30 October 2013

Our ref: ICAEW Rep 156/13

Your ref: ED/2013/7

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

Dear Hans

ED/2013/7 – Insurance Contracts

ICAEW is pleased to respond to your request for comments on *ED/2013/7 Insurance Contracts*.

We commend the IASB Board members and staff for continuing to persevere with the development of the insurance contracts standard and recognise the considerable effort that has been put into the extensive number of outreach activities undertaken by the board and staff.

The IASB has moved forward in issuing the revised exposure draft, but in our view there are two areas which require further changes, being the mandatory use of other comprehensive income for discount rate changes and the accounting for participating contracts (including the accounting for the contractual service margin for with profit contracts). Addressing these two areas will reduce the complexity and lead to a workable final standard.

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

ED/2013/7 INSURANCE CONTRACTS

Memorandum of comment submitted in October 2013 by ICAEW, in response to the International Accounting Standards Board (IASB) exposure draft *2013/7 Insurance Contracts,* published in June 2013.

Contents **Paragraph**

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the exposure draft *Insurance Contracts,* published by the IASB on 20 June 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 a monthly magazine FS Focus.

MAJOR POINTS

A complex new standard

5. We support the IASB in their continued perseverance towards a new standard, which we feel is within reach, as long as the serious points raised below are properly addressed.

6. We believe that the revised exposure draft proposals increase the complexity of implementation by insurance companies and for understanding of the financial statements by their users, particularly for life insurers. For example, a simpler solution for participating contracts and other comprehensive income (OCI) needs to be developed to reduce systems changes for life insurers which do not lead to a marginal benefit in information reporting efficiency or clarity. We strongly recommend that the IASB reduce this complexity as we suggest in this response. In addition, the IASB should make its intentions clear on some of the detailed application as without sufficient clarity it is likely that inconsistent practices will develop. Further consideration is given to complexity in our answer to question 7.

Other comprehensive income

7. We believe a fair value through income statement approach should be the default mechanism for assets backing insurance contracts and insurance liabilities and disagree with the IASB's OCI approach. Under the model proposed by the IASB the income statement will not provide meaningful information on many types of insurance products for which an integral part of the operating performance is derived from investment earnings. If the IASB considers that OCI approach is appropriate for certain types of contracts, the standard should allow movements to be taken to OCI only for those types of contract where the performance reporting is better served by such a treatment. Please refer to our answer to question 4 for further consideration in this area.

Participating contracts

8. The "mirroring approach" is too complex to implement in practice. We advocate a single discount rate for liabilities using the building block approach as an alternative. A clearer definition of services under participating contracts is needed, along with further consideration of the impact on profit recognition.

9. In addition, for participating contracts, we have a particular concern that the ED gives rise to significant difficulties in measurement of the contractual service margin for with-profit products. These types of products are a very significant part of the business of the UK life industry and widely written around the world. Our proposals would align the accounting for these products with that envisaged for other participating business so that profits are recognised as earned. Please refer to our answer to question 2 for further detail.

Interaction with IFRS 9

10. We are concerned about the process and timing for the mandatory application date for IFRS 9 and the insurance contracts standard given their significant interaction. We sympathise that there is political pressure for implementation of IFRS 9 but consider it essential that entities issuing insurance contracts have the ability to adopt both standards at the same time. Accounting for investments is fundamental to understanding an insurer's financial position and performance. To have two significant changes in accounting for insurers in a short space of time will make understanding the financial results extremely difficult for users, where even in ideal circumstances there are likely to be difficult transitional issues. In addition, while insurers could adopt IFRS 9 based on the proposed insurance standard, the linkage between the accounting for assets and liabilities is so intertwined that insurers would need to be able to revisit the accounting for financial assets. Please refer to our answer to question 5 for further detail.

An untried and tested model

11. As it stands, the exposure draft proposals are significantly different from existing practices. New accounting practices often cause problems, and there is significant concern about the implementation of a new untried and untested standard, particularly for life insurers. Inherent in any unproven financial reporting practices there is a risk that the market could react negatively to potentially unreliable and unexplained volatility in results. This is further considered in our answer to question 6b.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

Q1: Question 1—Adjusting the contractual service margin

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if:

(a) differences between the current and previous estimates of the present value of future cash flows related to future coverage and other future services are added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative; and

(b) differences between the current and previous estimates of the present value of future cash flows that do not relate to future coverage and other future services are recognised immediately in profit or loss?

