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IFRS-Fachausschuss

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Berlin, XX. November 2014

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Dear Hans,

IASB Exposure Draft ED/2013/7 *Insurance Contracts* – Participating Contracts

The Accounting Standards Committee of Germany (ASCG) is following the IASB's redeliberations of the revised Exposure Draft on insurance contracts with great interest. In light of the current discussions regarding insurance contracts with participating features we believe there are still specific issues that need to be solved. Given that the IASB is going to come to a decision regarding participating contracts within the next couple of weeks, we would like to make use of the perhaps last opportunity to enter into dialogue with the IASB. That is why we would like to focus on the accounting for insurance contracts with participating features in this letter.

As mentioned in our comment letters both to the 2010 ED and to the 2013 ED we are supportive of the IASB's efforts to develop a global standard that deals with insurance contracts. We welcome most of the IASB's tentative decisions regarding contracts with no participating features except the decisions taken on the subject of reinsurance contracts. However, we have to admit that we have substantial doubts about the current debate with regard to contracts with participating features.

We appreciate the IASB's aim to develop a solution for participating contracts based on the following two steps:

1. Apply the general building block model developed for non-participating contracts to participating contracts.
2. Discuss what adaptations are needed to reflect the specific nature of participating contracts.

We already mentioned the advantage of having one model for all kinds of participating contracts in our comment letter in 2013. Nevertheless we disagree with some of the IASB's tentative views. In particular, our main concerns in this context refer to the unlocking of the contractual

service margin (CSM) and the discount rate to determine interest expense. We believe a proper solution regarding these issues is key for developing a standard that allows the appropriate depiction of participating contracts:

1. We consider it essential that the CSM will be unlocked for all prospective changes, that is to say financial and non financial assumptions. Only then can it be ensured that the profit sources from participating contracts and the insurer's re-investment risk are reflected adequately.
2. Next to the "fully unlocked" CSM we believe it is essential to require a book yield approach for interest accretion on insurance liabilities recognised in profit or loss. This approach takes into account that insurance contract liabilities are covered by underlying assets and avoid accounting mismatches, which is one of the key factors that needs to be considered.

This letters attempts to contribute to this discussion and support the IASB to develop an appropriate accounting model for participating contracts. Within our letter we would like to address especially the following issues in accordance with the questions raised in the last ASAF meeting: We first would like to highlight some specific characteristics of participating contracts, with a focus on German participating contracts. We further would like to express our view on which adaptations to the general building block model developed for non-participating contracts are necessary to adequately reflect the specific nature of participating contracts. In particular we mainly want to focus on the need for unlocking the CSM, an adequate recognition pattern for the CSM and as well address the discount rate to determine interest expense in profit or loss.

We would like to present our perspective in detail and refer to the attached appendix. If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr

President

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Appendix

A. Nature of participating contracts

The IASB properly determined in their May meeting that insurance contracts that contain participating features vary both within jurisdictions and between jurisdictions. Participating contracts imply that the policyholder transfers insurance risk to the insurer in exchange for a premium, that the entity invests the premium received in underlying items and includes those underlying items in its financial statements and the overall performance of the underlying items is shared between the entity and the community of policyholders as a whole.

We would like to focus on the nature of German participating contracts and their general the profit sharing concept. However, it should be noted that, while various types of participating contracts exists globally, participating contracts in many other jurisdictions work in a comparable way.

Generally all German life insurance contracts are participating in nature due to regulatory requirements. Insurers are required to adequately share the investment result, risk result and other result (including e.g., expense and lapse result) with policyholders. In addition, contracts typically provide minimum interest rate guarantees. Many contracts combine a saving component with a risk coverage component and thus provide asset management services and insurance coverage to policyholders.

The underlying item specified in German contracts is the assets and liabilities of the entity as a whole. Contracts specify a link between the payments to the policyholder and the returns on those underlying items. Assets are invested in one fund per legal entity covering all insurance liabilities. It is important to note that the ultimate benefits to the policyholders and the participation mechanism ultimately are based on the results according to statutory GAAP.

