Date

29 November 2007

Le Président

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Dear Sir David,

Re: IASB Discussion Paper Preliminary Views on Insurance Contracts

General

1. FEE (Fédération des Experts Comptables Européens, European Federation of Accountants) is pleased to submit its comments on the IASB Discussion Paper Preliminary Views on Insurance Contracts (the DP).

2. FEE as a founding organisation of EFRAG will also contribute to the EFRAG consultation process. However, we are in the process of finalising our comments on the EFRAG preliminary comments (as issued on 3 October 2007). As our comments on the EFRAG draft letter may also be of interest to you, we will send them to you once finalised.

3. We welcome the publication of the DP given the diversity in accounting practices and the need for improvement in the way insurance contracts are accounted for. We see this as a step forward in the development of a much-needed accounting standard. IFRS 4 has started to pave the way as an interim standard and has resulted in some limited improvements in accounting. We feel that the DP provides a basis for developing a comprehensive high quality International Financial Reporting Standard for Insurance Contracts subject to our comments in this letter.

4. Below we are providing you with our main comments. Our responses to the questions for respondents of the DP are presented in Appendix 1 to this letter.

Parallels with other projects

5. The publication of the DP raises a number of issues that are separately addressed in other current projects and may have implications for the general directions these projects may take. These include:

   - The objectives and qualitative characteristics of financial statements or the definition of an asset in the discussion on the financial reporting framework as part of Phase B of the conceptual framework project;

   - Issues related to IAS 39, in particular on measurement of financial instruments where there is no active market;

   - Revenue recognition and performance measurement.

These implications need to be carefully considered since the standards together with the Framework should together form a consistent, coherent and comprehensive set of standards.

6. However, the process of developing this international accounting standard for insurance contracts should not be further delayed. We feel that the creation of a comprehensive standard for insurance contracts should be in advance, since insurance contracts is one of the areas of accounting without a proper international standard currently. However the direction of those other developments should be clear before the final standard on insurance is issued.

Lack of active markets for Insurance Contracts

7. There are no active markets for rights and obligations under insurance contracts as defined in the discussion paper. We believe that two consequences of this raise particular concerns:

   - Lack of clarity over the cash flows that should be considered for the measurement of insurance liabilities and the basis of these cash flows. In particular, we consider that a settlement value concept would be more appropriate than the concept of transfer value, as a transfer to third party is for nearly all known circumstances not a realistic alternative to a fulfilment of the obligations with the policyholder or other beneficiaries;

   - Uncertainty and subjectivity with respect to the assumptions about what a third party would require for assuming the risks and obligation under insurance contracts. There are inherent limitations over the reliability of any measurement basis approximating a market basis as the objectivity of the information used for this purpose can be questioned when, at best, only a limited observable market price (i.e. what a market participant would require in a transaction) is available.

Inconsistencies

8. There are apparent inconsistencies between the concept of the current exit value as presented in the DP and the limitations to enforceable rights, legal and contractual obligations on one side and what price a market participant would set in a real transfer of a book of insurance policies. That inconsistency becomes obvious in the proposed treatment of policyholder behaviour and participating contracts.

Subsequent measurement

9. There is a need to elaborate further on subsequent measurement for insurance liabilities, as currently this area is not discussed in detail in the DP. Any decision on subsequent measurement needs to be consistent with initial measurement, in order to avoid simply deferring any problems arising from the uncertainty on initial measurement until subsequent measurement periods.

We would be pleased to discuss any aspect of this letter that you may wish to raise with us.

Yours sincerely,

Jacques Potdevin
President

Ref: INS/JP/LF-EF

APPENDIX 1

Responses to Questions for respondents of the Discussion Paper

Question 1
Should the recognition and derecognition requirements for insurance contracts be consistent with those in IAS 39 for financial instruments? Why or why not?

Recognition:

We agree with the IASB proposal to recognise insurance contracts when the insurer enters the contract by issuing a new contract or for contracts automatically renewed if not cancelled, on expiry of the cancellation notification period. This is consistent with the treatment of financial instruments and reflects that the insurer may be exposed to risk of adverse deviation and error even before the period of insurance cover commences.

However, we note that insurance contracts are typically a combination of financial, service and risk transfer elements and the proposal regarding the service element is inconsistent with the current treatment on revenue recognition for other service contracts and raise important implications. We recommend the latter issue is given a priority to avoid accounting arbitrage by having different accounting concepts in place for similar transactions.

