Deutsches Rechnungslegungs Standards Committee e.V.
Accounting Standards Committee of Germany
® Der Standardisierungsrat

DRSC e. V. • Zimmerstr. 30 • 10969 Berlin

EFRAG
Françoise Flores
35 Square Meeûs

B-1000 Brussels

Telefon +49 (0)30 206412-12
Telefax +49 (0)30 206412-15
E-Mail info@drsc.de

Berlin, 3 December 2010

Dear Françoise,

Exposure Draft ED/2010/8 Insurance Contracts

On behalf of the German Accounting Standards Board (GASB), I am writing to comment on EFRAG's draft comment letter on the IASB on the Exposure Draft ED/2010/8 Insurance Contracts. We appreciate the opportunity to comment on EFRAG's draft comment letter.

For our arguments, please see the appendix (comment letter to the IASB) attached to this letter.

If you would like to discuss any aspect of this comment letter in more detail, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President

DRSC e. V. • Zimmerstr. 30 • 10969 Berlin

Telefon +49 (0)30 206412-12
Telefax +49 (0)30 206412-15
E-Mail info@drsc.de

Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Berlin, 3 December 2010

Dear David,

Exposure Draft ED/2010/8 Insurance Contracts

On behalf of the German Accounting Standards Board (GASB), I am writing to comment on the Exposure Draft ED/2010/8 *Insurance Contracts* (herein referred to as ´the ED´). We appreciate the opportunity to comment on this Exposure Draft.

General remarks

As a general consideration, we support the idea that all standards should be as consistent as possible, no matter whether they are industry specific or of general nature. There are several projects, e.g. financial instruments, liabilities and revenue recognition, which are linked with this project. We advocate that the measurement of insurance contracts is comparable to other industries, but reflecting any special features of the insurance business.

The objective of a proposed standard is to faithfully present the substance of the insurance business and to give relevant information on the assets and liabilities of an insurance entity as well as its performance.

In order to accomplish this objective, it is key to determine the nature of insurance contracts as they contain diverse characteristics across business segments and geographies.

In our view, the ED provides a basis for eliminating the diversity and weaknesses in current financial reporting requirements and results in improved comparability as the current IFRS 4 allows insurers to use various pre-existing accounting models. The ED is comprehensive and contains positive elements. As stated in our comment letter on the Discussion Paper ´Preliminary Views on Insurance Contracts´, we disagree with a model based on an exit value. Accordingly, we welcome and support a measurement approach that considers the fact that an insurer usually fulfils its contract with an insured instead of transferring it to a third party.

However, we identified some areas where we have strong concerns that reflect significant doubts about the relevance and decision usefulness of the information provided under the proposals. Taking into account our concerns outlined below, we believe that it is essential that the Board reconsiders the proposals to improve those areas where we are in disagreement. To enable the Board to carry out such a thorough reconsideration, we could accept a potential delay in the standard's due process as the final standard should be based on sound principles that can be consistently applied in practice.

a) Subsequent measurement

The proposed approach for subsequent measurement is sensitive to short-term volatility in the market and impacts the usefulness of financial results for predicting long-term performance. There is a logical break between the methodology used at initial recognition (no day one gain) and subsequent measurement as re-estimates will be immediately recognised in profit or loss. Accordingly, an adverse change in assumptions or estimates impacting the present value of fulfilment cash flows can cause counterintuitive profit and loss impacts as the lock-in of the residual margin results in losses, even though there is still a residual margin storing profit. Furthermore, the proposed approach for subsequent measurement does not reflect appropriately the inter-relationship of financial assets and insurance liabilities that forms a key component of many insurers' business models. The proposed requirements for subsequent measurement would effectively preclude insurers from using the amortised cost category under the mixed measurement approach in IFRS 9. To allow insurers to classify and measure their financial assets and insurance liabilities according to their business model, the GASB supports the introduction of a mixed measurement model for insurance liabilities (following a similar logic to the approach contained in IFRS 9 for financial instruments). In our view, such an approach is effective in minimising the effects of possible accounting mismatches and allows insurers to adequately reflect the long-term nature of the insurance business.

We are aware of some in the insurance industry also supporting the introduction of an OCI option for insurance liabilities in order to address short term volatility due to interest rate changes. This proposal is made under the assumption that the so-called available-for-sale category for debt instruments will be re-introduced into IFRS 9 in order to avoid any accounting mismatch. However, a re-introduction of the available-for-sale category would require further consideration of impairment and hedge accounting requirements.

b) Presentation

Overall, we are not convinced that the objections against the current premium models justify such a significant change in presentation. Under the proposed summarised margin approach, presentation is based on reporting the changes in the building blocks that make up the measurement of the insurance contract. We do not believe that a pure focus on margins will actually lead to decision-useful information. No information on premiums, claims and expenses would be presented on the face of the income statement. Furthermore, the summarised margin presentation results in quite a specific presentation model that is not used for other industries. For non-life insurance contracts, the GASB rather favours reflecting earned premiums as revenue, as is currently done in the insurance industry. For life insurance contracts, we are aware of the fact that current premium models do not provide full transparency, because presenting the full premium including the deposit component as revenue is less informative. However, taking into account our concerns regarding the summarised margin approach, we also support the current premium model for the life industry and insufficient information provided in the income statement should be accompanied by appropriate disclosure requirements, e.g. about sources of earnings and margin information.

c) Transition

The proposed transition approach prevents insurers from reporting a material part of the profits on existing contracts through profit and loss and reduces comparability between the results on existing and new business. Accordingly, we believe that these transition requirements would not provide relevant and comparable information for many years, especially in the case of long-term insurance contracts. Therefore, we propose an accounting treatment which is in line with IAS 8 'Accounting Policies, Changes in Estimates and Errors' and to allow insurers and reinsurers to apply the new standard retrospectively. To the extent that this would be impracticable, we propose, in line with IAS 8, to allow a simplified approach by means of using a reasonable approximation for a retrospective application.

Please find our detailed comments to your questions raised in the ED in appendix A.

Should you or your staff have any questions on our comments, please do not hesitate to contact us.

Yours sincerely,

Liesel Knorr

President

Appendix A – Answers to the questions of the discussion paper

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?

A new model for all insurance contracts is necessary to eliminate the diversity and weaknesses in current financial reporting requirements and to provide improved comparability.

We appreciate that the proposed measurement model addresses some concerns that the GASB expressed in its comment letter to the discussion paper. We believe that the proposed measurement model provides relevant information about the amount and uncertainty of future cash flows that will arise as the insurer fulfils its existing insurance contracts.

The GASB generally agrees with the proposed approach including the four building blocks at initial recognition. The initial measurement model provides relevant information about cash flow projections and risk adjustments and constitutes a step forward in the accounting for insurance contracts compared to current requirements.

However, we do not agree with the proposal for subsequent measurement and believe that our concerns will significantly affect the relevance and decision usefulness of the information provided. The ED's related proposals may fail to help users of an insurer's financial statements to make appropriate economic decisions.

For further details we refer to our response outlined in question 3(a).

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?

We agree with the current IASB proposal that insurance contracts should be measured based on their fulfilment value.

In the proposed approach, the initial measurement is based on an explicit, unbiased and probability-weighted estimate of the future cash outflows and inflows that will arise as the insurer fulfils the insurance contract. Insurance liabilities are normally fulfilled by the originating insurance entity, i.e. the insurance entity holds the contract until the end of the insurance coverage rather than transferring it to a third party. Accordingly, the proposed fulfilment value faithfully represents the substance of an insurance business and is therefore considered to be relevant.