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

12. We agree with the proposal that changes in the present value of future cash flows should be recognised against the contractual service margin, subject to the margin not being negative. If the margin becomes negative, any further changes in liability movement are recognised in the income statement.

13. The standard should also specify whether losses recognised in the income statement are subsequently reversed through the income statement when the contract becomes profitable or whether the subsequent favourable changes are recognised as a contractual service margin. Whilst we believe the reversal of losses through the income statement may be more operationally challenging, it is the more appropriate treatment.

14. We also believe that changes in the risk adjustment related to future coverage and other future services should be recognised against the contractual service margin. Recognising these changes in the risk adjustment against the margin is consistent with adjusting the margin for changes in future cash flows so that the contractual service margin is a measure of the unearned profit on the contract.

15. For many long-term contracts, the amortisation of the contractual service margin will be a fundamental driver of profit recognition. We agree with the principle of amortising the contractual service margin over the coverage period in a systematic way that reflects the provision of services under the contract. However, we are concerned that, without further guidance, there will be significant diversity in the methods used to amortise the margin, even for similar contracts.

16. Appropriate profit recognition is critical to the success of the standard. It is therefore important that there is a widely understood definition of services. For example, for protection products it is possible to argue for a straight line basis of amortisation as there is a stand ready obligation over the life of the contract or that profit should be recognised on release of risk. These two methods lead to very different patterns for recognition of profit. Certainty in application of the standard will be vital for users and auditors and to ensure that there are no abuses that allow inappropriate acceleration of profit recognition. The standard needs to contain clear guidance in this area.

17. Unlocking the contractual service margin presents a number of practical challenges. For example, when changing assumptions about future cash flows there are likely to be impacts on the total liability that arise from changes in the discount rate. It is not clear how the impact of changes in the discount rate on the future cash flows should be accounted for. In this case the contractual service margin could either be adjusted by the change in future cash flows at the locked in rate, or by the change in future cash flows at the current period discount rate. The required treatment should be clarified.

18. It is not always clear in practice which movements in the insurance contract liability should be offset against the contractual service margin. For example paragraphs B68(d) and B68(e) appear to present conflicting approaches to the treatment of changes to insurance contract liabilities resulting from changes in the value of underlying items. Greater clarity of the principles in the final standard would be helpful.

19. Operationally, the unlocking requirements are likely to be complex to apply. For example, if the contractual service margin is set at a portfolio level, that portfolio may contain some contracts where the present value of fulfilment cash flows are negative and some that are positive. If the contractual service margin is limited to zero, allocating the contractual service margin to units of account below the portfolio might not make sense. However, allocation below portfolio might be necessary in order to amortise and track the required information for reporting purposes. While we understand that insurers may have to live with this complexity, we would encourage the IASB not to provide guidance on measurement and reporting that is too prescriptive if that might result in additional unnecessary complexity.

Q2: Question 2—Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items

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

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

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

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

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

(ii) changes in the fulfilment cash flows that are expected to vary indirectly with the returns on the underlying items would be recognised in profit or loss; and

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

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

<u>General points</u>

20. We do not believe the current proposals for accounting for participating contracts are appropriate. There is significant complexity in the proposed accounting requirements which will not only create implementation difficulties but may not produce meaningful results where the cash flows are interlinked.

21. With regard to the measurement of best estimate liabilities, the IASB's proposals based on the "mirroring" principle are too complex to introduce in practice. In particular, the need to bifurcate cash flows is not appropriate as cash flows linked to asset returns are inter-related with the other cash flows arising from the contract. The decomposition of cash flows in accordance with paragraph B86 maximises the extent of mirroring but does not reflect the economics of the contract and results in the recognition of options that are not consistent with the pricing of the contract or the way contracts are managed. The IASB needs to take account of the nature of many participating contracts which have embedded guarantees where the cash flows of the product are interlinked. We recognise that the need to value options and guarantees embedded in participating contracts is not easy.