Derecognition:

In principle, we agree that the derecognition criteria should be those for financial instruments, i.e. when obligations under contract are discharged, cancelled or expired. However the application and implementation guidance in IAS 39 may not be adequate in the special circumstances of insurance contracts.

Question 2
Should an insurer measure all its insurance liabilities using the following three building blocks:
(a) explicit, unbiased, market-consistent, probability-weighted and current estimates of the contractual cash flows,
(b) current market discount rates that adjust the estimated future cash flows for the time value of money, and
(c) an explicit and unbiased estimate of the margin that market participants require for bearing risk (a risk margin) and for providing other services, if any (a service margin)?
If not, what approach do you propose, and why?

General:

In general, we agree with the approach of using the 3 building blocks. We do not consider that it should be necessary to use the building blocks if there is a market price for elements that replicates the liability (mainly for financial instruments, e.g. unit linked). We do not consider that the third building block should be split between service and risk components but should be treated as one margin. The IASB should clarify its thinking on this point.

On building block (a):

Since there are usually no markets available and insurance is a settlement business, we suggest that expected cash flows to settle obligations and provide (administration, asset management and other) service are used rather than notional transfer values.

Any information about cash flows, which can be derived from observable market prices should be used when estimating cash flows. However, observable market prices will not be available for most of the

significant estimates that need to be made, including estimated claims, mortality and morbidity and the costs of handling claims and otherwise administering insurance contracts. Therefore we believe that the primary emphasis should be on estimating the future cash flows that the reporting entity will incur in settling its own liabilities. In that sense, we would emphasise a settlement/execution notion in preference to an exit/transfer notion. In both cases, estimates would be made using the entity's own historical claims data and the entity's own assumptions about mortality and morbidity, and expected future changes in such variables, since such cash flows are mainly portfolio-specific and only to a minor extent dependent on the insurer actually holding the portfolio.

Consequently the measurement of a portfolio of insurance liabilities should capture expected cash flows that can be attributed directly or indirectly to the settlement of the portfolio within the current organizational structure rather than in the environment of a hypothetical market participant acquiring the portfolio. In that context, we would include estimates of the entity's own administration and claims handling costs based on its own approach to claims management. We believe that this is the most useful and therefore relevant information for the intended user of the financial report.

In doing so, we assume that the entity would act in a rational manner, for example, if – and only if - there was a realistic market and opportunity for outsourcing such functions, then the lower cost would be included in cash flow estimates. Any reported losses from administration in subsequent years would demonstrate the opportunity cost of not acting rationally by cut costs through outsourcing in that period.

On building block (b):

We agree that the cash flows in any of the scenarios considered in building block (a) should be discounted, whereby each possible due date forms an individual scenario that is weighted with the probability of the due date.

Similarly, we believe that the discount rate used to measure insurance liabilities should not factor in the liquidity of the liability. By taking into account lapse probabilities in building block (a) and a risk margin on those lapses in building block (c), liquidity is already taken into account in measuring insurance contract liabilities.

If the Board wishes to retain an explicit adjustment for liquidity in the discount rate, then it should provide further guidance on the objective of such a requirement and how an entity should estimate the impact of liquidity on the discount rate. We consider that there is potentially a risk of double counting if all scenarios are introduced in projected cash flows, probability adjusted and allocated to specific settlement periods and that a liquidity adjustment is made in the discount rate. We believe the Board should particularly clarify why it considers that a replicating portfolio for a liability with significant uncertainty in cash flows should be regarded as having no liquidity risk.

On building block (c):

Risk margin

We agree that the measurement should reflect the risks embedded in a portfolio of uncorrelated risk exposures managed together to achieve risk mitigation in the portfolio and servicing needs of the contract. Regardless what approach is taken, uncertainty about future cash flows triggers a need for capital (at least for regulatory purposes), which has a cost. Some consider this gives sufficient support to the view that capital is a raw material to an insurance product and that the cost of that raw material should be considered in measurement. Under the IASB's proposal, we would argue, that this is the minimum amount a market participant would require when assuming the liability.

We encourage the Board to provide a clear definition of "market participant", since this may have a significant influence in the amount of insurance liabilities, depending upon the approach chosen in the profit recognition.