We believe that the approach of incorporating entity-specific data in the measurement better reflects the financial position of an insurance entity and provides a better basis for predicting future cash flows that shall reflect the manner in which the insurer expects to fulfil the contract.

We support the decision to use a “building block” approach which includes an explicit estimate of the effects of uncertainty about the amount and timing of the future cash flows (risk adjustment). Information about risk associated with the insurer´s contracts is an important feature of a measurement model that claims to provide relevant information to users, because accepting and managing risk is the essence of insurance.

In addition, we support the decision that policyholder options, as well as options, forwards, and guarantees related to existing coverage, should be included in the measurement of the insurance contract on a look through basis using the expected value of future cash flows to the extent that those options are within the boundary of the existing contract. They should be considered to present a complete picture of the economics of the insurance contract.

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

(b) Is the draft application guidance in Appendix B on estimates of future cash flows (B37-66) at the right level of detail? Do you have any comments on the guidance?

In our view, the draft application guidance in Appendix B on estimates of future cash flows is generally at the right level of detail. However, we identified some issues where clarification is required:

A portfolio of insurance contracts is defined as ‘Insurance contracts that are subject to broadly similar risks and managed together as a single pool’. We have some concerns that the notion of ‘broadly similar risk’ may lead to inconsistencies between insurers’ accounts as it can be interpreted in different ways and include a wide range of risks. Other standards do not use the term “broadly”, e.g. IAS 39 includes the wording “similar risk characteristics”. Furthermore, we believe that the notion “similar risk” would not constrain the current practice of how portfolios are set up. Therefore, we ask for further clarification regarding the necessity to include the additional term “broadly”, while considering the specifics of the insurance business and the practical consequences.

Further, the reference to contract in the definition of a portfolio can cause issues for contracts that cover more than one risk, since insurers do not pool contracts but risks.

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?

Discount rate at initial recognition

We agree with the proposed measurement that, in general, insurance contracts should reflect the time value of money in order to faithfully represent the value of future cash flows and the insurer's financial position.

The GASB generally supports the approach that if the cash flows of an insurance contract do not depend on the performance of specific assets, the discount rate shall be consistent with observable current market prices for instruments with cash flows whose characteristics reflect those of the insurance contract liability and not those of the assets backing that liability.

We theoretically agree with the use of a risk-free rate at inception. The cash flows arising from the assets do not affect the cash flows arising from the liability unless there is a contractually defined relationship that clearly links the cash flows of both. In addition, the risk free rate is generally a market-based and observable information and its use provides consistency.

If the amount, timing and uncertainty of the cash flows from the insurance contract depend on the return of specific assets, we support the proposal that the measurement of those insurance liabilities should reflect that dependence.

Subsequent measurement

We believe that the proposed subsequent measurement approach does not reflect the insurers' business model. It is sensitive to short-term volatility in the market and can impact the usefulness of financial results for predicting long-term performance and to assess the insurer´s long-term stability.

There is a logical break between the methodology used at initial recognition to eliminate a day one gain and subsequent measurement. Initial measurement is consistent with the proposals on revenue recognition whilst subsequent measurement is based on the principle proposed in the project on liabilities.

As the residual margin is locked-in, changes in the present value of the fulfilment cash flows will be immediately recognised in profit or loss upon subsequent measurement. An adverse change in assumptions or estimates impacting the present value of fulfilment cash flows can cause counterintuitive profit or loss impacts. For example, if the interest rate decreases, the lock-in of the residual margin results in losses that are recognised immediately, even though there is still a residual margin storing profit and the contract is still profitable. This is not a faithful depiction of the margin the insurer earns over the life of the contract.

One of the main arguments of the Boards mentioned in BC121 to not recognise a day one gain was their concern regarding reliability of the amount identified on the basis of future estimates. In our view, it would be consistent to adjust the residual margin for subsequent re-estimates.

In addition, we feel that the proposed ED does not appropriately reflect the inter-relationship of financial assets and insurance liabilities. The proposed approach for subsequently measuring insurance liabilities would effectively preclude insurers from using the amortised cost category for financial assets under the mixed measurement approach in IFRS 9.

Insurers generally measure financial assets at amortised cost to reflect their intention to hold these assets for the long-term business. Since the draft IFRS would measure insurance liabilities using current interest rates with all remeasurements recognised in profit or loss, accounting mismatches would arise if an insurer measures its financial assets at amortised cost.

We believe that requiring a measurement of all financial assets at fair value in order to address the accounting mismatch is not appropriate as such an approach does not reflect the insurers´ long-term business model and is sensitive to short-term volatility in the market. The proposed approach may result in recognising a gain or loss in one period only to reverse it in a subsequent period.

Our preferred approach

The GASB evaluated the Board’s proposals on subsequent measurement as well as certain alternative approaches discussed within the insurance sector. As a result, and in contrast to the Board’s proposal, the GASB supports the introduction of a mixed measurement model for insurance liabilities, as this would allow for a consistent measurement of financial assets and insurance liabilities, thus avoiding inappropriate accounting mismatches as far as possible.

Given the fact that insurers manage assets and liabilities together, we believe that classification and measurement according to the business model under IFRS 9 is equally relevant in determining the measurement approach for insurance liabilities.

IFRS 9 contains a mixed measurement model permitting an entity to classify assets at either fair value or amortised cost. The reasons for supporting that model are outlined in the Basis for Conclusions on IFRS 9 (cf. IFRS 9.BC10-15).

As regards the nature and substance of certain insurance contracts we believe that a lock-in of the discount rate for subsequent measurement accompanied by a liability adequacy test would be appropriate. The liability adequacy test should be triggered if the earned investment rate is lower than the accretion of the locked-in discount rate.

Additionally, we propose recalibrating the residual margin for changes in non-financial assumptions or estimates that have an impact on future periods. If the residual margin is smaller than the respective increase in the present value of the fulfilment cash flows (i.e. the contract becomes onerous), any remaining amount should be recognised in profit or loss immediately. Changes in assumptions or estimates that relate to present or past events should be reflected immediately in profit or loss, too.

The lock-in of the discount rate as per the mixed measurement model should give insurers the possibility to align the measurement of the insurance contracts with their business model as it allows for measuring financial assets at amortised cost to reflect the intention to hold these assets for long-term business.

Insurers applying this alternative should disclose information about changes in the current discount rate and the respective impact on the insurance liabilities in the notes.

Conversely, insurers that would measure their financial assets at fair value under IFRS 9 would measure their insurance liabilities according to the proposed measurement approach in the ED.

Overall, we consider that this approach provides users of financial statements with relevant information, minimises the effects of possible accounting mismatches and allows insurers to adequately reflect the long-term nature and substance of the insurance business.

We are aware of some in the insurance industry also supporting the introduction of an OCI option for insurance liabilities in order to address short term volatility due to interest rate changes. This proposal is made under the assumption that the so-called available-for-sale category for debt instruments will be re-introduced into IFRS 9 in order to avoid any accounting mismatch. However, a re-introduction of the available-for-sale category would require further consideration of impairment and hedge accounting requirements.

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

(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?

The GASB generally agrees with the proposal to consider the effect of liquidity in estimating discount rates for an insurance contract, but we believe that the liquidity adjustment is not conceptually sound in the context of a fulfilment value.