The participation in profits is collective (i.e., there is an assignment to a collective premium refund reserve). Thus, the “unit of account” for participation in profits is the community of policyholders. A regulatory rule defines a minimum policyholder participation for each of the three profit sources. The insurer has discretion to assign more profits to the collective premium refund than required by regulation.

The insurer assigns profits to individual policyholders out of the collective premium refund. The insurer has some discretion how to allocate the bonus to the different types of contracts. The insurer annually declares the individual participation. Typically, the bonus allocation increases the guaranteed level of benefits.

German participating life insurance contracts are typically very long-term in nature. As a consequence, the liability duration frequently exceeds the duration of underlying assets. This

DRAFT

introduces the risk to the insurer that market conditions at the date of future reinvestment will change, also affecting the insurer's share of returns on underlying items. Reinvestment assumptions are particularly relevant in combination with minimum interest rate guarantees.

Summing up, the following characteristics of these contracts are of particular relevance for accounting treatment:

- Many participating contracts imply a combination of asset management and insurance coverage;
- Policyholder participation, and in return the insurer's profits, are based on three profit sources: investment, risk and other;
- The insurer has discretion to share more than the minimum required by regulation;
- The biggest part of profits is allocated periodically;
- Liability duration typically exceeds asset duration, resulting in reinvestment risk for the insurer; and
- Policyholder participation is collective (i.e., there is no profit sharing on individual contract level).

B. Accounting model for participating contracts based on the general measurement approach

In our view, the general building block model developed for non-participating contracts should also be applied to contracts with participating contracts, with some adaptations to adequately reflect the specific nature of these contracts.

In the presentation for the September 2014 ASAF meeting, five issues were raised for discussion regarding potential adaptations for participating contracts:

1. Is a splitting of cash flows needed?
2. Should the insurance liability adjusted to offset the effect of net profit or loss from underlying assets?
3. How should changes in fulfilment cash flows related to options and guarantees be accounted for?
4. What is the appropriate recognition pattern for the contractual service margin for participating contracts?
5. How should interest expense in profit or loss be determined?

In the following, we will address each of these issues and in addition discuss the potential scope of contracts (6.) applicable to the proposed adaptations.

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1. Is a splitting of cash flows needed?

According to the IASB's tentative view no adaptations for participating contracts are needed regarding the determination of fulfilment cash flows. That means that fulfilment cash flows shall be determined consistently for both participating and non-participating contracts. We strongly support this proposal.

2. Should the insurance liability be adjusted to offset the effect of net profit or loss from underlying assets?

The ED 2013 states that the CSM under the general building block model developed for non-participating contracts at initial recognition is the difference between the present value of premium inflows and the present value of expected benefits and expenses plus the risk adjustment, reflecting the unearned profit from the contract. Applied to participating contracts, it would contain expected shareholder returns from all profit sources, including expected investment returns from existing assets and expected reinvestments.

For subsequent measurement, the CSM as determined at initial recognition would be carried on and allocated to future periods ("released as services are provided"). Under the 2013 ED, it would be unlocked for changes the shareholders' share of future risk and other returns, as they relate to non-financial assumptions. However, it would not be unlocked for changes in financial assumptions. Thus, changes in the insurer's participation in the investment result would be directly recognized in profit or loss.

Proposed adaptation: Unlocking the CSM for changes in financial assumptions

In our view, not unlocking the CSM for changes in financial assumptions is not in line with the general requirements to adjust the CSM for changes in estimates of future cash flows that are related to future coverage and other future services. For participating contracts, the CSM should be unlocked for changes in underlying items, especially for changes in reinvestment assumptions and the time value of options and guarantees ("fully unlocked CSM"). These changes relate to future services should result in an adjustment of the CSM, as this affects the future profitability of the entity.