As under the fair value hierarchy, conceptually market values for this cost should apply wherever there is an active market available or an (financial) instrument with a market value that replicates the cash flows and risks from the insurance contract. However, in the majority of cases, market values for risk margins are not available. Consequently, a model needs to be used in order to estimate a risk margin. Such a model could be based upon an enterprise's own approach to pricing of products and / or the enterprise's policies and procedures with respect to risk management and capital allocation.

The use of models and the choice of parameters may lead to a range of values for the risk margins that may all be acceptable. Therefore, we are not sure as to whether the modelling of this building block will necessarily lead to fair value, or any other consistent prospective measure, achieving comparability across the industry. Nevertheless, in our opinion the building block approach including the risk margin may very well lead to useful financial information, provided that proper disclosures are made. Such disclosures need to include information about the models and parameters used, the relation to the risk management and solvency disclosures, information on annual movements, explanation of changes in assumptions, explanation on observed volatility in recorded historical cash flows, etc.

Service margins

As an additional aspect, building block (c) includes a service margin, i.e. a margin that market participants would require to carry out some or more services that are embedded in the insurance contract. In many cases, no market information will be available. Unlike the risk margin, where the industry is in the process of developing measurement approaches, there are limitations on techniques available to model a service margin. Therefore, we have great concerns about the practical implications, especially with respect to a separate recognition of a service margin since it is not reasonable to assume that a separate service margin can be identified in situations where the contract as a whole cannot be unbundled into deposit, a service and an insurance risk components.

Surplus margins

The difference between the premium at one hand and the total of the building blocks at the other may lead to a surplus or deficit. While we note that a deficit must be recognised at inception and there is no conceptual reason why a surplus would not be recognised at inception, we repeat our view that a mark-to-model approach may imply a range of acceptable values. Consequently, it is not certain that any "free" margin will be (statistically) significant. Therefore, in our opinion, any positive "free" margin should only be recognised at inception if:

- The information implied by the premium as market evidence for the value of liabilities has been carefully considered and;

- The sources of "free" margins at inception have been positively identified.

Question 3
Is the draft guidance on cash flows (appendix E) and risk margins (appendix F) at the right level of detail? Should any of that guidance be modified, deleted or extended? Why or why not?

We do not consider that more detailed guidance is needed, but would welcome a clear description of what the intended measurement attribute is.

Under current exit value, one issue of concern is that by referring to servicing costs that market participants would incur (paragraph 60), an insurer may measure its liabilities at a lower amount than it expected to pay because of being less effective than other market participants. In a transaction situation, the assuming entity would incur migration costs to incorporate the assumed contracts in more effective systems. Such migration costs would be taken into account when establishing a price and should therefore be included in the measurement. Under these circumstances we would share the Board's view that, in most cases, the estimates of an entities own servicing costs may coincide with the compensation required by a hypothetical market participant (paragraph 62). We believe that this observation justifies an alternative approach to the Current Exit Value.

Question 4
What role should the actual premium charged by the insurer play in the calibration of margins, and why? Please say which of the following alternatives you support.
(a) The insurer should calibrate the margin directly to the actual premium (less relevant acquisition costs), subject to a liability adequacy test. As a result, an insurer should never recognise a profit at the inception of an insurance contract.
(b) There should be a rebuttable presumption that the margin implied by the actual premium (less relevant acquisition costs) is consistent with the margin that market participants require. If you prefer this approach, what evidence should be needed to rebut the presumption?
(c) The premium (less relevant acquisition costs) may provide evidence of the margin that market participants would require, but has no higher status than other possible evidence. In most cases, insurance contracts are expected to provide a margin consistent with the requirements of market participants. Therefore, if a significant profit or loss appears to arise at inception, further investigation is needed. Nevertheless, if the insurer concludes, after further investigation, that the estimated market price for risk and service differs from the price implied by the premiums that it charges, the insurer would recognise a profit or loss at inception.
(d) Other (please specify).

We refer to our comment on Question 2 (building block (c). Whereas we understand the logic of alternative (c) and may agree on it conceptually, there remain significant concerns with respect to the reliability of profit recognized under that approach as laid down above, which may be overcome by alternative (b).