As already stated in our answer on question 3(a), we support the proposal that the discount rate shall be consistent with observable current market prices for instruments with cash flows whose characteristics reflect those of the insurance contract liability and not those of the assets backing that liability.

Many insurance liabilities do not have the same liquidity characteristics as assets traded in financial markets. There are differences between the liquidity characteristics of the instruments underlying the rates observed in the market and the liquidity characteristics of the insurance contract.

However, from a conceptual point of view, the liquidity adjustment is not conceptually appropriate in a measurement model based on a fulfilment value as the insurers generally expect to fulfil their liabilities. A liquidity adjustment would be better suited to a measurement based on an exit value.

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

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

Long-duration insurance contracts

The concern we noted relates to the determination of the interest rate for long duration contracts, because these interest rates are not observable in the market. However, this is not an issue that is specific to the insurance industry. The ED requires a principle-based determination of the discount rate and includes no special modelling technique. We do agree with that approach being in accordance with other principle-based IFRSs and therefore relevant across industries.

Risk of non-performance by the insurer

We strongly believe that it would not be appropriate to include changes in a reporting entity’s own credit spread when measuring the fulfilment value of an insurance liability for the very same reasons that the IASB discussed when it dealt with the subsequent measurement of financial liabilities designated as at fair value through profit or loss. As stated in our comment letter to that proposal we believe that an entity’s own credit spread should not be taken into account unless the entity has the possibility and intent to early settle its obligation, thereby realising any gains/losses due to changes in own credit spread.

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.

In our view, the benefits of using a risk adjustment (plus a residual margin) are predominant, which is why we support the proposed separate recognition of a risk and a residual margin. However, we acknowledge that the composite margin has some advantages: Risk associated with the uncertainty in the cash flows is included in the composite margin and, therefore, locked-in, and changes in the uncertainty are not reflected in profit or loss. A composite margin approach eliminates the need to use subjective methods for measuring the risk adjustments and provides a simpler approach.

On the other hand, a risk adjustment provides a means for depicting the uncertainty inherent in the future cash flows of an insurance contract.

We believe that an explicit risk adjustment reflects the economics of the insurance business, because managing and accepting risks is the essence of insurance. Insurance companies make a risk assessment when they price contracts. A risk adjustment provides insight into management’s perception of the uncertainty and it gives users an indication of management’s appetite for risk.

We also believe that a separate risk adjustment better reflects the current obligations under the contract. A day one loss could arise for some insurance contracts with a separate risk adjustment that the composite margin model would not identify as onerous.

Lastly, and from a conceptual point of view, the use of a risk adjustment is broadly consistent with the requirements proposed in the ED IAS 37 “Measurement of Liabilities”.

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 fulfilment cash flows exceed those expected? Why or why not? If not, what alternatives do you suggest and why?

We agree that the proposed measurement of the risk adjustment is consistent with a fulfilment notion as it considers the entity´s assessment of the risk and does not represent the compensation a market participant would require in a transfer.

However, we do not fully support the definition that the risk adjustment "should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected".

As currently written, the proposed definition could cause interpretation difficulties in determining the risk adjustment and result in inconsistencies in practice as explained in the following:

As regards the wording "maximum amount", the standard should clarify that the relevant estimate should reflect opportunity costs and not a prudent value on the upper end of the range. We read the proposal such that the amount should consider the perspective of a rational insurer and what it would rationally pay to be relieved of the risk regarding uncertainty in the cash flows.

Therefore, the GASB proposes a clearer definition that the risk adjustment "should depict the best estimate of the amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows deviate from those expected".

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

(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?

We acknowledge that in most cases the proposed techniques are sufficient to estimate the risk adjustment.

However, from a conceptual point of view, the GASB believes that it would not be appropriate to limit the choice of techniques for estimating risk adjustments according to the framework where accounting standards are intended to be principle-based.

Accordingly, the GASB disagrees with the proposal in B73 to limit the choice of techniques to the confidence level, conditional tail expectation and cost of capital method.

No one technique appears to be superior to others and for all types of insurance contracts, and the best technique depends on the particular circumstances. The wide range of insurance contracts requires the option to select the best technique for determining a risk adjustment.

We are aware of the fact that the use of various techniques could affect comparability, but the restriction to specified techniques would also preclude any improved technique being introduced at a later date. The rapid pace of development and the continued advances in techniques for estimating uncertainty necessitate the need for flexibility.

To achieve a certain degree of comparability and yet provide flexibility, we suggest including a rebuttable presumption in the final standard that an insurer would generally apply the three techniques described in the ED with the option to use a different technique if that reflected the uncertainty more appropriately. If the insurer chooses another technique, he should disclose the rationale as to why it best meets the measurement objective.

However, once a technique is chosen, it is important to ensure that the technique is consistently applied in subsequent periods. We propose a requirement to disclose the rationale and impact of a change in techniques from one reporting period to another.

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

(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?

The GASB does not agree that if either the conditional tail expectation or the cost of capital method is used, the insurer should disclose the confidence level to which the risk adjustment corresponds.

We acknowledge the Boards` reasoning behind the disclosure requirement, which is to provide comparability if insurers use different approaches. The disclosure is intended to achieve some sort of market discipline to calibrate in a reasonable manner.

However, we believe that the required disclosure for the confidence level can only provide a limited contribution regarding comparability and indication of the prudence level. The insurer uses other parameters and assumptions where judgement is applied, and disclosing just the confidence level might create the illusion of precision which inherently does not exist.

We believe that the proposed disclosure requirements, especially the methods and inputs used to estimate the risk adjustment, are sufficient and appropriate to provide transparency to users.

In addition, we have strong concerns regarding the requirement for an insurer to translate its risk adjustments into a confidence level for disclosure purposes, even if the insurer had not used such technique to determine the risk adjustment. We do not support a requirement to apply two techniques as it constitutes a significant additional workload for the insurers without enhancing the benefits to the same degree.

From a conceptual point of view, such a requirement is not in line with the framework where accounting standards are intended to be principle-based. The disclosure requirement highlights the confidence level technique as superior and contradicts the appropriate use of the variety of methods as it creates an incentive to apply that technique.

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

(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?

We support an approach that in general the risk adjustment should be measured at a portfolio level of aggregation (ie a group of contracts that are subject to similar risks and managed together as a pool).

However, insurance is based on the concept of balancing risks in a collective of insurance contracts. For this reason we would support that diversification or negative correlation between portfolios should be considered, when the insurer manages portfolios in a way that risks are clearly offset or reduced across portfolios and the insurer benefits legally and practically from such diversification or negative correlation between portfolios.

In order to provide appropriate transparency disclosures are required to reflect the way the insurance business is managed and to provide information about the amount and nature of the diversification effects taken into account.

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

(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?

We believe that the application guidance in Appendix B on risk adjustments is at the right level of detail.

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?

We agree with the proposed approach that the purpose of the residual margin is to eliminate any day one gains.

The treatment that the residual margin is calibrated at inception to an amount such that the insurer recognises no gain on entering into an insurance contract is consistent with the revenue recognition proposal for performance obligations, where revenue is recognised as the entity fulfils its obligation under the contract.

Furthermore, the residual margin is a calculated difference based on estimates. We therefore share the Boards´ concerns mentioned in BC121 regarding the reliability of that amount identified as a day one gain. In this context we do not understand the proposed subsequent measurement approach where changes in these uncertainties would immediately be recognised in profit or loss and refer to our response on question 3(a).