At initial recognition, there is no difference between a fully unlocked CSM and the CSM determined under the general building block model developed for non-participating contracts. Under both approaches, the CSM is unlocked for subsequent measurement for changes in expected cash flows resulting from non-investment profit sharing (i.e., risk and other result). The key difference is the treatment of changes in financial assumptions for subsequent

measurement. A fully unlocked CSM is also adjusted for changes in the insurer's expectations regarding future participation in the assumed investment result.

Rationale for the proposed adaptation

As discussed above, participating life insurance contracts are very long-term in nature. Thus, the insurer's financial position and future earnings strongly depend on contracts issued in the past ("in-force portfolio"). An accounting model for participating contracts based on a fully unlocked CSM provides users of financial statements with a comprehensive picture of the insurer's performance and financial position:

- The income statement reflects the insurer's performance of the period;
- The CSM presents the unearned future profits from all contracts issued based on current assumptions;
- The liability measured at current fulfilment value in the statement of financial position reflects the insurer's obligation based on current assumptions.

Without unlocking the CSM for changes in financial assumptions, a change in expected reinvestment assumptions would impact net income of the period, also in the absence of options and guarantees. We do not believe this would provide an adequate picture of the insurer's performance of the period.

At the same time, the CSM would not represent the unearned profit from all contracts issued in the past and loses its prospective nature. Interest rates in Germany have significantly declined over the past years. For a contract issued in the 1990ies, the CSM at initial recognition would have been based on investment returns for existing assets and future reinvestments way above current market conditions. If the CSM for this contract was not unlocked for changes in financial assumptions, but instead the CSM determined at initial recognition was allocated over the coverage period, the CSM as of today would significantly overstate the unearned profits from the contract, because they would be based on investment margins that are much higher than what the insurer can expect under today's market conditions.

Concerns regarding a fully unlocked CSM

We understand that the IASB has identified some conceptual concerns regarding an unlocking of the CSM for changes in financial assumptions. While we understand these concerns and believe they bring up some valid points, we still believe that on balance an unlocking of the CSM for changes in financial assumptions is an appropriate solution for

DRAFT

participating contracts. In the following, we would like to take up some of the concerns and present our view.

1. <u>Concern raised:</u> *Under the IASB's model, the cash flows relating to the insurer's share of the underlying items are not part of the fulfilment cash flows of the contract, because they arise from the underlying items and not from the rights and obligations of the contract to the policyholder. (Agenda paper 2D for the June 2014 IASB meeting)*

   <u>Discussion:</u> The policyholders' share and the shareholders' share are always projected out together (i.e., based on 100% of the returns on underlying items). The shareholders' share is everything that is not allocated to the policyholder. As a consequence, expected returns on underlying items can be seen as cash flows within the contract boundaries, similar to the premiums. They are included in contractual cash flows when projecting expected outflows to policyholders. A fully unlocked CSM captures the insurer's share in expected returns on underlying items (i.e., the share not expected to result in cash outflows).

   As noted, the insurer assigns profit participation to a collective "premium refund reserve". As the name of this reserve indicates, the profit participation can be considered as a repayment of parts of the policyholder's original premium payment. This repayment arises because the original premium was calculated based on conservative assumptions. This indicates that the premium under a participating contract is variable in nature, among others depending on investment returns. There is a close link between premium payments and investment returns.

2. <u>Concern raised:</u> *Adjusting the contractual service margin by changes in estimates of the entity's expected profit from the underlying items would be inconsistent with other IFRS (for example, IFRS 9 Financial Instruments). The entity's share in the performance of the underlying items is a consequence of the entity controlling the underlying items and having to recognize those underlying items in the balance sheet and profit or loss in accordance with IFRSs. Consequently, it is inconsistent with IFRSs to change the timing of when these income and expenses of the underlying items are recognized in profit or loss so that they would be significantly different from how such underlying items would be accounted for if they did not back insurance contracts with participating features. The IASB notes that such inconsistencies increases structuring opportunities and, therefore, may reduce the transparency of the results between economically similar transactions. (Agenda paper 2B for the May 2014 IASB meeting)*

DRAFT

Discussion: Unlocking the CSM for changes in financial assumptions does not change the way for the underlying assets are accounted for in the statement of financial position, other comprehensive income or profit or loss. Investment returns according to IFRS 9 or other applicable IFRSs would be presented in profit or loss and other comprehensive income. There would be no difference to the way these assets would be accounted for if they did not back insurance contracts with participating features.