The reason for concerns expressed is mainly the indefiniteness of statistical estimations under often extreme long durations and the secondary uncertainty (i.e. the uncertainty about the appropriateness of models and parameters), leveraging all effects adding a special quality of uncertainty. As a consequence, measurement lacks often of reliability and verifiability, but includes a significant degree of subjectivity. The approach discussed under alternative (c) by the IASB to require a review of all assumptions made, if they lead to significant initial gains, is insufficient. An arbitrary and judgmental choice of assumptions in an environment of uncertainty of cash flows and statistical indefiniteness will not change in a review, except if there is more discipline in the IFRS guidance to avoid gains from choosing assumptions if not verifiable or reproducible. We note, that under any measurement approach, all assumptions must be reviewed in order to perform a liability adequacy test and in case of a deficit the outcome of this test should be disclosed in the financial statements. However it is consistent with the conventions applied in other standards, to accept that subjectivity in the direction of recognizing losses under impairments (e.g. goodwill, equity securities) or onerous contracts but not to recognize increases in values or gains under executory contracts.

Under alternative (b) initial gains should be limited to those verified by positive evidence based on available data. Such an approach is consistent with IAS 39 that requires in cases of lacking supporting market data normally to use the observed transaction price, except if there is positive evidence from markets for another value (AG 76).

In our reaction to Question 2 we observed that margins in many cases have to be marked to model and that a free margin in addition to the total of building blocks may or may not be (statistically) significant. Therefore, we would find alternative (b) an acceptable approach, but we would suggest to restrict the recognition of profit at inception to situations where the evidence on the sources of profit at inception is strong enough to override the informational value of the observed transaction price (the premium).

As important as the question of “profit at inception” is the need to provide for a consistent solution for subsequent measurement. Under any approach of calibration, the issue of subsequent measurement arises. Similar to IAS 39.AG76A, profits should be recognised only in those instances, where a profit would be recognised at initial measurement. We would therefore understand that profits are recognised according to release from risk, but not where there are changes in assumptions without evidence, that a measurement under continued use of previous assumptions would result in a liability out of the range of justifiable values. Whereas we would not argue for a “shock absorber”-attribute for the risk margin, it

should be considered, that a change in one single assumption might not have any impact in price that market participants would require. It may be the case from a market participant's view the change of that assumption is considered less relevant than the overall uncertainty and indefiniteness of the liability. Nevertheless, any changes in assumptions shall not be absorbed by the "minimum risk margin" as discussed above under Question 2.

Question 5
This paper proposes that the measurement attribute for insurance liabilities should be the amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity. The paper labels that measurement attribute 'current exit value'.
(a) Is that measurement attribute appropriate for insurance liabilities? Why or why not? If not, which measurement attribute do you favour, and why?
(b) Is 'current exit value' the best label for that measurement attribute? Why or why not?

Question (a)

We are not convinced that measuring estimated cash flows and margins based on assumptions about the amounts that market participants would require to assume the obligation contributes to the objective of providing useful information about the amounts, timing and uncertainty of cash flows that will arise on the reporting entity's own insurance contracts. It will not often be the case, for non-financial variables, that the estimates of any single market participant could be demonstrated to be less biased than the entity's own estimates. We believe that the insurance standard should take this into account in its measurement attribute as a principle and not only as a fall-back-position.

We note, furthermore, that the proposals in the Discussion Paper on how to achieve a current exit value are inconsistent with that measurement attribute in several instances including the proposals on guaranteed insurability and participating contracts. A market participant would take into account all expected cash flows under insurance contracts in determining a transfer price.

We propose, instead, an approach within which estimated cash flows and risk margins would be based on entity-specific data for example, on estimated claims, mortality, costs of handling claims and otherwise administering insurance contracts. We note that internal information that is used by the management for its own purposes may be more relevant and of a higher quality than any data available externally.

Question (b)

The label should reflect the measurement attribute. Hence we do not agree with an approach labelled "current exit value".

Question 6
In this paper, beneficial policyholder behaviour refers to a policyholder's exercise of a contractual option in a way that generates net economic benefits for the insurer. For expected future cash flows resulting from beneficial policyholder behaviour, should an insurer:
(a) incorporate them in the current exit value of a separately recognised customer relationship asset? Why or why not?
(b) incorporate them, as a reduction, in the current exit value of insurance liabilities? Why or why not?
(c) not recognise them? Why or why not

We agree with the DP, i.e. favour alternative (b), but refer also to our answer to Question 7. However in the situation where the expected cash inflows exceed the cash outflows for a unit of account, an asset would be recognised.