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

(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?

We agree with the proposed approach that if the present value of the fulfilment cash flows specified is greater than zero, the insurer shall immediately recognise that amount in profit or loss as an expense. It is not appropriate to defer losses over the coverage period.

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

(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?

The GASB agrees with the approach to estimate the residual 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.

This level of measurement reflects the characteristics of the residual margin as it is calculated at the date of inception and released over the coverage period. However, from a practical point of view, we would be concerned if such calculation would be required for each day of a reporting year.

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

(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)?

We generally agree with the proposed approach that an insurer shall recognise the residual margin as income in profit or loss over the coverage period in a systematic way that best reflects the exposure from providing insurance coverage.

The proposed approach to determine the release pattern for the residual margin on the basis of an insurer's performance under the contract seems appropriate. The level of performance is generally the coverage the insurer provides for the duration of the contract. To base the release on performance is consistent with the proposed approach in the revenue recognition project.

The claims handling period is the period during which an insurer will be fully released from the risk of variability in the cash flows. The risk margin deals with this uncertainty; in our view, the claims handling period is therefore not suitable for the release of the residual margin.

Our proposed approach to recalibrate the residual margin for changes in assumptions or estimates that have an impact on future periods does not affect the proposed method to release the residual margin.

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

(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?

We refer to our response on question 4 that we do not support the composite margin approach.

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

(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?

We do not support the proposal that the residual margin should be adjusted for the time value of money and believe that interest should not be accreted.

The GASB does not see the rationale to accrete interest on a figure that results from a calculation based on discounted amounts.

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

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?

The GASB welcomes the Board´s decision that certain acquisition costs should be included in the initial measurement of the insurance contract as contract cash outflows.

We acknowledge and support the proposal that only incremental acquisition costs for contracts issued should be included and that all other acquisition costs should be recognised as expenses when incurred.

The insurer typically charges the policyholder a price that the insurer regards as sufficient to compensate it for two things: (a) undertaking the obligation to pay for insured losses and (b) the cost of originating the contracts.

Acquisition costs should not result in a loss at initial recognition of an insurance contract (unless the contract is onerous). The proposal to include certain incremental acquisition costs in the contractual cash outflows results in their offset against the initial residual margin and amortisation into income consistent with the residual margin release pattern.

We are aware of the concerns mentioned in BC139 that the definition of incremental acquisition costs at a contract level is too narrow to adequately reflect the various sales structures of insurers.

However, we do not support a wider definition of incremental acquisition costs since we believe that any inclusion of other direct costs as well as any systematic allocations of other direct costs are more subjective. The proposed approach includes only those costs that can be clearly identified as relating specifically to the contract and provides in our view a clearer application.

We would like to underpin our above conclusions by referring to our comment letter on the IASB ED `Revenue from Contracts with Customers´, where we commented that matching the direct cost of obtaining a contract with the revenues from the respective contract provides useful information. We therefore proposed that direct costs of obtaining the contract should be capitalised in the same manner as costs of fulfilling a contract.

Question 8 – Premium allocation approach (paragraphs 54–60 and BC145–BC148)

(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?

Permit but not require

We support view (ii) that the Board should permit but not require the measurement approach for the pre-claims liabilities of some short-duration insurance contracts.

In some cases it might not be practicable for insurers to apply the modified measurement model.

As the modified measurement approach should be a reasonable proxy for the full measurement model, we support the alternative to include it as an option for a simplified measurement approach.

Furthermore, as outlined in BC147, requiring an insurer to use a measurement approach which is intended to be a simplification is inconsistent with the rationale for a shortcut.

Pre-claims and post claims model

We understand the approach to measure the pre-claims liability of an insurance contract separately (and differently) from post claims liabilities.

We read the ED in such a way that the claims liability is measured on the same basis as other insurance contracts, except that no residual margin is included. Setting up a residual margin is not necessary as the release of the pre-claims liability (the unearned part of the premium) includes the residual margin to be released. We propose to include examples in the final standard to provide consistency in interpretation regarding the interaction between the pre-claims and the post claims model.

Modified approach

In our view, it is appropriate to allow for a modified approach for pre-claims liabilities that should provide a practical shortcut for short-duration contracts. We believe that the use of the proposed premium allocation approach provides decision-useful information and is a reasonable proxy for the full measurement model.

It is our understanding that the premium allocation approach was meant to be a simplified approach. However, the proposal seems to imply that an insurer has to calculate the present value of fulfilment cash flows (including risk adjustments) at each reporting date to ensure that a contract is not onerous. We believe that this requirement would make the modified measurement approach overly burdensome and suggest that an onerous test should be required only if there are certain indicators or triggering events.

Additionally, we are concerned about the notion that an insurer shall discount the present value of future premiums and accrete interest on the carrying amount of the pre-claims liability. We believe that the benefit of mandatory discounting of future premiums arising within insurance contracts with a coverage period of approximately one year or less does not exceed any reasonable cost-benefit threshold. To provide a simplified measurement approach the pre-claims liability should not accrete interest.

Short-duration criterion

We support a clear scope definition and believe that the modified measurement approach should only be allowed for short-duration contracts with a coverage period of one year or less.

However, we are unclear regarding the scope of the modified measurement approach in respect of reinsurance contracts ceding typical one year P&C contracts. Those contracts may have durations of more than one year and would therefore be excluded from the simplified approach in contrast to the reinsured direct contracts. We support further clarification as we have the impression that the Board wants to include those contracts.

Question 9 – Contract boundary principle (paragraphs 26–29 and BC53–BC66)

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?

We agree with the proposed boundary principle to distinguish the future cash flows that relate to the existing insurance contracts (which are included in the measurement) from those that relate to future insurance contracts (which are not included in the measurement).

In our view, the point at which the insurer is no longer required to provide coverage and the policyholder has no right of renewal is one point on the boundary of the existing contract. In addition, we believe that the ability to re-price as a result of policyholder risk is a key element in determining the contract boundary. So at the point at which the insurer has the right (evidenced by the contract) or the practical ability (e.g. through access to claims information) to reassess the risk presented by a policyholder and can set a price that fully reflects that risk, the insurer is no longer bound by the existing contract.

We agree with the example outlined in BC57 that a contract that permits an insurer to reprice on the basis of general market experience (e.g. mortality experience), but without permitting the insurer to reassess the individual policyholder's risk profile, (e.g. the policyholder's health) lies within the boundary of the existing contract.

However, we suggest that the application guidance should include some examples regarding specific insurance contracts (e.g. group contracts) in order to ensure consistent application in practice.

From a conceptual point of view the GASB generally supports consistency across standards. We therefore propose to include that proper 'boundary' principle in the Exposure Draft 'Leases' and the Exposure Draft 'Revenue from Contracts with Customers'.

Question 10 – Participating features (paragraphs 23, 62–66, BC67–BC75 and BC198–BC203)

(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?

Inclusion of participating benefits

We agree that the measurement of insurance contracts should include participating benefits.

In our view, the participation of policyholders is to be considered as part of the best estimate liability, because these benefits are an integral component of the contract.

We share the Boards´ views mentioned in BC70 to not limit the cash flows to those for which a legal or constructive obligation exists. Premiums for participating contracts are generally set in the expectation that the insurer will pay distributions. Therefore, it is appropriate to include these distributions in the measurement on the same expected value basis as the premiums.

