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Organización Internacional de Comisiones de Valores
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Organização Internacional das Comissões de Valore

December 13, 2010

Exposure Draft: Insurance Contracts
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: Exposure Draft: Insurance Contracts

Dear IASB Members:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (Standing Committee No. 1) thanks you for the opportunity to provide our comments regarding the International Accounting Standards Board (IASB or the Board) Exposure Draft: *Insurance Contracts*.

IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting standards, including rigorous application and enforcement. Members of Standing Committee No. 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect a general consensus among the members of Standing Committee No. 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

General Observations

While we support the overall direction and objective of the project, we have provided some feedback on certain aspects of the proposal where we have some concerns. In particular, we believe that considerations relating to transition, effective date and coordination with IFRS 9 are of critical importance as discussed in our responses to Questions 17 and 18 below, and views in this area are generally consistent among our members. Although views vary among members with respect to discount rate, risk adjustment vs. composite margin and presentation, we believe these issues are equally important.

We encourage the Board, as part of its deliberations, to continue to work with the FASB to develop a fully converged global standard for insurance contracts. Our comments below address the specific questions posed by the Board where we have concerns.

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Responses to the Board's Questions

Question 1 – Relevant information for users (paragraphs BC13–BC50)

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?

Question 2 – Fulfilment cash flows (paragraphs 17(a), 22–25, B37–B66 and BC51)

- 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?

SC1 members agree that, overall, the proposed measurement model will produce relevant information that will help users of an insurer's financial statements to make economic decisions, and that the model would result in improved financial reporting under IFRS. We support the overall measurement approach based on the present value of the fulfillment cash flows, and agree with the principle in the Exposure Draft that no day one gain should be recognized.

Some members are concerned as to how the building block model would be applied to contracts with low frequency, high severity types of insured events (e.g., – catastrophe coverage). These members note that the proposed model appears to have been developed primarily to address the accounting treatment for long-duration life insurance contracts, where the insured events will always occur, subject to uncertainty regarding the timing of cash outflows, as opposed to short-duration contracts with a catastrophe type component, for which the timing and amount of losses (if any) is highly uncertain. These members encourage the Board to conduct outreach to ensure that the considerations of all types of insurers have been appropriately considered, including whether the application guidance in paragraphs B37-B41 is sufficient.

Question 3 – Discount rate (paragraphs 30–34 and BC88–BC104)

- 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 fulfillment cash flows should not reflect the risk of non-performance by the insurer?

Some SC1 members agree that the discount rate should be based on the characteristics of the liability rather than the assets backing the liability, unless there is a contractual link between the underlying assets and liabilities. These members note that similar arrangements exist in other industries where specific assets and liabilities are managed in conjunction with one another without resulting in any accounting linkage. Other members believe that insurers should be allowed to use an asset-based discount rate (e.g., based on specific company assets, or a high grade Corporate Bond rate), to appropriately reflect the business model of insurers. These members believe that since the earnings on the invested assets are integral to the pricing of the contracts and the resulting premium stream, this should be captured in the measurement of the insurance contract liability.

If the discount rate is adjusted for liquidity, more specific guidance about how the adjustment would be measured is needed. While some members believe that the conceptual basis of the liquidity adjustment is valid, some of these members are uncomfortable with the proposed liquidity adjustment being required since there is no consensus on how it would be measured. Other members believe that the conceptual basis of the liquidity adjustment is flawed since it is inconsistent with the overall fulfillment value measurement model, and that any adjustment for illiquidity would be arbitrary.

Some members believe that the discount rate for insurance liabilities should closely reflect the insurer's business model. In particular for long-duration insurance contracts, these members believe that profit or loss reporting should avoid short-term volatility which could occur from very small shifts in interest rates on a large volume of business. In addition, they believe that the discount rate should be consistent with other standards such as IAS 19. These members believe that using a market rate such as a high quality corporate bond which includes credit risk for the liabilities, and reporting the difference between an insurer's expected rate and the market rate in other comprehensive income would better reflect the business model.

**Question 4 – Risk adjustment versus composite margin
(paragraphs BC105–BC115)**

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.

**Question 5 – Risk adjustment
(paragraphs 35-37, B67-B103 and BC105–BC123)**

- 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 fulfillment 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?

**Question 6 – Residual/composite margin
(paragraphs 17(b),19–21, 50–53 and BC124–BC133)**

- 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?

Some SC1 members support a separate risk margin as proposed in the ED, but are concerned with the limited number of specified measurement techniques which would appear to preclude the use of improved techniques that may be developed in the future, as well as the apparent bias toward the confidence level approach. In addition, some members believe that the residual margin should be allowed to be used as a buffer to absorb adverse changes in projected cash outflows, similar to the treatment under the revenue recognition model.

Other members support the composite margin favored by the FASB, due to uncertainty regarding the measurement techniques and related audit considerations, increased potential for manipulation of results, and inconsistency of the risk margin concept with the overall fulfillment value approach.

**Question 7 – Acquisition costs
(paragraphs 24, 39 and BC135–BC140)**

- 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?