Question 7
A list follows of possible criteria to determine which cash flows an insurer should recognise relating to beneficial policyholder behaviour. Which criterion should the Board adopt, and why?
(a) Cash flows resulting from payments that policyholders must make to retain a right to guaranteed insurability (less additional benefit payments that result from those premiums). The Board favours this criterion, and defines guaranteed insurability as a right that permits continued coverage without reconfirmation of the policyholder's risk profile and at a price that is contractually constrained.
(b) All cash flows that arise from existing contracts, regardless of whether the insurer can enforce those cash flows. If you favour this criterion, how would you distinguish existing contracts from new contracts?
(c) All cash flows that arise from those terms of existing contracts that have commercial substance (i.e. have a discernible effect on the economics of the contract by significantly modifying the risk, amount or timing of the cash flows).
(d) Cash flows resulting from payments that policyholders must make to retain a right to any guarantee that compels the insurer to stand ready, at a price that is contractually constrained,
(i) to bear insurance risk or financial risk, or (ii) to provide other services. This criterion relates to all contractual guarantees, whereas the criterion described in (a) relates only to insurance risk.
(e) No cash flows that result from beneficial policyholder behaviour.
(f) Other (please specify).

We appreciate the IASB's preparedness to find a compromise between pure contractually enforceable cash flows and the economic business model, since the non-anticipation of non-enforceable future premiums typically results in an initial loss. The criteria proposed by board (guaranteed insurability) is found normally only in case of life insurance with significant death coverage, requiring health examination at outset, or with insurance contracts that promise a loyalty bonus. Therefore we believe that the solution proposed is insufficient, since it would result in initial losses in case of regular premium deferred annuities and in case of universal life contracts caused by initial cost covered by future, non-enforceable premiums. We encourage the IASB to elaborate further on its discussion with respect to the framework and relate the recognition of contractually agreed premiums to the definition of an asset (present economic resource and "privileged access") under a contract.

Question 8
Should an insurer recognise acquisition costs as an expense when incurred? Why or why not?

We agree with the DP (expense), as long as the treatment of beneficial policyholder is as discussed above. See also our answer to Question 7.

Question 9
Do you have any comments on the treatment of insurance contracts acquired in a business combination or portfolio transfer?

We would expect that a prospective valuation, even if it is not in its entirety a current exit value as proposed in the DP, would be acceptable as "fair value" under IFRS 3 if all cash flows resulting from the insurance contracts (including policyholder behaviour with respect to continuation of premium payments) are taken into account, excluding the costumer relationship going beyond those discussed under Question 7 which needs to be recognised separately as intangible asset. Hence we do not believe, that there is need for an expanded presentation as under current IFRS 4.31.

Question 10
Do you have any comments on the measurement of assets held to back insurance liabilities?

The application of a prospective approach based on expected discounted cash flows will result in a more extensive use of the fair value option in IAS 39.9 2nd sentence lit. (a) (ii) in order to avoid

accounting mismatches. An exemption should be provided from IAS 39.9 2nd sentence, lit. (b) in the period when the new standard for insurance contracts is applied for the first time.

Question 11
Should risk margins:
(a) be determined for a portfolio of insurance contracts? Why or why not? If yes, should the portfolio be defined as in IFRS 4 (a portfolio of contracts that are subject to broadly similar risks and managed together as a single portfolio)? Why or why not?
(b) reflect the benefits of diversification between (and negative correlation between) portfolios? Why or why not?

The basis for calculating the risk margin should reflect the underlying economics of insurance. Especially, it is important to note, that insurers do not manage individual contracts but risk exposures within pools of contracts. The basis for calculating the risk margin should be a portfolio of non-correlated risks that provide a pooling effect. We believe that accounting should follow the management approach, which means that risk margins should be reduced to reflect any risk mitigation benefits provided by pooling.

We agree that a true current exit value model would incorporate benefits of negative correlations where it can be demonstrated that the defined market participant will utilize that benefit and include it in its pricing for assuming the insurance liabilities.

Question 12
(a) Should a cedant measure reinsurance assets at current exit value? Why or why not?
(b) Do you agree that the consequences of measuring reinsurance assets at current exit value include the following? Why or why not?
(i) A risk margin typically increases the measurement of the reinsurance asset, and equals the risk margin for the corresponding part of the underlying insurance contract.
(ii) An expected loss model would be used for defaults and disputes, not the incurred loss model required by IFRS 4 and IAS 39.
(iii) If the cedant has a contractual right to obtain reinsurance for contracts that it has not yet issued, the current exit value of the cedant's reinsurance asset includes the current exit value of that right. However, the current exit value of that contractual right is not likely to be material if it relates to insurance contracts that will be priced at current exit value.