If the cash flows exclude the participating benefits, that exclusion will increase the residual margin. If the cash flows for each scenario include the estimated participating benefits, the resulting pattern of income recognition will represent the economics of the transaction more faithfully.

Expected present value basis

We support the proposal that measurement of policyholder participations should be based on the expected amounts to be paid according to the participation arrangements or, if applicable, existing legal requirements.

If the amount, timing and uncertainty of the cash flows from the insurance contract depend on the return of specific assets, we support the proposal that the measurement of those insurance liabilities should reflect that dependence. We understand paragraph 32 in the way outlined in BC97 that the dependence on assets is only relevant for unit-linked contracts and for the participation business.

We have some concerns as to how that linkage will be reflected. Paragraph 32 simply states that any dependency of cash flows from investment earnings should be considered in measurement – it does not even require that this has to be reflected in the discount rate. We suggest further clarification regarding the two possible approaches.

We generally agree that the IASB proposes a fully principle-based approach, i.e. describes the general measurement objective and attribute, regarding the extreme variety and complexity of such features word-wide.

However, we believe that a minimum level of guidance (e.g. example for traditional life contracts) should be included in the final standard to provide some consistency in interpretation. In addition, it would be helpful to clarify that it was intended to provide a principle-based approach with generic guidance since otherwise some could try to derive from the ED guidance by interpretation or analogy.

Question 10 – Participating features (paragraphs 23, 62–66, BC67–BC75 and BC198–BC203)

(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?

The GASB generally agrees with the proposal that certain participating investment contracts should be treated in the same way as participating insurance contracts although those contracts do not meet the proposed definition of an insurance contract.

From a conceptual point of view, one could argue that subsuming certain financial instruments under this standard labelled "Insurance Contracts" could cause misinterpretations regarding the scope of the proposed standard.

However, some types of investment contracts often have characteristics, such as long maturities, recurring premiums and high acquisition costs, that are commonly found in insurance contracts. The proposed model for insurance contracts can therefore generate useful information about contracts containing these features.

Furthermore, measurement of discretionary features was specifically considered as part of this project and not in the financial instrument project.

To identify the participating investment contracts that should be within the scope of the draft IFRS, the Board proposes to use the existing definition of a discretionary participation feature in IFRS 4, with one modification that the contracts must participate with insurance contracts in the same pool of assets, company, fund or other entity.

Cash flow distributions to participating policyholders that are made in aggregate for both participating insurance and investment contracts should be measured using the same model as it might be problematic to apply different accounting models to different parts of that aggregate participation. Using the same approach for both types of contract will produce more relevant information for users and simplifies the accounting for those contracts.

We welcome the IASB's efforts to find a new condition to provide a clear scope definition. However, we are concerned that the new condition could result in different accounting treatments for similar contracts.

It is common to find investment contracts with discretionary participation features invested in segregated funds where no insurance contracts participate in the performance. Certain jurisdictions require the use of a segregated fund without the participation of insurance contracts, for example in Italy. Furthermore, the German regulator requires products with discretionary features to invest in segregated funds when they reach a certain threshold. These contracts would be accounted for under IFRS 9, whereas similar contracts held by the same company would be accounted for under IFRS 4.

We therefore developed another criterion, being "financial instruments and the insurance contracts should be managed together". This new condition can provide a clear and appropriate scope definition according to which investment contracts with discretionary participation features should be included or accounted for under IFRS 9.

Question 10 – Participating features (paragraphs 23, 62–66, BC67–BC75 and BC198–BC203)

(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?

The contract boundary principle for these contracts builds on the defining characteristic of these contracts, namely the presence of the discretionary participation features, rather than the existence of insurance risk. We consider that the chosen criterion that the contract boundary is at the point of time at which the contract holder no longer has a contractual right to receive benefits arising from the discretionary participating feature is appropriate.

We also agree with the proposed principle that the residual margin shall be recognised over the life of the contract in a systematic way that best reflects the asset management services.

Question 11 – Definition and scope (paragraphs 2–7, B2–B33 and BC188–BC209)

(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?

From our perspective, the definition of an insurance contract in IFRS 4 Phase I has worked quite well.

We believe that the new requirement to take into account the time value of money will not change the current practise.

However, we have some concerns regarding the proposed explicit risk transfer test. If such an explicit risk transfer test would be included, it is indispensable, particularly in the reinsurance business, that other concepts currently included in U.S. GAAP that have to be seen in conjunction with an explicit risk transfer test, such as the reasonably self-evident argument and the substantially all argument, are also included.

The main reason is that - in contrast to primary insurance business - the smallest level of measurement in the reinsurance business is a single reinsurance contract, i.e. a portfolio of single policies. Such portfolios in many cases benefit from diversification effects. Consequently, they often produce relatively stable expected results (i.e. only a small range of possible outcomes) and the probability of a loss (i.e. present value of net cash outflows exceeding the present value of net cash inflows) is relatively low.

We propose an overarching principle that a business, which meets the definition of an insurance contract in the primary insurance sector, should also be considered as an (re)insurance contract if this business (or parts of it) is reinsured and the reinsurer covers the risks inherent in this portfolio on an analogous basis.

In addition, we support further clarification that the assessment of a contract is only carried out once, i.e. at inception.

Question 11 – Definition and scope (paragraphs 2–7, B2–B33 and BC188–BC209) (b) Do you agree with the scope exclusions in paragraph 4? Why or why not? If not, what do you propose and why?

The GASB agrees with the scope exclusions in paragraph 4, but we propose that the following matter should also be excluded from the scope of the ED:

We read the ED in the way that certain performance guarantee contracts would be included in the scope of the insurance standard. We would not agree with such a scope inclusion, as we believe that the existing practice of accounting for such contracts under IAS 37 provides relevant information for the users of financial statements. Changing the existing accounting for these contracts would impose costs for no significant benefit. From a conceptual point of view, subsuming these contracts under this standard labelled "Insurance Contracts" could cause misinterpretations regarding the scope of the proposed ED.

Question 11 – Definition and scope (paragraphs 2–7, B2–B33 and BC188–BC209) (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?

These contracts transfer credit risk and are generally financial instruments. The general discussion around these contracts is based on the fact that a contractual precondition for any payment under the contract is that the holder has suffered a loss, and this is a distinguishing feature of insurance contracts.

Nonetheless, the GASB does not support the proposed approach that financial guarantee contracts as currently defined in IFRSs should be brought within the scope of the IFRS on insurance contracts.

In our view, such a requirement causes practical application issues for non-insurance entities that have historically been accounting for such contracts under IAS 39. These contracts are measured at inception at fair value and subsequently at the higher of the amount determined in accordance with IAS 37 and the amount initially recognised less amortisation. We believe that the current accounting for such contracts provides relevant information for the users of financial statements.

Furthermore, we considered that the business model of non-insurance entities and how the contracts are managed differs from the insurance business underlying the proposed building block model. For example, the banking industry manages credit risks on the basis of the “expected loss” model together with credit exposures on other financial instruments. This model differs from the actuarial techniques applied for insurance contracts and the entities are unlikely to have relevant actuarial expertise.

Therefore, we propose an approach to assess financial guarantees contracts that would follow the underlying business model and the nature of the contract. A possible feature to distinguish whether to apply financial instruments accounting or accounting for insurance contracts could be the contractual partner. In general, the relevant contractual partner for a financial guarantee contract issued by banks is the debtor and not the creditor, as is the case in the traditional credit insurance business.

