



31 October 2013

Our ref: ICAEW Rep 158/13

Your ref: FRED 49 FRS 103

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Via email: ukfrs@frc.org.uk

Dear Jenny

Financial Reporting Exposure Draft 49 FRS 103 Insurance Contracts

ICAEW is pleased to respond to your request for comments on *Financial Reporting Exposure Draft 49 – Financial Reporting Standard 103 Insurance Contracts*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

FRS 103 INSURANCE CONTRACTS

Memorandum of comment submitted in October 2013 by ICAEW, in response to Financial Reporting Council exposure draft FRS 103 Insurance Contracts published in July 2013

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the exposure draft *Financial Reporting Exposure Draft FRS 103 Insurance Contracts* published by the Financial Reporting Council in July 2013, a copy of which is available from this [link](#).

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
4. The Financial Services Faculty was established in 2007 to become a world class centre for thought leadership on issues facing the financial services industry acting free from vested interest. It draws together professionals from across the financial services sector and from the 25,000 ICAEW members specialising in the sector and provides a range of services and provides a monthly magazine, FS Focus.

MAJOR POINTS

Support for the initiative

5. We support the introduction of FRS 103 as an interim measure. The elements drawn from the current IFRS 4 are based upon a temporary standard devised to restrict extreme divergence of accounting for insurance contracts around the world, rather than being a standard that has been developed from first principles. As such we encourage the FRC to conduct an analysis of insurance accounting under UK GAAP when the IFRS for insurance contracts has been implemented, in order to determine the best approach going forward, with particular regard to smaller insurers and mutuals.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

Q1: Do you support the introduction of FRS 103, based on IFRS 4 and incorporating many of the requirements of FRS 27 Life Insurance and elements of the ABI SORP? Does it achieve its aim of allowing entities, generally, to continue with their existing accounting policies for insurance contracts? If not, why not?

6. We support the introduction of FRS 103 and believe it achieves its aim to allow entities to continue their existing accounting policies.
7. We note that the drafting is a combination of IFRS and UK GAAP and as a result has language drawn from both with little attempt to merge the styles. This may be acceptable for a short-term solution but should be revisited if the standard were to persist for a significant period of time following the implementation of the IASB's proposed new standard for insurance contracts.
8. At this time it will either be appropriate to update FRS 103 to adopt IFRS 4 phase 2 comprehensively to ensure consistency with international standards, or alternatively retain a separate UK GAAP to allow smaller insurers to avoid the potentially onerous requirements of

the new international standard. In the latter case it is still likely to be appropriate to update the language of FRS 103 for the longer term future and potentially embrace some elements of IFRS 4 phase 2 if not the entire standard.

9. We would also note that the guidance to FRS 103 includes sections from FRS 27 and the ABI SORP where the words are largely unchanged from the original and include wording such as "shall". This is not the usual style of wording for guidance and we would recommend that the guidance is redrafted where necessary to avoid any implication that the guidance is mandatory.
10. There are however some potential changes that will be required to insurers accounting policies by FRS 102 where it is different to previous UK GAAP. A particular change in FRS 102 that may affect the future accounting treatment of insurance transactions for some insurance entities is currency translation in relation to unearned premiums and deferred acquisition costs.
11. Under current UK GAAP, accounting practice in respect of foreign currency denominated insurance business is to treat some balances arising out of insurance contracts (e.g. deferred acquisition costs or unearned premiums) as non-monetary items and others (e.g. outstanding claims) as monetary items for the purpose of applying FRS 23's requirements in respect of foreign currency translation. This treatment can give rise to accounting mismatches when the foreign currency assets backing the insurance contracts are all retranslated at year end exchange rates. We note that the IASB, in its recent insurance contracts exposure draft (paragraph 20), is proposing that all elements of an insurance contract should be treated as monetary items.
12. We would welcome the FRC providing a similar clarification in FRS 103. Accounting for an insurance contract as a whole (including any associated deferred acquisition costs) as a monetary item would reduce complexity, eliminate certain accounting mismatches and maintain consistency with the approach being proposed under IFRS.
13. There are also some insurers who will need to classify their contracts as insurance or investment for the first time as a result of IFRS 102/103, although in regulatory terms all may be classified as insurance contracts. The impact will tend to fall more upon smaller insurers and vary according to their need to adopt fair value accounting. For these entities there will be some additional cost in adopting FRS 102/103 and potential adjustments required between financial statements and regulatory returns.
14. We would also note that the wording of the guidance at IG2.37 could potentially be confusing. It would be helpful if the wording could emphasise that this paragraph only relates to evaluating whether a provision is required to be made and does not alter the requirement to disclose discontinued operations in accordance with paragraph 5.7D of FRS 102.

