Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

15 February 2013

Insurance Contracts Project

Dear Mr Hoogervorst,

This letter has been drafted by the European Insurance CFO Forum, a body representing the views of 20 of Europe's largest insurance companies and Insurance Europe, representing 95% of the premium income of the European insurance market. Accordingly, it represents the consensus view of a significant element of the European Insurance industry.

We are writing to express our views on the Insurance Contracts Project, ahead of the expected publication of a new exposure draft (ED) later this year.

The Insurance Contracts Project is of crucial importance to the insurance industry and we are committed to the development of a high quality comprehensive accounting standard for insurance contracts. In this context, it is important to us that the project progresses to its conclusion.

We believe that the final standard for insurance and related assets must clearly reflect the insurance business model and the performance of insurance businesses, including for participating contracts.

The insurance business model is centred around asset liability management in which insurance liabilities, guarantees and related assets (including derivatives) are managed together. The accounting should reflect this linkage. Accounting requirements that deal with individual components in isolation, separate from the overall asset/liability management ("ALM") strategy, which result in different measurement (either through P&L or OCI) and presentation requirements for different components of the ALM strategy, do not adequately reflect the insurance business model and the related performance in earnings. Whilst we acknowledge that current measurement of assets and liabilities in the balance sheet may present useful information to investors, depending on the nature of the insurance products and the related assets, there is a specific need for each of the following: Floating Residual Margin, Amortised Cost, Other Comprehensive Income and Fair Value through P&L.

We appreciate the significant progress that the Board has made in recent years to advance the Insurance Contracts Project and the open dialogue between members of the Board and its staff with the insurance industry. We also appreciate many of the significant changes that the Board has introduced since the 2010 ED and a number of these changes have gone a long way towards addressing our concerns. The most significant of these include the introduction of OCI for presenting the effect of changes in discount rate in OCI, changes to the discount rate to be more principle based, unlocking of the residual margin, the introduction of the mirroring principle for participating contracts and the introduction of retrospective transition provisions with the use of practical expedients.

However, as we outline below, whilst there has been substantial progress towards the goal of adequately reflecting the insurance business model, the current tentative decisions for IFRS 4 and IFRS 9 do not yet achieve this goal. We believe that there are a number of critical areas which require further development before an ED can be issued. During 2012, we met with a number of Board members and staff to discuss these critical areas and our proposals to address these issues. Several of our proposals were summarised in the July 2012 Industry Viewpoints Presentation which was prepared in conjunction with the HUB Global Insurance Group and Insurance Europe. These critical areas for which we believe further amendments to the tentative decisions are necessary are detailed below.

- **Interaction between IFRS 4 and IFRS 9 needs further consideration:** As our views have consistently highlighted, the interaction between assets and liabilities is the fundamental core of an insurer's approach to managing its business. Consequently, we believe that the interaction between IFRS 4 and IFRS 9 needs further consideration to take account of ALM. As the IFRS 4 ED is not yet available, our assessment on IFRS 9 cannot be finalised until such time as we are able to assess both draft standards together. Furthermore, as we highlighted in our December 2012 letter, insurers should not be required (but permitted) to adopt IFRS 9 before the mandatory effective date of IFRS 4. Otherwise it may put into question the usefulness of financial reporting for users in the period between IFRS 9 and IFRS 4 adoption, as users will experience two major changes in an insurer's financial statements in short succession.

- **Floating Residual Margin (FRM) for participating contracts is needed:** The proposed measurement model for participating contracts does not adequately reflect the nature of these products. The shareholder profit expectations from these contracts depend on the mechanism of sharing asset returns between the policyholder and shareholder. Consistent with deferral of profit at inception on non-par contracts, changes in the future gross profit expectations should not be recognised in P&L immediately. Instead they should be deferred through the residual margin and recognised when earned. Our FRM proposal involves recalibrating the residual margin in order to reflect changes in future profit expectations and the un-apportioned surplus. This in effect represents the application of the unlocking principle to participating contracts where changes in the liability cash flows are dependent on asset cash flows. The staff made a recommendation to the Board in December which was directionally consistent with our FRM proposal. We are disappointed the Board rejected the proposal as we see it as a critical element of the measurement model. The rejection of this proposal leaves the application of the unlocking principle to participating contracts unclear.