Question 12 – Unbundling (paragraphs 8–12 and BC210–BC225)

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 believe that unbundling is appropriate when separate recognition and measurement of the components better reflects the substance of the contract and thus can enhance the usefulness of information for users by increasing transparency and comparability.

Unbundling can provide insights into the different components of an insurance contract and an insurer accounts in the same way for a non-insurance components as another entity (goods or services other than insurance coverage would be accounted for under the revenue model and investment components would be accounted for under IFRS 9 or IAS 39 respectively). Mixing up the cash flows of the non-insurance component with insurance related cash flows can obscure the true nature of the risks arising from both, the insurance and non insurance component.

However, unbundling should result in similar accounting for similar contracts. We think that the proposed criteria “not closely related to the insurance coverage” and the underlying examples mentioned in paragraph 8 of the ED do not sufficiently help to interpret and consistently apply the principle in practice.

We believe that a significant degree of judgement may be needed to determine which components of a contract are not closely related to the insurance coverage specified in the contract.

The example relating to an investment component reflecting an account balance does not fully explain how the principle might be applied in practice across a wide variety of situations. We have doubts whether the unbundling principle would be fulfilled by contracts if there is no obligation to forward the entire investment return to policyholders. Therefore, many of these contracts found in practice may not meet the full form of the example.

Overall, we support the “closely related” principle as it is reasonable. However, we believe that the principle is missing supporting explanations and guidance to allow preparers to understand and apply consistently the principle without significant and burdensome efforts and costs.

Question 13 – Presentation (paragraphs 69–78 and BC150–BC183)

(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?

The GASB does not agree with the IASB’s proposed summarised margin approach for the presentation of insurance contracts in the statement of comprehensive income.

For non-life insurance contracts the unearned premium approach provides useful information. The objections against the premium models relate mostly to the life industry as they do not provide full transparency, especially for products with a deposit component. Recognising the full premium including the deposit component as revenue is less informative.

In the proposed summarised margin approach, however, presentation is fully focused on reporting the value change in the liabilities, and margin information in particular. Considering the subjective character of margins, we doubt that a focus purely on margins is actually decision-useful information.

The GASB is concerned regarding the loss of familiar metrics in the statement of comprehensive income. In the proposed approach no information on premiums, claims and expenses as we know it from the income statement today will be presented on the face of the income statement.

Furthermore, the summarised margin approach does not present revenue as defined in the Exposure Draft ‘Revenue from Contracts with Customers’, because the summarised margin approach depicts as income only parts of the total consideration receivable from the policyholder, namely the risk adjustment and the residual margin.

Financial statement presentation should reflect the information that “Insurance can be described as being paid to assume risk, reimburse insurance claims, have some internal expenses and possibly earn a financial return between the payments of premiums and claims” (AV13). Under the summarised margin approach the users would have to consult the footnotes to obtain this information.

In addition, the summarised margin presentation results in quite a specific presentation model that is not used for other industries. A conglomerate-insurer also reports non-insurance activities as it operates in other industries.

Overall, we support that volume information should be presented on the face of the income statement as we believe that gross flows are easier to analyse and predict than net flows.

Therefore, we are not convinced that the objections against the current premium models justify such a significant change in presentation. For non-life insurance contracts, the GASB proposes to reflect earned premiums as revenue, as currently applied in the insurance industry. As already outlined, we are aware of the fact that current premium models do not provide full transparency for life contracts, because what is currently presented as revenue is less informative for products with a deposit component. However, taking into account our concerns regarding the summarised margin approach, we also support the currently applied premium model for the life industry. Insufficient information provided in the income statement should be accompanied by appropriate disclosure requirements, e.g. about sources of earnings and margin information.

Optional presentation approach for short-duration contracts

The short-duration contracts should be accounted for under the premium allocation approach (as specified in paragraphs 55-60 of the ED).

In our view, a presentation approach for those contracts showing the allocated premium (i.e. the earned premium) as revenue and incurred claims as an expense would be consistent with the revenue recognition proposals and would provide users with relevant information that faithfully represents the performance of these contracts.

For short-duration contracts the ED requires that a reporting entity presents the underwriting margin and changes in additional liabilities for onerous contracts on the face of the income statement.

Paragraph 75(a) gives the entity the option to disaggregate that margin either in the statement of comprehensive income or in the notes into volume information (premium revenue, claims incurred, expenses incurred, amortisation of incremental acquisition costs).

As already mentioned in our response to question 13, we believe that relevant volume information should be presented on the face of the income statement.

Furthermore, we have concerns that the proposed option reduces comparability between entities regarding the presentation of short-duration contracts.

We therefore propose that the alternative in paragraph 75(a) to present the disaggregated information for short-duration contracts on the face of the statement of comprehensive income should be mandatory.

Question 13 – Presentation (paragraphs 69–78 and BC150–BC183)

(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?

Subsequent Measurement

As already outlined in our response to Question3 (a), we do not agree with the approach that all changes in the present value of the fulfilment cash flows should be immediately recognised in profit or loss on subsequent measurement and support a mixed measurement model.

Accounting mismatches regarding the OCI option for equity instruments under IFRS 9

The ED proposes that no changes in value resulting from the insurance contract be presented in other comprehensive income. We have some concerns that this treatment can create accounting mismatches by accounting for insurance contracts and related financial assets measured at fair value through other comprehensive income (OCI option for equity instruments under IFRS 9). The current IFRS 9 permits an entity to make an irrevocable election to present in other comprehensive income changes in the fair value of an investment in an equity instrument that is not held for trading (B5.12). Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss. Dividends on such investments are recognised in profit or loss in accordance with IAS 18 'Revenue Recognition'.

An accounting mismatch occurs, where under the terms of an insurance contract (or certain financial instruments) with participating features, amounts will be payable by the insurer to the policyholder upon sale of an underlying equity security that is measured at fair value through OCI. In this instance, the insurer would recognise the proceeds from the sale of the equity security as an amount payable under the insurance contract, but in accordance with IFRS 9 would not recognise the gain on sale.

We propose that the decisions that have been made on shadow accounting should be reconsidered.

Overall, we are concerned that where participating features relate to equity securities, the proposed measurement approach for the liabilities would effectively preclude insurers from using the option to measure the equity securities at fair value through other comprehensive income to avoid accounting mismatches. We do not agree with the Boards´ proposal that an insurer should avoid the accounting mismatch by using the fair value option for its assets and the reasons outlined in BC179-181.

Question 14– Disclosures (paragraphs 79–97, BC242 and BC243)

(a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?

We generally agree with the proposed disclosure principle which requires an insurer to disclose qualitative and quantitative information about the amounts recognised in its financial statements and the nature and extent of risks arising from insurance contracts.

To disclose information that helps users to understand the amount, timing and uncertainty of future cash flows arising from insurance contracts will provide decision useful information to users of the financial statements.

From a conceptual point of view, we believe that an overall disclosure framework would be preferable to having separate objectives in each standard.

As outlined in our response on question 14(c), we have concerns that there is a tendency that converting that principle into concrete disclosure requirements results in additional disclosures, which appears especially true for this ED. We wonder why a proposal for a measurement model for insurance contracts needs such excessive disclosures.

Question 14– Disclosures (paragraphs 79–97, BC242 and BC243)

(b) Do you think the proposed disclosure requirements will meet the proposed objective? Why or why not?

In our view, the disclosure requirements do not fully meet the proposed objective and we have concerns in respect of certain detailed disclosure requirements.