The CSM would be adjusted according to IFRS 4 subsequently. We acknowledge that although a fully unlocked CSM does thus not overrule IFRS 9, net income is affected due to the interaction between IFRS 9 and IFRS 4. This reflects strong interrelation between profit sources for the shareholder for participating contracts. This dependency is reflected in the initial measurement of the CSM and should be maintained for the subsequent periods as well.

In the case of German participating contracts where bonuses are allocated periodically in line with the realisation of underlying assets, the major impact from changes in financial assumptions which should unlock the CSM relates to changes in current reinvestment assumptions. For expected reinvestments, the entity currently does not hold any assets and thus unlocking the CSM does not relate to profit or loss from existing assets. The entity does not control the underlying items with regard to reinvestment, as future market rates that are out of the insurer's control. Without a CSM unlocking for such effects, the entity's net income of the period would be impacted from "assets" the insurer does not yet have on its book, also in the absence of options and guarantees. We do not believe this would provide an adequate picture of the insurer's performance of the period.

3. *Concern raised: A fundamental difficulty with the proposal to adjust the margin to reflect the entity's share of the underlying items is that it would require the IASB to specify which underlying items would qualify. However, identifying such criteria would be difficult. (Agenda paper 2B for the May 2014 IASB meeting)*

   Discussion: As discussed above, the policyholders' share and the shareholders' share are always projected out together. As policyholder cash flows for participating contracts depend on the development of underlying items, these underlying items need to be identified anyway to determine expected cash outflows. The CSM would be determined on the same grounds. This is a direct consequence of the prospective nature if the general building blocks model the IASB has selected as the measurement basis for insurance contracts.

DRAFT

In the case of German participating business, identification of underlying items is not critical, as they are clearly defined by regulation and bonus declaration is always based on the assets the insurer holds.

While we understand that identification of underlying items may be conceptually challenging for some other types of participating contracts, we heard from preparers of the ACGS's working group *Insurance* that in practice this topic is less critical than one would expect from a conceptual view. Underlying items need to be identified already under IFRS 4 Phase I or national GAAP, e.g. for the purpose of liability adequacy testing, where the expected return from underlying items are taken into account. Practicable and auditable ways to determine these underlying items have been developed in most circumstances.

4. *Concern raised: Investment returns on underlying items acquired with premiums from an insurance contract are also a source of profit for the entity for non-participating insurance contracts. (Agenda paper 2B for the May 2014 IASB meeting)*

   Discussion: The accounting is driven by the fact that for participating contracts, asset management services are services provided under the contract, which is not the case for non-participating contracts. The fact that the liability cash flows depend on the investment return from the underlying items creates a conceptual link which does not exist for non-participating contracts.

   Considering asset management services as part of the services provided under a participating life insurance contract, and thus investment income as part of the underwriting income, is a well-established concept in insurance accounting in many jurisdictions.

Unit of account for determination of CSM

As described above, the participation in profits for German participating contracts is collective (i.e., the "unit of account" for participation in profits is the community of policyholders). The insurer assigns profits to individual policyholders out of the collective premium refund, having some discretion for the exact allocation. This introduces some degree of cross-subsidization between policyholders also for the management of options and guarantees.

The unit of account for the measurement of the CSM needs to take into account the economics of the participation mechanism, which is collective for German participating contracts, and the implications this has for the value of options and guarantees. Determining a CSM on single contract level would not adequately reflect the insurer's true financial position and performance.