In principle we agree with a prospective approach that is consistent with the treatment of the underlying gross insurance business. We would welcome if the IASB would expand conceptually upon the issue of cessations in general, not only in case of reinsurance. There is no rationale to apply a different measurement attribute to a cessation than for the ceded item. Any inconsistent measurement would distract from the true nature of the transaction. The concept of a cessation will be relevant as well for developing accounting for policyholders, for the treatment of compensation rights like subrogation and for performance-linkage under participating contracts.

Question 13
If an insurance contract contains deposit or service components, should an insurer unbundle them? Why or why not?

We doubt that unbundling will contribute to an increase in relevance, since in most cases unbundling will be possible only in arbitrary way. A prospective approach for insurance contracts, as proposed would be broadly consistent with IAS 39, so that an incentive for accounting arbitrage would be negligible.

Any unbundling requirement leads to further questions: e.g. how to deal with service components? Would it need to be allocated to the financial instruments element (i.e. separated and accounted under IAS 18) or to the insurance element (presumably no separation would be required). A theoretical alternative would be to require an unbundling as well of a service component with in insurance

contracts. However, this would require a clear description what the service component is (e.g. in a non-life or conventional life insurance contract) and we doubt that any such unbundling would be practicable in a non-arbitrary manner.
However, if the components are in any way interdependent such that the components are not readily identifiable under the terms of the contracts, we hold the view that no unbundling should be permitted. That would make the criterion operational and applicable. Any approach where the border could be interpreted to be on both sides of that level would cause significant inconsistencies in practice.

Question 14
(a) Is the current exit value of a liability the price for a transfer that neither improves nor impairs its credit characteristics? Why or why not?
(b) Should the measurement of an insurance liability reflect (i) its credit characteristics at inception and (ii) subsequent changes in their effect? Why or why not?

Consistently with the past FEE responses on this issue and related matters – (i.e. the IASB Discussion Paper Measurement Bases for Financial Accounting - Measurement on Initial Recognition, and the IASB Discussion Paper on Fair Value Measurements), we overall agree with the fact that the credit risk associated with a promise to pay enters into the determination of the fair value. However, we recognise that credit risk is an issue for subsequent measurement. Concerning subsequent measurement, we are concerned about the effects of accounting for an entity's own credit risk, and in particular the valuation of liability. Any deterioration in a debtor's creditworthiness could result in the recognition of a gain by that debtor when the fair value of its liabilities is perceived to have declined. We also agree that inclusion of "own credit risk" in the fair value has a counter intuitive effect of reporting an increase in earnings when the entity's credit rating is lowered and that it does not provide useful information to users. The market takes implicitly into account the entity's financial capacity. If changes in own credit risk were to be reflected, the measurement effects would be better shown by an entirely separate movement in equity rather than as a component of profit/income.

In addition, we doubt that a recognition of changes in the credit worthiness would have any impact on the assessment by a market participant since insurance is usually a regulated industry, which limits the effects of changes in credit characteristics to a non-relevant level.

Question 15
Appendix B identifies some inconsistencies between the proposed treatment of insurance liabilities and the existing treatment under IAS 39 of financial liabilities. Should the Board consider changing the treatment of some or all financial liabilities to avoid those inconsistencies? If so, what changes should the Board consider, and why?

The treatment of investment contracts with participating features remains unclear. In order to avoid conceptual inconsistencies between the treatment of investment contracts and insurance contracts, we suggest, that investment contracts with participating features remain under the scope of IFRS 4. We recommend that the Board first reviews the comments from constituents on the Insurance Discussion Paper, and then considers a project separately to remove potential inconsistencies.

Question 16
(a) For participating contracts, should the cash flows for each scenario incorporate an unbiased estimate of the policyholder dividends payable in that scenario to satisfy a legal or constructive obligation that exists at the reporting date? Why or why not?
(b) An exposure draft of June 2005 proposed amendments to IAS 37 (see paragraphs 247–253 of this paper). Do those proposals give enough guidance for an insurer to determine when a participating contract gives rise to a legal or constructive obligation to pay policyholder dividends?

We believe that the factors mentioned in paragraph 251 provide evidence that a liability exists. We believe that anyway all expected cash flows that arise under existing contracts and that are linked to the performance of the insurer should be taken into account in the measurement, since the issue of the

contract will give rise to an obligation. Hence cash flows should not be limited to those under legal and constructive obligations arising from the participating feature only.