Level of detail

We believe that the principles regarding the level of detail outlined in paragraph 81 are sufficient and should not be supplemented by the paragraphs 83 and 84.

Reconciliation of contract balances

As already mentioned in our answer on question 13, we do not support the proposed presentation model according to which information on premiums, claims and expenses should be presented in the notes and not on the face of the income statement.

Furthermore, it is not clear to us how the line items prescribed in the reconciliation of insurance contracts in paragraph 87 apply to the reconciliation of risk adjustment and residual margin.

Methods and inputs used to develop the measurements

The proposed ED includes a more detailed explanation of methods, inputs and processes used in the measurement.

The GASB understands the Boards´ view that since the proposed measurement for insurance contracts is a current measure of items that may be difficult to measure, transparency of the inputs and methods used is important to users of the financial statements.

However, we are concerned regarding the extensive disclosure requirements and the degree of granularity in the disclosures as outlined in our answer on question 14(c).

With respect to the new disclosure requirement in paragraph 90(b)(i) (confidence level on risk adjustment) we refer to our answer on question 5(c).

Paragraph 90(d) requires a measurement uncertainty analysis of the inputs that have a material effect on the measurement. This disclosure requirement should inform users about the extent to which the insurer might reasonably have arrived at different measurements. The ED proposes to take the effect of correlation between inputs into account if such correlation is relevant. We are unclear how the new disclosure is linked to existing analysis. In that context we also raise the question how the different sensitivity analysis requirements proposed are supposed to work together (paragraph 96(a), paragraph 92(e)(i), paragraph 90(d)) as we have the impression that there might be an overlap between the analyses.

Nature and extent of risks arising from insurance contracts

Paragraph 92(e)(i) requires information about the sensitivity to insurance risk. This disclosure was already included in the existing IFRS 4, but the option to disclose qualitative information has not been retained in the ED. We propose to include that option in Paragraph 92(e)(i) of the ED.

Question 14– Disclosures (paragraphs 79–97, BC242 and BC243)

(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 generally agree that existing disclosure requirements in IFRS 4 (including the disclosure requirements in IFRS 7 that are incorporated in IFRS 4 by cross-reference) provide an ideal starting point to assess the disclosure requirements for insurance contracts on the basis of the new measurement model according to the Board's statement in BC243. IFRS 4 allowed insurers to continue using various existing accounting practices that have been developed over many years. We understood the approach underlying existing IFRS 4 to extend the disclosures to provide consistency and comparability.

In our view, the proposed ED eliminates the diversity and weaknesses in current financial reporting requirements, but contains more disclosure requirements compared to the existing requirements in IFRS 4.

We are concerned about the volume and level of detail of the proposed requirements and see the risk of information overload. The proposed requirements may impose additional costs for gathering that information and have a corresponding impact on systems expenditure.

Finally, we suggest further consideration of the extent to which the disclosures required in the existing IFRS 4 will continue to be required in the final standard and which additional disclosures are mandatory regarding the new measurement model.

Question 15 – Unit-linked contracts (paragraphs 8(a)(i), 71 and 78, Appendix C, and paragraphs BC153–BC155 and BC184–BC187)

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

Measurement Approach

We generally agree with the proposed measurement approach for unit-linked contracts and the proposal that assets for which existing requirements result in an accounting mismatch should be recognised and measured at fair value through profit and loss. Eliminating the accounting mismatch for insurer's own shares and property occupied by the insurer makes financial statements more relevant and understandable and the proposal is a pragmatic approach.

However, we have some concerns regarding the principle outlined in BC154. It describes that if the insurer also has its own interest in the same fund, the insurer should measure those assets at fair value and that in the case of property, changes in the fair value of the insurer's own interest in the property would be recognised in other comprehensive income as a revaluation.

We do not support that principle as it restricts the general application and measurement of these assets under IAS 32 and IAS 16.

Presentation

We support the Boards' proposal in paragraph 71 that the pool of assets underlying unit-linked contracts and the portion of the liabilities from unit-linked contracts linked to the pool of assets shall be presented as a single line item and not be commingled with the insurer´s other assets or other insurance contract liabilities. Assets that are assigned to the policyholder in unit-linked contracts are not for the benefit of other shareholders or other policyholders.

In addition, presentation of income and expenses mentioned in paragraph 78 as a single line item is consistent with the balance sheet presentation. In our view, the proposed presentation requirements for unit-linked contracts makes performance reporting more useful, because it separately presents the performance directly related to such contracts.

A more general point relates to the special paragraphs for unit-linked contracts mentioned above and their interrelation with the proposed unbundling principle. We propose that the final standard should clarify that interrelation as unit-linked contracts that are unbundled are accounted for within the scope of IFRS 9 or IAS 39. We support the approach that the measurement should be dealt with under IFRS 9 / IAS 39 and the presentation under the insurance standard. Regarding the proposed unbundling principle we refer to our response on question 12.

Question 16 – Reinsurance (paragraphs 43–46 and BC230–BC241)

(a) Do you support an expected loss model for reinsurance assets? Why or why not? If not, what do you recommend and why?

From a conceptual point of view we support an expected loss model.

This approach is consistent with the Board's exposure draft 'Financial Instruments: Amortised Cost and Impairment', which proposes to switch to an expected loss model for financial assets. We suggest that any final outcome in that project should also be considered in the project on insurance contracts.

We have some concerns whether a sufficient empirical basis for a reliable measurement of that probability is available.

Question 16 – Reinsurance (paragraphs 43–46 and BC230–BC241)

(b) Do you have any other comments on the reinsurance proposals?

We have concerns whether the underlying economics are properly taken into account under the current proposal to calibrate the residual margin of the business ceded to the reinsurance premium.

In general, the measurement of assets and liabilities should be based on consistent principles.

According to this view, we consider that the measurement of reinsurance assets should be based on an assessment of the risk relief for the reinsured party by the reinsurance contract. In our view, the current proposal to calibrate the residual margin of the business ceded to the reinsurance premium raises concerns, whether the underlying economics would be properly taken into account as it might not reflect the realisation principle.

Regarding presentation a user of financial statements might get the wrong impression about the percentage of the primary insurer´s risks reinsured.

If the reinsurance contract appears to be non-profitable from the primary insurer´s perspective (e.g. if the reinsurer assesses the risk higher than the primary insurer and assumes business on conditions worse than the original conditions) this will result in a too high residual margin on the asset side. Due to the proposed calibration of the residual margin, the expected loss will be deferred rather than recognised immediately. In addition, a user of financial statements might get the wrong impression that the reinsurance asset is higher than the share ceded to the reinsurer.

A reinsurance premium that is beneficial for the cedant would result in a too low residual margin on the asset side. Preferred conditions the reinsurer can give under a contract should result in a gain at inception and not be deferred. Furthermore, a user of financial statements might get the wrong impression that the reinsurance asset is less than the share ceded to the reinsurer.

As already mentioned, we believe that the reinsurance asset should reflect the economics of the contract by considering the risk relief generated by the reinsurance cover. E.g. for a 100% quota share, the cedant on an economic net view is not at risk anymore.

Therefore, we propose that the measurement of the residual margin of the reinsurance asset should be based on the risk transferred from the cedant to the reinsurer. This could be achieved if, at the initial measurement, the residual margin of the reinsurance asset is equal to the proportion of the risk adjustment of the reinsurance asset to the risk adjustment of the liability applied to the residual margin of the liability.

