconsistent measurement models prevailing through the grandfathering of existing GAAP in IFRS 4 and hence the extent to which it will continue to be required should be carefully evaluated. We are concerned that this evaluation has not taken place and suggest that further consideration is given to this in the final standard.

Question 15 – Unit-linked contracts

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

(a) Yes. We support the proposals to require fair value measurement for treasury shares and owner-occupied property to address mismatches for unit-linked contracts. However, we are concerned that not all mismatches have been addressed, such as discounting deferred tax and treatment of own debt. Furthermore, these proposals will not address mismatches for non-linked business, notably relating to participating contracts, For example, with profits funds who hold owner-occupied properties currently may apply shadow accounting to avoid mismatches; however, this option has now been removed.

We welcome the presentation of unit-linked assets backing unit-linked liabilities in a separate single line item. We believe that all related balances backing unit-linked liabilities, be it assets or liabilities, should be reflected in this single line item.

In addition we believe that it is essential to widen the single line presentation proposals to unit-linked contracts within the scope of IFRS 9 as well as IFRS 4 to provide consistency and comparability within the financial statements.

Question 16 – Reinsurance

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

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

(a) Yes, we support an expected loss model for reinsurance assets as this is consistent with existing practice, for example, within economic capital models and also consistent with the proposed impairment model for financial instruments.

(b) As previously communicated to the IASB Staff, many of our members are concerned that the measurement of reinsurance ceded does not fully reflect the underlying economics of the business particularly in relation to the measurement of the residual margin of a reinsurance asset.

In our view, the measurement of assets and liabilities needs to be based on consistent principles. Therefore, it is essential that the measurement of reinsurance assets needs to reflect an assessment of the risk relief for the reinsured party by the reinsurance contract. In particular, this implies that in a net view the obligation on the side of the cedant should just reflect the part of the obligation which economically stays with the cedant. Therefore, according to our understanding, the proposal in the ED to calibrate the residual margin of the ceded business to the reinsurance premium leads to a misleading presentation. In most cases (i.e. when the reinsurance premium is not exactly the same as the respective premium of the business assumed by the cedant) the reader will get a wrong impression about the percentage of the primary insurer´s risks reinsured:

- If the reinsurance contract appears to be non-profitable from the primary insurer´s perspective (if the reinsurer assesses the risk higher than the primary insurer and assumes business on conditions worse than the original conditions) the application of the proposal in the ED will result in a residual margin on the asset side that we consider as being too high. Due to this calibration of the residual margin the expected loss will be

deferred rather than recognised immediately. In addition, a balance sheet reader gets the wrong impression that the reinsurance asset is higher than the share ceded in fact to the reinsurer.

- Vice versa, a reinsurance premium that is beneficial for the cedant would result in a residual margin on the asset side that we consider as being too low. Preferred conditions the reinsurer can give under a contract should result in a gain. To the extent this benefit is irrevocable it should be realised at inception of the contract and not be deferred. Furthermore, a balance sheet reader gets the wrong impression that the reinsurance asset is less than the share ceded in fact to the reinsurer.

We believe that the total reinsurance asset should reflect the economics of the contract and this is the relief generated by the reinsurance cover – independent of the level of the reinsurance premium. Although some of our members have a different opinion on the basis that they see the treatment as inconsistent with the philosophy of introducing a residual margin, we propose that the measurement of the residual margin of the reinsurance asset should be based on the risk transferred from the cedant to the reinsurer. This could be achieved if, at the initial measurement, the residual margin of the reinsurance asset is equal to the proportion of the risk adjustment of the reinsurance asset to the risk adjustment of the liability applied to the residual margin of the liability. Subsequently, the amortization of the residual margin of the reinsurance asset should be based on the same pattern as the amortization of the residual margin of the liability.

Furthermore, we are unclear as to how the reinsurance asset should be measured where the modified approach is used for the liability measurement and believe that it should be made clear that the simplified model should be available for reinsurance contracts where it is used for the related direct insurance contracts. We would also point out that certain contracts that meet the definition of short duration may be covered by a longer term reinsurance agreement which is less likely to meet the definition or longer term insurance contracts may be covered by a short duration (i.e. one-year) reinsurance contract. Accordingly, the mandation of the PAA could result in different measurement approaches between the underlying direct insurance contract and the reinsurance contract.

Finally, a number of issues around recognition require further consideration by the IASB:

We fully support the objectives around recognition of an insurance contract in paragraphs 13-15 of the ED but are concerned that the proposals may have unforeseen consequences where a reinsurance treaty is written before the coverage period commences. In many cases of practical importance the reinsurance contracts cover future new business of the ceding entity. Such a contract often is underwritten several months in advance of the underlying direct insurance contract(s) being written. The proposals would require the recognition of an insurance liability for the reinsurer at the date the contract was signed even though no direct insurance contract exists and the direct insurer would also have to recognise a reinsurance asset at that time even though they had no liability as they had not yet written the underlying policy.