- **OCI model needs to be optional:** We welcomed the Board decision to introduce an OCI model in IFRS 4 and reintroduce FVOCI in IFRS 9 as we see OCI as a vital element to adequately reflect the performance of an insurer in a current measurement environment. However, the OCI model as currently proposed would still result in several possible accounting mismatches, including situations where an insurer is required to measure assets at FVTPL or where the FVOCI business model is not applicable. To reflect how insurers approach asset / liability management, OCI must not be mandatory. Instead recognition through OCI and through the P&L for both assets and liabilities must be available through a fair value election on both the asset and the liability side to eliminate or significantly reduce accounting mismatches. We believe that mandatory OCI would give rise to misleading performance reporting for certain types of insurance business. Whilst we understand the IASB's desire for consistency, the requirement for OCI to be mandatory must be reconsidered to arrive at a solution for all types of insurance business.

- **Limitation of OCI for insurance contracts to only change in the discount rate requires further consideration:** For non-participating contracts and to the extent not covered by the Floating Residual Margin for participating contracts, we believe that further consideration is necessary to what extent interest sensitive assumptions should be reflected in OCI. We would be happy to work with your staff to develop a principle on which interest sensitive assumptions should be included in OCI.

- **Practical application of the mirroring approach needs further consideration:** Whilst we welcome the introduction of the mirroring principle as a measure to reflect the asset dependency of participating contracts, we believe further work is needed to establish how this principle will operate in practice. We are concerned about the staff's illustration of the mirroring approach in recent staff papers (October and November 2012) which show the separation and valuation of participating contract cash flows using different discount rates. This poses significant conceptual and operational challenges. The insurance industry proposal for participating contracts incorporates the mirroring principle without separation of cash flows. It achieves this by reflecting the asset dependency of the insurance liability in the cash flow projections and discount rate, together with applying the full floating residual margin concept, to provide a more comprehensive approach to accounting for participating contracts. In addition, we believe the definition of participating contracts that qualify for the mirroring approach based on a "contractual linkage" needs further consideration. We do not believe it is necessary to distinguish between contracts with a "contractual linkage" and other participating contracts. Instead, we believe all of these contracts share a common characteristic (i.e. policyholders may receive, as a supplement to guaranteed benefits, additional benefits) and thus, should be accounted for similarly.

- **Concerns remain on measurement of reinsurance residual margin:** In addition to the above, we have previously highlighted our views on the reinsurance model and we appreciate the progress made so far regarding definition of insurance contracts and recognition of reinsurance ceded assets. However, we are still concerned about the measurement of reinsurance ceded, in particular the residual margin. From an economic perspective, a reinsurance contract is highly dependent on the underlying direct insurance contracts, and we believe this fact should be taken into consideration when measuring the corresponding reinsurance asset.

- **Presentation and disclosure requirements are too complex:** We also believe that further consideration should be given to the presentation and disclosure model. Whilst we welcome the decision to allow insurers to follow the prescribed primary statement format in IAS 1, the earned premium approach and the requirement to disaggregate premiums represent a complex undertaking. We do not believe the expected benefits of this approach would outweigh the cost to preparers, not least the cost to implement the system architecture needed to produce information in this manner. Furthermore, we do not believe that investors will recognise premiums under this approach as useful or a number they rely upon for their analysis. This may result in significant operational complexity to report disaggregated earned premiums, whereas users will continue to focus on simple (existing or non-GAAP) volume measures. In response to the 2010 ED, we said the disclosure requirements should be principles based, we were concerned about the volume and level of detail in the requirements and we did not believe such prescriptive rules based requirements should be included. Our concerns remain with the revised disclosure package which continues to contain a large volume of detailed requirements.

In October 2012 we wrote to you about the planned limited re-exposure draft for IFRS 4 where we explained that in taking into account the importance of the project for the industry, we feel there must be a comprehensive consideration of the standard as a whole. Many elements of the proposals are interrelated and need to be assessed in the context of the overall proposals.

Furthermore, it is important to consider whether all matters that have been re-deliberated since the 2010 ED are consistently and appropriately reflected and do not have unintended consequences. Indeed, there are topics outside of the scope of the re-exposure draft which we believe still need further consideration, including:

- The proposed wording and application guidance for the standard in particular for discount rates, contract boundaries and fulfilment cash flows
- The impact of the revised unbundling requirements on different types of products
- Whether the changes made to the Premium Allocation Approach are appropriate and address our prior concerns (for example the requirement to accrete interest is not consistent with a principles based simplified approach)

We have always maintained a constructive dialogue with the IASB throughout the Insurance Contracts Project. We would very much like to continue this and work with you and the staff on these areas over the coming months. We would appreciate the opportunity to meet with you to discuss our views and the way forward.

Please feel free to contact us to discuss any matters raised in this letter.

Yours sincerely

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