DRAFT

3. How should changes in fulfilment cash flows related to options and guarantees be accounted for?

Background:

According to the 2013 ED, the present value of fulfilment cash flows should be determined as an explicit, unbiased and probability-weighted estimate (i.e., expected value) of the present value of the future cash outflows less the present value of the future cash inflows that will arise as the insurer fulfils the insurance contract, plus a risk adjustment. For complex contracts, such as participating contracts, an insurer will typically develop scenarios to reflect different assumptions for the development of financial (e.g., interest rates) and non-financial assumptions (e.g., mortality). These scenarios are assigned a probability weight and discounted consistently with the expected interest rate development under this scenario to determine the present value of expected cash flows.

Cash flows from options and guarantees embedded in the insurance contract that are not separated as not closely related embedded derivatives should be treated consistently with all other expect cash flows and thus be reflected when determining cash flows under the different scenarios. They should to be reflected in the expected cash flows under each scenario.

Cash flow projections for each scenario need to reflect expect cash outflows and inflows based on expected asset returns and reinvestment assumptions under this scenario. Under certain scenarios the option or guarantee will "bite", under other scenarios it will not. For example, a minimum interest rate guarantee will impact expected cash outflows to policyholders in scenarios where expected reinvestment rates will be lower than the minimum guaranteed interest rate.

The value of options and guarantees represents the difference in the present value of future cash flows under all scenarios between a situation where these options and guarantees are reflected in the expected cash flows and a situation where cash flows are determined on the same assumptions in each scenario, but without taking the options or guarantees into account.

The value of options and guarantees reflects the fact under a certain (adverse market) scenario, cash outflows are higher due to the guarantee than they would be without. It thus reflects the risk an option or guarantee will "bite" under certain scenarios.

Discussion:

For the case of minimum interest rate guarantees, changes in market conditions will not affect investment returns and thus not change cash flows to policyholders and shareholders

DRAFT

to the extent these cash flows are determined by existing fixed interest rate assets. The value of a minimum interest rate guarantee is fully determined by expected reinvestment assumptions (i.e., expected interest rates). It thus reflects cash flows to policyholders due to changes in financial assumptions. Since the IASB decided in March 2014 that differences between the current and previous estimates of the risk adjustment that relate to future coverage and other services should adjust the CSM, we believe this can and should also be transferred to risk included in options and guarantees.

Therefore value of options and guarantees should be recognized where changes in expected cash flows due to changes in financial assumptions are recognized. As in our view, changes in financial assumptions should adjust the CSM for participating contracts, also changes in the value of options and guarantees should adjust the CSM.

4. What is the appropriate recognition pattern for the contractual service margin for participating contracts?

Under the 2013 ED, the CSM is recognized in profit or loss over the coverage period in the systematic way that best reflects the remaining transfer of services that are provided under the contract. This principle can also be applied to participating contracts. However, it needs to be discussed what the services provided under a participating contract are and how these services should be reflected in a release pattern for the CSM.

Contracts with participating features are predominantly contracts that oblige the entity to provide asset management services in addition to insurance coverage. The 2013 ED acknowledged that the services in a participating contract include insurance coverage and asset management. According to Agenda Paper 2B for the May 2014 IASB meeting, because the CSM is a blend of insurance coverage and asset management services that are not separately identifiable, any recognition pattern for the CSM is inevitably arbitrary, at least to some extent, and will be different for different types of participating contracts. The insurer needs to determine the predominant driver that best reflects the pattern of transfer of the combined coverage and asset management services and then recognize the CSM in profit or loss over the coverage period.

We do not believe that a strict rule for the release pattern would adequately reflect the characteristics of participating contracts sold in different jurisdictions. However, we believe that a pure principles-based approach (“as service is provided”) would impair comparability and transparency. The aim should be to develop a clear objective for the release pattern that supports preparers and auditors to select and apply a pattern which best reflects the nature

DRAFT

of the underlying services on the one hand but limits discretion and manipulation on the other hand.