With respect to measurement, we believe it is helpful to distinguish between obligations requiring the payment of benefits, which are in normal course of events seen to be fixed, including those unrelated to current surplus, and obligations, which in the normal course of events vary directly with the linked performance of the insurer.

To the first category principally belong guaranteed benefits, but which can be modified under a premium or benefit adjustment clause if an unfavourable development of the performance of the insurer requires that, or in a weaker form, benefits paid based on a conservatively determined dividend scale forwarded to the policyholder at outset which is maintained as long as the actual performance allows to do that without reducing stockholders' profit unduly or the remaining surplus becomes unreasonably high. Such obligations are very close to normal guaranteed benefits and should be measured as such, just considering the modification occurring in some scenarios. Presumingly, stochastic models will be needed to be applied in those cases where the outcome depends significantly on different financial scenarios. The margin will need to consider the risk reducing effect of the ability to adjust the benefits in adverse circumstances but as well any possibility that the benefits will be increased in beneficial circumstances.

The second category refers to obligations where policyholders and insurers do not expect specific amounts to be paid but in the normal course of events a certain share of actually incurred performance of the insurer, measured according to contract or law, is directly allocated to the community of policyholders or individual policyholders. Under that category, specifically the performance of the insurer is ceded to the policyholders. In unexpected cases the share in performance might be limited to guarantees provided or upper limits of a share in performance. For this category an alternative approach should be considered, under which the minimum guarantee is measured as any cash flow under insurance contract, while the performance linkage on top is measured consistently with the items to which performance is linked. The asymmetry, as outlined in the DP, is considered in the margin reflecting the remaining position of the insurer after all contractual rights and obligations, i.e. after the participation process.

Question 17
Should the Board do some or all of the following to eliminate accounting mismatches that could arise for unit-linked contracts? Why or why not?
(a) Permit or require insurers to recognise treasury shares as an asset if they are held to back a unit-linked liability (even though they do not meet the Framework's definition of an asset).
(b) Permit or require insurers to recognise internally generated goodwill of a subsidiary if the investment in that subsidiary is held to back a unit-linked liability (even though IFRSs prohibit the recognition of internally generated goodwill in all other cases).
(c) Permit or require insurers to measure assets at fair value through profit or loss if they are held to back a unit-linked liability (even if IFRSs do not permit that treatment for identical assets held for another purpose).
(d) Exclude from the current exit value of a unit-linked liability any differences between the carrying amount of the assets held to back that liability and their fair value (even though some view this as conflicting with the definition of current exit value).

All obligations arising under insurance contracts should be recognised as liability, including those that are linked to value of investments. Where the amount of the obligation is linked to the fair value of certain instruments, the fair value of those linked instruments best reflects the liability. The different character of those instruments (risk borne by policyholder) justifies different treatment (fair value measurement and no consolidation) of assets to back those liabilities in order to achieve consistency. We believe that the presentation of assets in one separate line is the most transparent categorisation.

Question 18
Should an insurer present premiums as revenue or as deposits? Why?

Current practices are well established, including the need for premium collapsing in the case of separate accounts under FAS 97. In all other cases the premiums represent one single consideration for a set of interdependent benefits and services. We don't believe that the Board has made sufficiently the case for need of change.

Question 19
Which items of income and expense should an insurer present separately on the face of its income statement? Why?

Performance reporting plays an important role in providing information on insurance contracts, as with other areas of financial reporting. This issue should be considered further once the measurement approach has been decided upon and in the context of the IASB's performance reporting project.

Question 20
Should the income statement include all income and expense arising from changes in insurance liabilities? Why or why not?

See Question 19.

Question 21
Do you have other comments on this paper?

The IASB may find that various items of prospective information may be necessary to properly explain the reported assets and liabilities, which should be included in the notes. There may be other pieces of prospective information that are also considered useful, but that might be provided in the management's report as an alternative to the notes. There will be differences in the audit requirements according to where the information is provided. The Board may wish to consider which additional information is required to be provided in the audited financial statements and which might be provided elsewhere, such as in the management report.

We encourage the IASB to revisit the financial statement disclosures in order to ascertain that the measurement of insurance liabilities is adequately supported by transparent disclosures like appropriate roll forward information of insurance liabilities, analysis of sources of earnings, analysis of experienced to assumed cash flows, etc. Such disclosures are essential for the user to form an opinion about the credibility of financial statement estimates and the development of and uncertainty relating to cash flows.