We agree that incremental acquisition costs should be included as part of the present value of the fulfillment cash flows. Some members believe that the level of measurement for acquisition costs should be at a portfolio level rather than an individual contract level, since this would be consistent with the overall model as well as the manner in which insurers manage their business. These members believe that more specific guidance should be provided regarding whether allocations of internal costs could be included in incremental acquisition costs as defined by the proposed standard. These members are concerned that a potentially unintended consequence of the proposed treatment of acquisition costs may be that insurers will change their business practices towards more outsourcing in order to be able to

include certain costs as part of the fulfillment cash flows. Other members believe that measurement of acquisition costs at the individual contract level is appropriate, primarily because this would ensure that costs relating to unsuccessful contract acquisition efforts are not inappropriately reflected in the measurement of the insurance liability.

These members also believe that consistency of the definition of acquisition costs between the proposed model and other projects, including IFRS 9 and revenue recognition, should be maintained.

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?

We would support a modified measurement approach, provided that such an approach would be less onerous for preparers without compromising the integrity of the reported information. However, some members question whether the alternative approach for short-duration contracts represents a substantive simplification. In addition, some members believe that this approach should be permitted rather than required.

Other members believe that the guidance on short-duration contracts should be expanded to clarify how the alternative measurement model would be applied, and how it would interact with measurement of the post-claims liability under the building block approach. These members believe that limited consideration appears to have been given to how the proposed model would be applied to various types of short-duration contracts, particularly those which are not subject to predictable historical loss trends.

Question 9 – Contract boundary principle

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?

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?

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?

We agree with the Board's conclusions regarding contract boundary, participating contracts, and definition and scope, except as discussed below.

We believe that current financial guarantee accounting guidance is insufficient, resulting in some contracts being accounted for under IAS 39/IFRS 9, some under IFRS 4 and others under IAS 37. This gives rise to a concern about potentially inconsistent accounting between some types of insurance contracts and financial guarantee contracts purely as a consequence of their legal form rather than the substance of the contract.

While the Board has attempted to address this issue by scoping such contracts into the Exposure Draft if they contain significant insurance risk, we note that the primary purpose of many financial guarantee contracts that would be scoped into the Exposure Draft remains to transfer credit risk. Accordingly, we believe that the Board should provide expanded application guidance to clarify how entities would account for financial guarantee contracts under the proposed standard. In doing so, the Board should ensure that the required measurement and accounting does not result in the possibility for significant arbitrage between IAS 39/IFRS 9 and the Exposure Draft for contracts with similar terms but a different legal form.

Question 12 – Unbundling

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?

We agree with the proposed unbundling principle, but believe that application guidance should be provided to illustrate how the principle would be applied.

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 information regarding premiums and claims is useful to financial statement users. Some members would prefer this information to be presented on the face of the income statement, noting that such presentation would minimize potential inconsistency between the presentation of short-duration and long-duration contracts.

As recommended by some members in response to Question 3, presentation of short term volatility from a shift in discount rates between the market rate on insurance liabilities and an insurer's expected rate could be presented in other comprehensive income which would reverse on fulfillment or lapse of the contracts.

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.

We agree with the proposed disclosure requirements in the Exposure Draft. In addition, members who believe that short term volatility from changes in discount rates should be presented in other comprehensive income believe that the components of the insurer's expected rate on insurance liabilities and the movement in other comprehensive income should be explained.

Question 15 – Unit-linked contracts

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

Some SC1 members agree with the proposed treatment of unit-linked contracts. Some members disagree with the proposed treatment of unit-linked contracts, with the view that assets and liabilities for unit-linked contracts should not be consolidated.

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?

Some members agree with proposed requirements for reinsurance contracts. Some members question why an insurer should be allowed to recognize a gain on a reinsurance contract if they were unable to recognize a gain on the original contract, noting that this could create the potential for abuse through using reinsurance to unlock embedded gains, potentially even for contracts where a loss was recognized at the original contract inception. These members note that the conceptual basis for recognizing gains on reinsurance contracts appears to be that the accounting should mirror the accounting for the original insurance contract, although the transactions may be recorded at different amounts. However, the same rationale would not necessarily apply in situations where the cash flows of the reinsurance contract differ from the cash flows under the original insurance contract, which is the case for a significant portion of reinsurance agreements. Accordingly, these members believe that the Board should more fully deliberate the conditions under which reinsurance gains could be recorded.

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.

Question 18 – Other comments

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

We are uncomfortable with the proposed transition requirements, in particular the elimination of embedded contract profits, since this will result in a lack of comparability between contracts in place at the transition date and new contracts that are accounted for under the proposed measurement model. The magnitude of this issue is increased for long-term contracts since many of these contracts will remain in place for long periods of time subsequent to transition. This issue may be addressed through an IAS 8 type approach, with retrospective application from the earliest date practicable.

We believe that the effective date of the insurance standard should be aligned with IFRS 9 to the extent practical, and that the coordination and interplay of various issues between the insurance standard and IFRS 9 needs to be more comprehensively evaluated. Some members also believe that the definition of a portfolio should be conformed to that in IFRS 9, and since discount rates are discussed in various standards, that a consistent approach should be applied across all standards. Lastly, since the proposed measurement model will represent a fundamental change to historical practices for most insurers, the Board should conduct outreach to ensure that the mandatory effective date will provide sufficient lead time for insurers to make the necessary changes to their internal reporting systems and processes to accommodate the proposed requirements.

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We appreciate your thoughtful consideration of the comments raised in this letter. If you have any questions or need additional information on the recommendations and comments that we have provided, please do not hesitate to contact me at 202-551-5300.

Sincerely,



Julie A. Erhardt
Chairman

IOSCO Standing Committee No. 1