Question 17– Transition and effective date (paragraphs 98–102 and BC244–BC257)

(a) Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?

Transition requirements

We disagree with the IASB proposed transition requirements to recognise any positive or negative difference arising from the transition "calculation" in opening retained earnings of the earliest period presented. The approach that an insurer should, on first applying the new IFRS, measure its existing contracts at that date by setting the residual margin equal to zero does not fairly reflect the performance of the insurer.

As a consequence, for contracts in force, when the new IFRS comes into effect, an insurer will not recognise residual margins as income for any subsequent period. The insurer will recognise income arising from the release of residual margins only for contracts recognised initially after adopting the IFRS. In our view, such a treatment prevents insurers from reporting a significant part of the profits on existing contracts through profit and loss and reduces comparability between the results on existing and new business.

Especially for long-term insurance contracts, we considered that the proposed transitional rules do not provide relevant and comparable information for many years and may reduce the usefulness of financial statements.

Furthermore, we believe that such an approach would put insurers at a comparative disadvantage to other industries and would distort capital and earnings ratios.

Therefore, we propose an accounting treatment which is in line with IAS 8 ‘Accounting Policies, Changes in Estimates and Errors’ and allows an insurer to apply the new standard retrospectively.

We understand the Boards’ arguments against retrospective application and the concerns that the insurer would need to estimate the future cash flows as if it had estimated them at initial recognition of the contracts and that this exercise may be burdensome. However, we do not believe that this approach causes costs that are disproportionate to the resulting benefit for users in all cases.

To the extent that this would be impracticable, we propose, in line with IAS 8, to allow a simplified approach by means of using a reasonable approximation for a retrospective application. We consider an approach, which compares the liability under current GAAP with the present value of the fulfilment cash flows at the beginning of the earliest period presented. One part of the calculated transition difference that is driven by different accounting treatments between old GAAP and new GAAP should be covered within retained earnings. From a practical point of view, we considered that it would not be consistent with a simplified approach to determine all effects that are driven by different accounting treatments as such a requirement would be burdensome and costly. We therefore propose to only reflect the different discounting effects. The remaining difference would be recognised in the residual margin and released over the remaining coverage period.

We generally understand the Boards concerns on the approach to treat the whole transition difference as residual margin as outlined in BC249. The Board rejected the approach because the resulting residual margins would not have been comparable with residual margins for subsequent contracts and would have depended significantly on the pattern of income recognition under previous accounting models. Therefore, we propose to record the effects of different discounting within retained earnings.

We acknowledge the deficiencies of our simplification approach. However, in our view, the proposed IASB transition approach provides even less comparability with subsequent contracts, because an insurer will not recognise any residual margins as income for subsequent periods.

Transition for short-duration contracts

Transition for short-duration contracts can also be relevant, but there are no transition requirements in the current proposals: the ED should also include guidance on transition for those contracts.

Question 17– Transition and effective date (paragraphs 98–102 and BC244–BC257)

(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)?

As already mentioned in our responses to other questions we do not agree with the FASB's composite margin approach, because the risk adjustment should be separately measured.

Question 17– Transition and effective date (paragraphs 98–102 and BC244–BC257)

(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?

We propose that the effective date of the IFRS on insurance contracts should be aligned with that of IFRS 9. As already mentioned in our response to question 3(a), it is important that the measurement of insurance liabilities and directly related financial assets reflects the nature of that relationship. Re-designation reduces the usefulness and the comparability of information and causes additional costs. In our view, it is more efficient and effective to allow insurance companies to adopt IFRS 9 and the final insurance standard at the same time, so that they would not have to face two rounds of major changes in a short period.

If the effective dates cannot be aligned, we generally agree with the proposal that insurers should be given the ability to re-designate financial assets at the time that the new insurance standard is adopted. The re-designation of financial assets is only permitted for financial instruments measured at fair value through profit or loss to reduce inconsistency in measurement or recognition. The re-designation of assets to amortised cost is not permitted. Therefore, we disagree with the Boards´ decision and propose that insurers should have an unrestricted ability to reclassify financial instruments at the date of transition to reduce or avoid accounting mismatches.

Question 17– Transition and effective date (paragraphs 98–102 and BC244–BC257)

(d) Please provide an estimate of how long insurers would require to adopt the proposed requirements.

As a general remark, we would support an implementation approach which primarily considers the quality of the final standard by accepting a potential delay in the timeframe. We believe that it is essential that the final standard is based on sound principles that can be consistently applied in practice.

To facilitate adoption, we believe that if a final standard was published in June 2011, the transition date should be no earlier than for reporting periods starting on or after 1 January 2014.

Depending on the internal processes that an insurer uses in managing its insurance business, the insurers need to change operational processes as well. For instance, some insurers do not regularly make an explicit estimate of the future cash flows required to fulfil an insurance contract. Similarly, determining risk adjustments is an emerging practice in the insurance industry, and only some insurers have developed the processes and systems to do this for risk management purposes.

Therefore insurers will need a reasonable time in order to adopt this new and complex standard.

Question 18 – Other comments

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

Recognition

Under the ED proposal, an insurer would recognise an insurance contract liability or an insurance contract asset when the insurer is bound by the terms of the insurance contract or when the insurer is first exposed to risk under the contract. The date on which the insurer recognises the insurance contract is particularly important in determining the residual margin.

We are concerned that such a requirement could cause additional costs and that insurers will not always have reliable information at that date. Insurers may not have the systems and processes to capture the necessary commitment information early enough. In its current form, the ED proposal would require system changes for the purpose of recognising a contract, which are likely to be time consuming and costly.

We further raise our doubts regarding the treatment of changes in assumptions between initial recognition and the start of the coverage period. Once the residual margin is locked-in, any changes to forward projections, such as changes in estimated lapse rates and discount rates, would be recognised immediately in profit or loss immediately.

For some types of insurance contracts, the insurer may become a party to the contract long before it considers that coverage starts, e.g. in cases of some deferred annuities with guaranteed terms, which are not triggered until payments are made or when annuitisation begins. In these cases, it is likely that the residual margin is released a long time after initial recognition.

Overall, as already outlined in our comments on the IASB Discussion Paper 'Preliminary Views on Insurance Contracts', we support the approach that except for any payments made in advance by the insured party, insurance contract liabilities or insurance contract assets should be recognised at the beginning of the insurance coverage period rather than upon signing the contract. Insurance contracts should be recognised when the insurance coverage has become effective, i.e. the first day of the insurance contract period in analogy to the settlement date accounting as outlined in IAS 39.AG56. In applying this approach, the insurer would be required to record any cash receipts received and cash payments made before the start of the coverage period and would also need to recognise a provision for any contract that becomes onerous, IAS 37 needs to be applied.

Question 19 – Benefits and costs (paragraphs BC258–BC263)

Do you agree with the Board's assessment of the benefits and costs of the proposed accounting for insurance contracts? Why or why not? If feasible, please estimate the benefits and costs associated with the proposals.

The GASB believes that a consistent and comprehensive IFRS for insurance contracts is needed.

The implementation of a new standard will certainly create burdensome and costly efforts for all companies, but a new standard would eliminate the diversity and weaknesses in current financial reporting requirements.

In our view, the proposed measurement model includes improvements to the current accounting for insurance contracts and is a step in the right direction.

Nonetheless, as already mentioned in our responses, we disagree with the proposals on subsequent measurement, presentation and transition. They significantly affect the benefits we expect from a new insurance standard.