Q2: Draft FRS 103 paragraph 2.3 includes the 'improvement' options from IFRS 4 (ie permitting entities to change accounting policies for insurance contracts in certain circumstances). Do you agree with the inclusion of these options in the draft FRS? If not, why not?

15. We consider the option for improvements is reasonable and provides consistency with IFRS4, although there is a small risk of reducing comparability across firms.

Q3: Draft FRS 103 paragraph 1.5 requires new entrants to apply the same requirements as existing preparers in setting a benchmark for their accounting policies, but they are also permitted to utilise the improvement option where justified, in finalising their initial accounting policies.

Is there sufficient clarity on the application of the draft FRS by new entrants? If not, how should this be improved?

- 16.** This appears reasonably clear for most circumstances. However there could be more clarity through addition of details in the Implementation Guidance and cross referred from paragraph 1.5 that explains the background to the history and context of IFRS 4, as in general the Implementation Guidance is drawn from the SORP and provides little guidance on any IFRS 4 aspects of FRS 103.

Q4: Draft FRS 103 includes paragraphs from IFRS 4 on future investment margins. Paragraph 2.8 notes that an insurer need not change its accounting policies to eliminate future investment margins, however there is a rebuttable presumption that an insurer's financial statements will become less relevant and reliable if an accounting policy is introduced that reflects future investment margins in the measurement of insurance contracts (unless those margins affect contractual payments). Paragraph 2.9 describes how an insurer might overcome the rebuttable presumption.

Do you agree with the rebuttable presumption? If not, please describe your preferred measurement basis for insurance contracts and whether or not you would permit insurers to continue with their existing accounting policies in this area for the time being?

- 17.** We have not identified a reason not to apply IFRS 4 and the rebuttable presumption regarding future investment margins. We believe the requirements should apply equally for existing insurers and new entrants.

Q5: Draft FRS 103 paragraph 4.7(c)(iii) has adopted the IFRS 4 requirement for claims development disclosures. Is the data for these disclosures readily available to preparers?

- 18.** We would expect claims development data to be available to UK insurers, as similar information is required in regulatory returns.

Q6: The requirement to provide capital disclosures is now contained in paragraph 34.31 of FRS 102 and Section 3 of the draft Implementation Guidance provides only guidance on how those disclosures might be made by insurers with long-term insurance business, rather than mandating a particular presentation.

Do you believe this approach is appropriate in the context of applying draft FRS 103 with FRS 102? Will it have an impact on the usefulness of the disclosures to users of financial statements?

- 19.** We consider that in the context of FRS 103 it is helpful to provide additional guidance in relation to some of the disclosure requirements introduced by FRS 102, particularly as they are largely drawn from existing guidance previously within FRS 27. We note that this goes further than what is strictly required by FRS 102, but it is already provided under FRS 27 and therefore should not be unduly onerous.

Q7: Do you think the guidance on providing capital disclosures, set out in Section 3 of the draft Implementation Guidance, should also be applicable to other financial institutions applying FRS 102, such as banking entities?

- 20.** For other financial institutions such as banks there may be some useful guidance that could supplement FRS 102 regarding capital disclosures, but any such guidance should not be part of FRS 103.
- 21.** Any such guidance should be driven by replacement of previous guidance in relation to such matters has been lost with the introduction of FRS 102, although we note there is no equivalent standard to FRS 27 that has been withdrawn as a result of FRS 102.

Q8: Draft FRS 103, as with other accounting standards, is written in the context of a company and the relevant legal requirements. Appendix IV recognises that draft FRS 103 applies to other entities, including mutual insurers established under the Friendly Societies Act 1992.

Are there any requirements of the draft standard or accompanying draft Implementation Guidance that you consider require amendment in order to be applied by insurers other than companies?

- 22.** We have not identified any amendments that are necessary for insurers other than companies, such as Friendly Societies.
- 23.** We do however note that there are some smaller “non-directive” friendly societies that comply with an alternative format under The Friendly Societies (Accounts and Related Provisions) Regulations 1994 that differs from the Companies Act 2006.

Q9: Do you agree with the proposed effective date? If not, what alternative date would you propose, and why?

- 24.** We believe the alignment of the effective date with FRS 102 is appropriate and necessary.

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