In the case of German participating contracts, the policyholder shares in the realised returns on underlying assets. Bonuses based on investment and non-investment profit sources are declared periodically when those returns are realised. Bonus declaration thus reflects asset management services and insurance coverage and might thus be a reasonable proxy for the services provided for such contracts.

We note that the “projected credit approach to effective yield” for participating contracts as discussed in agenda paper 2A for the September 2014 IASB meeting uses entity’s projected crediting rates to recycle amounts stored in OCI, which reflect the effects from changes in financial assumptions, to profit or loss. While this approach has some severe disadvantages when applied to participating contracts, we believe the discussion about the release pattern for the CSM should consider this recycling mechanism.

5. How should interest expense in profit or loss be determined?

Under the 2013 ED, entities were required to determine interest expense in profit or loss for non-participating contracts based on the interest rate locked-in at contract inception. The difference in discounting between the current rate and the locked-in rate would be stored in other comprehensive income (“OCI”). In its re-deliberations, the IASB introduced an accounting policy choice on portfolio level to present the effect from changes in discount rates in OCI or profit or loss.

The IASB rightfully acknowledged, e.g. in Agenda Paper 2A for the September 2014 IASB meeting, that a presentation of interest expense based on interest rates locked-in at contract inception would not fairly reflect the economic effects of a change in interest rates for participating contracts.

For participating contracts, the interest rate used to determine interest expense on insurance liabilities in profit or loss needs to reflect the funding of the liabilities via investment returns on underlying items to avoid an accounting mismatch in profit or loss.

IFRS 9 introduces a mixed measurement model to accounting for financial instruments. During their re-deliberations to the 2013 ED, the IASB started discussing a book yield approach. This approach presents interest expense in profit or loss consistently to how the interest income on underlying times is presented in profit or loss. The book yield thus avoids accounting mismatches under a mixed measurement environment for the underlying assets, as is the case under IFRS 9.

DRAFT

As the book yield approach results in a profit or loss discount rate which is consistent with the profit or loss rate from the underlying assets, this should effectively lead to a situation where the overall amount stored in OCI from liabilities is close to the amount of OCI produced by debt instruments accounted for at fair value through OCI (“FVOCI”) or amortized cost (i.e. the net OCI is close to zero). In addition it should be noted that liability OCI under a book yield approach is only resulting from the period where assets and liabilities are duration matched.

Where the duration of the liabilities exceeds the duration of underlying assets, assumptions about future reinvestment have to be made. As a consequence, for this unmatched part of the liability the current rate used for the balance sheet and the book yield are equal, resulting in no OCI. The volatility in the fulfillment cash flows resulting from changes in reinvestment assumptions will not be reflected in OCI under a book yield approach. As discussed above, in our view the effect from changes in reinvestment assumptions should be reflected in the unlocked CSM.

The book yield avoids accounting mismatches in profit or loss in an environment where the insurer accounts for its assets under a mixed measurement approach according to IFRS 9. As long as an option exists in IFRS 9 to designate all financial instruments as at fair value through profit or loss (“FVPL”) to eliminate or reduce an accounting mismatch, generally there is no need for a book yield approach for participating contracts to avoid accounting mismatches. The entity’s overall net income of the period should be largely unaffected by the introduction of a book yield.

The biggest benefit of the book yield is that is does not require insurers to account for all assets backing insurance liabilities for participating contracts at FVPL, which in most cases would differ from the business model classification required under IFRS 9 and from what insurers would opt for if the assets did not back participating contracts. Thus, the investment result presented in profit or loss loses some of its meaning to users of financial statements if all assets are accounted for at FVPL.

One disadvantage of the book yield is its interaction with the interest rate used to accrete interest on the CSM:

- If interest accretion on the CSM for participating contracts is based on the current yield for both profit or loss and the balance sheet, the entity could be forced to account for underlying assets at FVPL to avoid accounting mismatches in profit or loss. As a consequence, the book yield would not be applied.
- If interest accretion on the CSM for participating contracts is based on the book yield for both profit or loss and the balance sheet, the amount of CSM recognized in the

DRAFT

balance sheet will depend on the measurement approach the entity applies to account for underlying assets. Thus, a presentation decision (FVOCI or FVPL for underlying assets) will impact the measurement of the insurance liability.