22. In our opinion the IASB proposals for contracts with asset-dependant cash flows should be based on the measurement principles of best estimate liabilities (including the valuation of options and guarantees) using the building block model with a single discount rate and without decomposing the contract cash flows. There are a number of strands that require consideration in determination of projected earned rates and discount rates in such a model. In addition to giving consideration to extrapolation at the long end of the yield curve and the basis for determination of the risk free rate component these include:

- the degree of inclusion of long-term asset risk premia, such as for corporate bonds, equities and investment property, and

- the approach to setting equity volatility assumptions

In considering the appropriate discount rate for such a model for participating contracts the IASB needs to have regard to the valuation of options and guarantees.

<u>Services provided in participating contracts</u>

23. A participating contract may contain a package of services, including insurance coverage and other services, such as asset management, guarantees and management of market volatility (for example, by crediting bonuses that reflect a longer term rate of return on assets in a with-profits fund).

24. In our view, the exposure draft does not deal adequately with defining the array of services provided under a participating contract. Defining the services would help in determining an appropriate method for recognising the profit from participating contracts that reflects the services provided.

25. Within a participating contract, the insurer's share of returns on underlying items represents the remuneration for the package of services provided over the life of the contract. For a unit-linked contract, this remuneration is earned through the fees that are charged by reference to the fund value. For a with-profits contract, remuneration includes the shareholders' share of bonuses that are added to policyholders' benefits. These are therefore a component of the profits in the contract that should be recognised as the services are provided. In a with-profits contract, a number of these services are provided over the term of the contract, such as smoothed returns and guarantees.

26. Changes in this component represent changes in the profitability of the contract. We believe that the proposals should reflect the change in the total profitability of the contract by adjusting the contractual service margin for the movements in assets backing the unearned profit so that profit is recognised as services are provided, rather than being recognised immediately.

27. We are concerned that the exposure draft proposals for participating contracts result in the insurer's share in a participating fund being recognised in a similar manner to, say, a 10% interest in a mutual fund containing financial assets, with movements being recognised immediately in profit or loss. We believe this does not reflect the substance of these contracts. Accounting for the movement in the value of the underlying items for these contracts immediately in the income statement without adjustment to the contractual service margin does not reflect the obligation to provide future services over the term of the contract.

28. We encourage the IASB to reconsider both how profits are measured for participating contracts and how these are recognised in profit or loss in a manner that reflects the services provided. A key aspect of this will be to identify explicitly the types of services provided under participating contracts so that insurers can ensure they recognise profits on those services in the appropriate period.

Q3: Question 3—Presentation of insurance contract revenue and expenses

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

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

29. We believe that financial statements should present information about revenue and expenses from insurance contracts in alignment with the requirements of the revenue standard. We consider that the proposals on revenue and expenses will improve the comparability of insurers' financial statements, but there are significant costs and risk associated with these changes that have not been assessed fully by either users or preparers at this stage.

30. We support the proposals in the exposure draft as they relate to short duration contracts. For long duration contracts, the measure for revenue will be unfamiliar to users and hence care must be taken that the benefits of a measure of revenue that is consistent with other industries outweigh the costs associated with educating users and upgrading reporting systems. Overall we support a consistent measure for revenue based on the IASB proposals.

31. We point out that the industry has worked hard to provide users with the information they require through the use of non-GAAP measures. Many insurers will continue to present their own measure of volume (such as annual premium equivalent and present value of new business premiums) in order to provide users with comparable information, and this is likely to persist for a number of years after a new insurance contracts standard comes into effect.

Q 4: Question 4—Interest expense in profit or loss

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

(a) recognising, in profit or loss, the interest expense determined using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows; and

(b) recognising, in other comprehensive income, the difference between:

(i) the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date; and

(ii) the carrying amount of the insurance contract measured using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows?

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

<u>Other comprehensive income</u>

32. We disagree with the IASB's model and believe that a fair value through income statement approach should be the default mechanism for assets backing insurance contracts and for insurance liabilities. We do not believe that the income statement will provide meaningful performance information on many types of insurance products where an integral part of the operating performance is derived from investment earnings.

33. Under the proposed model we cannot see the justification for mandating that a significant part of the performance be taken to OCI. If the IASB considers that the OCI approach is appropriate for certain types of contracts, the standard should allow movements to be taken to OCI only for those types of contract where the performance reporting is better served by such a treatment. In addition we recommend that the option to select the income statement approach should be irrevocable at the portfolio level on inception of the portfolio or on transition.