Another issue resulting from the proposed recognition criteria relates to the binding offer by a reinsurer to a broker in which the reinsurer confirms its written share of, say, 30%. The broker would confirm the signed share once all placement is completed. The reinsurer might be signed down the relevant percentage – say 10% - which would be confirmed to the reinsurer at a later point in time. In accordance with present practice we would not recognise any cash flows from the contract prior to that point in time. However, on the basis of the proposals in the ED it is unclear to us, from when, and to what extent, the reinsurer would have to recognise cash flows from the above.

We believe these topics require further consideration and members who are concerned about these issues would be happy to discuss the details further with you.

Question 17 – Transition and effective date

(a) *Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?*

(b) *If the Board were to adopt the composite margin approach favoured by the FASB, would you agree with the FASB's tentative decision on transition (see the appendix to the Basis for Conclusions)?*

(c) *Is it necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9? Why or why not?*

(d) *Please provide an estimate of how long insurers would require to adopt the proposed requirements.*

(a) No. We do not support the transitional arrangements as we do not believe they are fit for purpose. We are extremely concerned that the "loss" of the residual margin for existing contracts will effectively portray the whole industry as start up businesses with post-transition profit emergence from existing business severely curtailed.

The proposals would result in a significant drop in post-transition earnings from existing books of long term business for most insurers. The transition adjustment under the ED proposals would be a significant amount for our members. Based on a high level estimation exercise carried out by a number of our member companies, initial estimates indicate that the aggregate adjustment would be in the region of €70bn for 12 life businesses and €20bn for seven non-life businesses. The proposals would create inconsistent accounting models for existing contracts and new business for a significant period of time post-transition which will not provide decision useful information to users. In particular, we believe that the proposals will cause distortions for users assessing capital availability for dividend payments and other payments to shareholders.

We believe that the most appropriate conceptual approach to transition is a full retrospective application of the new accounting model, in line with IAS 8 and such an approach should not be prohibited. However, we acknowledge that this approach is likely to introduce some significant practical issues for many entities. Accordingly, we support the development of an alternative simplified approach for those companies that are unable to apply the full retrospective approach which could represent a suitable proxy. We believe it is important to try to understand the difference between existing GAAP and the ED proposals and hence are exploring a simplified approach that would adjust the difference on transition such that it is a suitable proxy for a fully retrospective determination of the residual margin on our existing business. Further time is needed to explore this proposal further and we are keen to work with you to develop an appropriate approach.

Transition proposals must give consideration to short duration contracts and to certain contracts or components of contracts currently under IFRS 4 which may fall out of scope as this is currently not covered in the ED.

We do not support the inability to redesignate financial assets to amortised cost on adoption of the Insurance Contracts standard. Such redesignation may be very important for early adopters of IFRS 9 if they are required to unbundle elements of insurance contracts and wish to account for these components at amortised cost.

(b) We do not support the composite margin as set out in our response to question 4.

(c) Yes. As previously set out in our response to the "Financial instruments: classification and measurement" ED, we believe that a fundamental aspect of insurers' business models is asset/liability matching and therefore the measurement basis for insurance contracts must be developed concurrently with the proposals for financial instruments. We therefore support the

Board's considerations to delay the effective date of IFRS 9 if the IFRS on insurance contracts has a mandatory effective date later than 1 January 2013.

We would also point out that the determination of the effective date should take into consideration that certain jurisdictions and SEC reporters are required to provide more than 1 year of comparatives.

(d) We believe that the two years usually applied to new standards is not sufficient given the fundamental changes the proposals will bring to the insurance industry and the associated operational challenges. Based on our understanding of the Board's current timetable we do not believe that the final standard can be implemented for periods commencing before 1 January 2015.

There will be a need to operationalise a principles-based standard working internally and then with auditors to interpret the requirements into reporting practices, assessing data requirements and then implementing systems changes. Such changes will be required to both accounting and policy administration systems, with the latter often tailor-made.

The timescales involved must also consider the need to educate the market ahead of transition date with provision of trend data prior to an opening balance sheet and comparatives. The Board should also be aware that European insurers are facing significant operational challenges around the implementation of Solvency II.

We note the Board's recent publication of a request for views on effective dates and early adoption for a number of standards, including Insurance Contracts. We will look to respond to that document in due course but, in the meantime, we ask the Board to take the points above into consideration when finalising the effective date of the standard.

Question 18 – Other comments

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

(a) No.

Question 19 – Benefits and costs

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

(a) No. As the proposals are currently drafted, we do not agree with the Board's assessment that the proposed IFRS would improve the financial reporting of insurance contracts at a reasonable cost.

We do agree that a new insurance contracts standard is required and that the application of other standards to insurance business would not provide decision useful information to the users. However, further work is needed to produce a standard that meets the Board's objectives of providing decision useful financial information.

We have set out our concerns and suggestions in relation to key aspects of the proposals in our cover letter and in the detailed questions above in relation to both measurement and presentation models. If our concerns are addressed, we will be in a better position to fully assess the benefits and costs of the proposals but will need time to do so as part of a comprehensive field testing exercise.