- A solution could be to use the current rate for interest accretion on the CSM in the balance sheet and the book yield for interest accretion on the CSM in profit or loss. However, this solution will introduce “OCI on the CSM” and add additional complexity to the overall accounting model for insurance contracts.

When deciding whether or not to introduce a book yield in addition to the fully unlocked CSM, the IASB needs to balance the weight of the benefits of this approach against its disadvantages. As noted above, policyholder participation for German participating contracts, as well as in many other jurisdictions, is based on realised asset returns. In addition, insurers would very likely not account for debt instruments at FVPL if these assets were not used to cover insurance liabilities. To better reflect this, the ASCG supports the introduction of a book yield approach, which would allow insurers to account for underlying debt instruments at FVOCI, which is more align with the participation mechanism in many jurisdictions.

As noted in our comment letter to the 2013 ED, some contracts, such as unit-linked contracts or variable annuities, are managed on a FVPL basis. Recognizing the effect of changes in discount rates on the insurance liability in OCI does not appear appropriate in these cases. If the IASB decides to introduce an OCI solution also for participating contracts, this should thus be based on an accounting policy choice for OCI vs. profit or loss presentation of the effects from changes in discount rates, consistent with the tentative decision for contracts with no participating features.

We note that the IASB heard different views about how the accounting returns might be reflected for some asset classes when determining the book yield. The FVOCI category for equities under IFRS 9 does not include a recycling mechanism for realised gains or losses. Since these realisations will be shared with policyholders under a participating contract, insurers are forced to classify equities as at FVPL to avoid accounting mismatches. In our view, debt instruments accounted for under FVOCI or amortized cost introduce the highest potential for accounting mismatches with regard to participating contracts.

During the September 2014 Board discussion, the following proposal for a book yield approach was brought up:

- For debt instruments measured at FVOCI or amortized cost, the bond’s effective yield is used, adjusted for impairments requirements according to IFRS 9.
- For all other assets, the current rate is used.

DRAFT

- For the period beyond the duration of existing underlying assets, the current rate is used.

In our view, this approach provides a practicable solution that avoids accounting mismatches where they are most severe, and at the same time provides an objective and transparent solution.

The ASCG strongly supports the tentative decisions with regard to OCI presentation of the effect of changes in interest rates for non-participating contracts. Whatever the final decision for an OCI solution for participating contracts will be, this should not re-open the discussion with regard to non-participating contracts.

6. Scope

The final standard needs to define the contracts to which the proposed adaptations apply. A8(b)(i) in Appendix C of agenda paper 2 for the October 2014 IASB meeting explains how the IASB directed the staff to restrict the applicability of the book yield approach as follows:

a) the returns passed to the policyholder arise from the underlying items the entity holds (regardless of whether the entity is required to hold those items); and

b) the policyholder will receive a substantial share of the total return on underlying items.

We believe the same scope criteria should apply to both the fully unlocked CSM and the book yield, in order to avoid complexity and undesired outcomes. The book yield only addresses effects from changes in discount rates that do not affect the insurer's future profits, which would be captured in the fully unlocked CSM. If a book yield was applied without a fully unlocked CSM, changes in expected reinvestment assumptions would directly affect net income, which in our view would not adequately reflect the performance of the period.

In our view, these criteria could be a good starting point for a discussion about a robust solution to distinguish contracts for which the proposals are appropriate from those for which the proposals would not be appropriate.

The additional criterion (minimum amount that the entity must retain) suggested for eligibility of a contract for a fully unlocked CSM is artificially narrow, even under an implicit fee notion. We heard from preparers that this criterion would de facto scope out all participating contracts that are typically sold. This would also exclude German participating contracts from CSM unlocking, because the insurer has discretion to share more than the minimum regulatory required amount with policyholders.

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