34. For many insurers who write long-term business, the linkage between assets and liabilities is fundamental to how the business is managed, as well as how it is analysed by users. We understand that the IASB does not want accounting for assets to be within the scope of the proposed insurance contracts standard but within the relevant standards such as IFRS 9, IAS 39 or IAS 40. However, it is important that the proposed accounting for insurance contracts does not introduce accounting mismatches as a result of inconsistent accounting treatment for insurance liabilities and the associated assets. The mandatory use of OCI for changes in discount rates create a number of issues as outlined in the following paragraphs

35. For contracts where the contractual cash flows are substantially matched through the use of assets in categories where a fair value through the income treatment is mandated under IFRS 9, they will appear unmatched under the IASB's model. We note that the IASB's "mirroring" approach goes some way towards meeting this concern for certain participating contracts but do not believe the proposals articulated in the exposure draft are the right way to proceed. A fair value through the income statement approach without constraint would be a more appropriate basis for accounting than mirroring, which would only apply to certain contracts.

36. We therefore suggest the IASB revert to the proposal in the 2010 exposure draft to recognise all changes in discount rate immediately in the income statement, rather than in OCI. The current accounting for insurance in the UK uses this approach with the majority of associated assets being recognised at fair value through the income statement. While this does introduce volatility in the income statement, some of this volatility is due to real economic mismatches between the assets and liabilities, which we believe it is appropriate to recognise in the income statement.

37. Whilst market movements will cause short-term volatility, UK insurance companies have successfully made use of a normalised operating profit measure to explain the underlying results of the business to analysts. We envisage that some insurers will wish to continue publishing operating profit on similar lines after adoption of the insurance contracts standard. Under the IASB's current proposals however, this will only be possible if insurers ignore the result reflected in the income statement and instead analyse the comprehensive income. This cannot be a desirable outcome.

38. Many insurers also purchase or use derivatives to economically hedge the risk within insurance contracts and may hold other categories of investments which will not be measured at fair value through OCI. Recognising changes in interest rates in OCI for these contracts will introduce significant artificial volatility in the income statement. We emphasise that the scale of mismatches arising from interest rate derivatives would produce meaningless results, and that such outcomes would reduce the understandability and therefore credibility of insurers' financial statements.

39. The benefits of an income statement default approach would be:

- A conceptually sound presentation showing the entire performance of the business with all movements being recognised in the primary income statement.

- Reduced complexity, as preparers would not be required to split the discount rate and the results would be simpler to understand. This would be of particular benefit to writers of non-life insurance contracts who would not have to capture and retain discount rates at the dates policies were written.

Interest Expense

40. We do not support segregation of interest expense and believe that all of the interest expense associated with insurance contracts should be recognised in profit or loss, except in certain limited circumstances, for the following reasons:

- The analysis of interest expense between profit or loss and other comprehensive income does not provide relevant information about underwriting performance because insurers will likely define underwriting profit to exclude interest expense;

- The requirement to analyse between these two components introduces significant additional complexity to the model, requiring entities to compute and record insurance liabilities on two different bases;

- The requirement complicates the transitional adjustment and accounting for contracts acquired in business combinations or portfolio transfers.

- The current proposals under IFRS 9 would require certain assets to be accounted for at fair value through the income statement. These would include equities, derivatives (including interest rate derivatives) and some debt instruments. In addition, investment property is accounted for at fair value through profit or loss. Many insurance liabilities will not meet the linking criteria for 'mirroring'. In these cases, requiring interest expense to be allocated between profit or loss and other comprehensive income will create accounting mismatches where assets and liabilities are matched economically.

Q5: Question 5—Effective date and transition

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

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

41. We agree with the simplifications for transition included in the exposure draft.

42. As we have previously communicated in respect of IFRS 9, we urge the IASB to consider a mechanism for insurers to implement IFRS 4 Phase II and IFRS 9 concurrently. This will avoid the difficulties in explaining multiple changes which would arise should insurers have to implement IFRS 9 in advance of IFRS 4 Phase II.

43. Should insurers be able to implement both IFRS 4 Phase II and IFRS 9 at the same time, the IASB should consider the requirement for restating comparatives under IFRS 4 Phase II, which is not required for IFRS 9. We would urge the IASB to come to a pragmatic solution in this area as we understand there are concerns about the practical ability to restate comparatives under IFRS 9. Transitional issues are likely to be very complex in any case, without this additional burden.

44. We believe that the costs and impact of implementation are currently underestimated. We encourage the IASB to be mindful of the numerous issues that arose during the implementation of IFRS 4, a standard which did not make any major changes to the valuation of liabilities. It is much more likely that issues arising from the implementation of IFRS 4 Phase II will be felt more acutely, and potentially have more severe consequences in practice.

Q6: Question 6—The likely effects of a Standard for insurance contracts

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

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

(a) the transparency in the financial statements of the effects of insurance contracts and the comparability between financial statements of different entities that issue insurance contracts;

45. While greater comparability between insurers' financial statements may result from the new standard, the current proposals are complex and it is arguable whether they will lead to greater transparency. The new standard could be more complex and therefore difficult to understand than the current accounting that is used in some cases. We would also emphasise that consistent interpretation will be required in order to achieve comparability. There have been previous industry standards, such as embedded value, where varying interpretations have eroded the confidence of the users as the published numbers have not been comparable. We would urge the IASB to work with preparers and auditors prior to finalising the standard to ensure that there will be consistency in its application. .

46. The 2013 exposure draft introduces much more complexity than the previous version. We would recommend simplification in the following areas:

- Use of a single discount rate in the measurement of insurance contracts by taking all discount rate movements through the income statement
- No bifurcation of cash flows for discretionary participating contracts
- No disclosure of confidence interval for risk adjustment

(b) the compliance costs for preparers and the costs for users of financial statements to understand the information produced, both on initial application and on an on-going basis.

47. We are concerned about very large implementation costs, but believe the benefits of international comparability for the first time which will be brought by a new international insurance contracts standard will, in time, outweigh these costs.

48. It is difficult to give meaningful comments on the costs of implementing a new standard for insurance contracts, but we expect them to be significant. Until the fundamental concerns noted in this response (the current unsatisfactory solution for participating contracts and the mandating of the use of OCI in particular) are addressed, we do not feel there will be a sufficient improvement in information presented by the new accounting standard to justify the extensive costs of transition and implementation. Any efforts to simplify the proposals and provide reasonable guidance will be likely to reduce the costs of implementation.

49. There is a risk that the proposed approach is too complex and the failure of a consistent approach to valuing assets and liabilities and the presentation in the income statement could undermine the positive features of the building block approach and the current value model for valuing liabilities.

50. As it stands, the exposure draft proposals are significantly different to existing practices. New accounting practices often cause difficulties in some cases, but we feel that the current proposals will be particularly problematic for life insurers. We would like to point out that as the insurance industry and accounting profession remains focussed on key conceptual issues in relation to the proposals, there has been less consideration of the detailed proposals and measures outlined. Should the standard be set to be applied in its current form, we would expect there to be issues arising with the detail as the new principles are put into practice.

51. There is significant concern about the implementation of a new standard that is untried and untested, particularly for life insurers. We feel it is important to point out that with any unproven financial reporting practices there is a risk that the market could react negatively to potentially unreliable and unexplained volatility in results. This risk is increased in Europe by the likely change in regulation caused by Solvency II where there may be potential for cross over in the implementation periods.

52. To help deal with these concerns we propose that a review draft of the standard is issued on the following timescale to finalisation and implementation:

- A review draft of the standard be published following redeliberation
- A final standard be published two years after the review draft
- Mandatory implementation to follow two years from the final standard

53. In the intervening periods we would encourage the IASB to maintain an open dialogue with the industry and the accountancy profession as issues may take two balance sheet cycles to emerge. The IASB and IFRIC need to be prepared to correct or give guidance on accounting issues or anomalies as they arise. A specialist IFRIC subcommittee may need to be convened to assist in this, as we are not confident that there is the relevant level of technical insurance knowledge within the committee. We would suggest that experts from industry and practice be selected for this purpose.

Q7: Question 7—Clarity of drafting

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

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

54. We have included points regarding drafting within the attached appendix where we also refer to other small points of a similar nature.

Appendix 1

Mutual insurers

It will be important for the IASB to acknowledge and accommodate that mutual shareholders do not have the same needs as company shareholders and that the exposure draft as written gives little or no consideration to the position of mutual insurers; in particular, to how mutual capital (or working capital) might be presented and movements in it period to period.

Policyholders are viewed as “creditors” for all entities by default as a result of the corporate/proprietary company model that the IASB uses as a basis.

With regard to specific implementation concerns, the considerable complexity in the new proposals (for example splitting the contractual service margin and risk margin from cohorts of policies, and tracking them over time), will require extensive investment in systems and management/actuarial time to interpret which may be of little benefit if there is no equity in the financial statements for such entities.

Discount rate

We agree that insurers should be able to choose a top-down or bottom-up approach in determining the discount rate. The requirements for the top-down approach in paragraph B70(a)(iii) indicate that while there may be remaining differences between the liquidity characteristics of the insurance contract and the liquidity characteristics of the assets in the portfolio, an entity applying the top-down approach will not need to make adjustments to eliminate these, whereas the example in paragraph B74(a) shows that a ‘market premium for liquidity’ has to be eliminated from the total bond yield. Given that the example seems to contradict the guidance, we suggest deleting the reference to market premium for liquidity.

UK-style with-profit contracts

Paragraph B66(k) notes that payments arising from existing contracts that provide policyholders with a share in the returns on underlying items are included in the fulfilment cash flows, regardless of whether those payments are made to current or future policyholders.

This potentially implies that if said ‘existing contracts’ terminate or lapse, any amounts arising from those contracts but expected to be paid out to future policyholders would be recognised in equity, but subsequently recognised in the insurance contract liability when new contracts are initiated. We do not believe this was the Board’s intention.

Paragraph B66(k) could be clarified by referring to the expectation for ‘existing and prior contracts’ cash flows to be included in insurance contract measurement regardless of whether they arise from current or past contracts.

Portfolio transfers – paragraphs 43 – 46

There are potential complexities where acquiring both live and in run off contracts concerning profit/loss recognition. This may be treated differently by different entities and different contract types and prevent investors from having a clear view of performance.

The requirements are unclear as to whether an insurance contract in its settlement period that is acquired through a portfolio transfer should be treated as the remainder of a pre-existing contract that is in its post coverage period or as a new insurance contract which is at the beginning of its coverage period.

In the latter case, the insured event would be the discovery of the ultimate cost of those claims and a contractual service margin would be set-up in accordance with paragraphs 18(b) and 28.

However, if the contract is treated as a pre-existing contract, a contractual service margin cannot be recognised as the contract is in its settlement period.

We believe contracts acquired in a portfolio transfer are akin to acquiring new insurance contracts and therefore should be re-assessed at the acquisition date to determine whether they transfer significant insurance risk and qualify for the premium allocation approach or building block model. We note that some insurance contracts that qualified as premium allocation approach before the portfolio transfer may not qualify for premium allocation approach after the acquisition.

We believe that contracts acquired in a portfolio transfer should be treated as new insurance contracts if they are acquired in the settlement period and the insured event is the discovery of the ultimate cost of those claims noted in paragraph B5. This implies that these contracts have a coverage period that ends upon the discovery of the ultimate cost of those claims. As such more clarity is needed in the final standard regarding the coverage period for insurance contracts that cover events that have already occurred but whose financial effect is still uncertain.

Premium allocation approach - paragraphs 38 – 40

Clarification is needed around received vs. receivable in paragraph 38 (a) (i) as the language has changed from the previous exposure draft. However, we feel that, once an insurer is 'on risk', this should be recognised, though if receivables are not shown, there are potential cash management concerns.

We believe that showing a single measure on the balance sheet as opposed to assets and liabilities is potentially misleading as it does not give investors adequate information to make decisions based on the position of the company or make judgements about asset quality amongst other factors.

Contract boundaries - paragraph 23

This is problematic for life insurers in terms of defining when the 'right or practical ability to re-assess the risks' applies. With unit linked contracts the duration of the insurance risk is not necessarily the same as the duration of the contract and it must therefore be decided when the insurance contract starts or ends.

Confidence level disclosures

We do not believe confidence level disclosures should be required. There are several ways in which such assessments can be made and expressed and there is significant subjectivity in the results produced. This can potentially lead to misunderstandings between preparers and users of what the disclosed amount precisely means. In addition there can be significant additional cost in calculating such values.

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