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Association suisse des Actuaires
Schweizerische Aktuarvereinigung
Swiss Association of Actuaries

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30 Cannon Street
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Zurich, 31 October 2003

Comments on the IFRS ED 5 "Insurance Contracts"

Dear Peter,

The Swiss Association of Actuaries (SAA) represents the life actuaries, the property/casualty actuaries as well as the pension actuaries in Switzerland and is pleased to take the opportunity to provide comments on ED5.

Through its Accounting Committee, the SAA follows the IASB's Insurance Contracts Project and participates in the IAA's Insurance Accounting Committee and actively promotes discussion of pertinent issues among its members and within the Swiss insurance industry.

The SAA broadly supports the IAA's views about phase I and ED5. We limit our comments to those issues raised by the IAA that are most critical in our view (asset-liability measurement mismatch, disclosures). We further provide comments to those questions raised in ED5 where Swiss-specific conditions apply, most notably on issues related to the BVG (occupational pension) business.

Yours sincerely,
Swiss Association of Actuaries

Guy Castagnoli
SAA Accounting Committee

Enclosure

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Support of IAA's position

We generally endorse the IAA's answers to ED5. In particular, we emphasize our support for the IAA's answer to **Question I Scope:** we share the IAA's concerns about the potential inconsistency of asset and liability measurements and support its proposal to either create a special asset class for assets backing insurance liabilities or to relax the tainting rules for the held-to-maturity asset class. We also particularly support the IAA's answers to **Question 10 Disclosure of fair value [..]** in which the IAA expresses concerns about conditions and form of disclosing the fair value of liabilities on 31/12/06 for the first time, and to **Question 11 - Other disclosures**, where we share the IAA's doubts as to the benefit to users of the large volume of disclosures proposed, as well as its doubts as to the reasonableness of the effort required to provide these disclosures. We believe, with the IAA, that a more streamlined concept of disclosures should be developed, e.g., by a field test, that will increase transparency in an effective way and serve users of financial statements better.

In the following we would like to state our position regarding selected issues raised in the "Invitation to Comments" of EDS:

Question 2 Definition of insurance contract

Significant insurance risk insurance classification within one product should be uniform: The amount of insurance risk may vary from contract to contract within one class of similar contracts and we argue that the parameter values of a particular contract should not determine whether a contract is insurance or not. While the valuation of a liability is probably not affected greatly by its classification, interpreting clients' payments for the policy as deposits or insurance premiums makes a great difference in presentation.

Swiss insurance contracts: According to the Draft Guideline of the IAA's Accounting Committee the following contracts issued by Swiss life insurers are considered as insurance contracts:
endowments, unit-linked life insurance contracts, term insurance, immediate and deferred annuities, disability income insurance, riders, BVG insurance contracts financed conformant to the Swiss BVG as well as group pension contracts issued before the introduction of the BVG (1985).

Question 3 (a) - Embedded derivatives

Valuing endowments' maturity and surrender guarantees - complications and inconsistencies:
The Draft Implementation Guidance (DIG) of EDS contains instances of contracts where accounting treatment varies depending on the value of a single parameter. One such instance are examples DIG 2.4 and 2.5 that pertain to the single premium endowments of the Swiss market:
depending on whether the (guaranteed) technical interest rate of a policy exceeds the applicable government rate at issue, the policy's guaranteed cash flows would have to be fair valued or not. In a Swiss context, this rule would complicate valuation by forcing to seek out those (few) contracts whose interest rate guarantee happened to be in the money at issue. These guarantees would have to be valued separately even though after issue, at the valuation date, they may be out of the

money. Conversely, there are contracts that don't meet the criterion at issue but whose interest rate guarantee is in the money at the valuation date: these contracts' guarantees wouldn't have to be fair valued.

As the implementation work of fair valuing Swiss endowments will be solved in phase II, it appears unjustified to us to force much of that step on a minority of the contracts already in phase I. