



FRED 64 Draft amendments to FRS 103 Insurance Contracts - Solvency II

ICAEW welcomes the opportunity to comment on the *FRED 64 Draft amendments to FRS 103 Insurance Contracts - Solvency II* published by FRC on 10 December 2015, a copy of which is available from this [link](#).

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MAJOR POINTS

1. We understand that the FRC's objective in proposing amendments to FRS 103 *Insurance Contracts* is to take account of the changes to the regulatory framework for UK insurers, that took effect on 1 January 2016 following the implementation of Solvency II, by removing references to the PRA realistic capital regime, the statutory solvency basis, and to sections of the Prudential sourcebook for insurers (INSPRU).
2. The approach adopted in FRED 64 includes replacing the defined term 'modified statutory solvency basis' with a new defined term 'established long-term insurance business liability basis', and replacing the old definition of 'realistic value of liabilities' with a new definition.
3. We have concerns with the proposed definitions. The definition of the 'established long-term insurance business liability basis' lists a number of required attributes without actually describing the basis. Three of the listed attributes are required to be 'appropriate' although no guidance is provided to explain how a preparer might determine what would be appropriate, in the circumstances. Although the listed attributes are features of the modified statutory solvency basis (as previously defined), they could also be features of other bases. The new definition of the 'realistic value of liabilities' introduces new terms that do not appear to be defined elsewhere in FRS 103.
4. Although both new definitions include a statement to the effect that the basis applied shall be consistent with the accounting policies applied in periods ending before 1 January 2016, this does not allow for the fact that an entity might have chosen to 'improve' its accounting policies in accordance with paragraph 2.3 of FRS 103, on first time adoption of FRS 103 in 1 January 2015. Keeping the current definitions for MSSB, 'statutory solvency basis' and 'realistic value of liabilities' unchanged, save for references to INSPRU being amended to references to 'INSPRU as at 31 December 2015' would provide a possible solution for this concern and would enable newly established insurers overcome the issue of not having accounting policies as at 1 January 2015 as well.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Do you agree with the amendments proposed to FRS 103 and the related Implementation Guidance? If not, why not?

5. We do agree with the proposed amendments as they will update FRS 103 for changes in the regulatory framework following Solvency II. As Solvency II replaces the PRA realistic capital regime and INSPRU, these references will be out of date.

Q2: Have you identified any other amendments that you consider should be made to FRS 103 or the related Implementation Guidance as a result of the changes in the regulatory framework? If so, please provide details of your proposed amendments and the rationale for them.

6. According to paragraph 2.3 of FRS 103 an insurer may change its accounting policies for insurance contracts if, and only if, the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs. The insurer shall judge relevance and reliability; hence it is conceivable that prior to IFRS 4 Phase 2 coming into effect insurers might consider using

Solvency II as a basis for their technical provision calculation. In our view the amendments to FRS 103 should explicitly recognise this.

7. Paragraph 1.5 in FRS 103 requires new entrant setting out accounting policies for the first time to consider the requirements of Section 3 as a means of establishing current practice as a benchmark before assessing whether to set accounting policies that differ from those benchmark policies. This is in effect proposing that any new entrants writing with-profits business must assess their accounting policies against the 'old' realistic capital regime. This regime became obsolete from 1 January 2016 when it was replaced by Solvency II. Arguably an obsolete regime is not an appropriate benchmark for new entrants to assess their accounting policies against as it does not represent current practice. It may also be unduly burdensome to require new entrants to assess their accounting policies against a benchmark that they would not consider for regulatory reporting purposes. One possible course of action would be the deletion of Section 3 from the body of the standard. To the extent that the content of Section 3 is relevant to those insurers that apply accounting policies based on (what was previously referred to as) the realistic capital regime or the 'modified statutory solvency basis', then its content could be incorporated into the non-mandatory implementation guidance to FRS 103.
8. FRED 64 is silent on business reorganisations – if a business is reorganised and a new entity is set up within the group, would that new entity considered to be a new entrant? What would be the implications of this on group accounting policies?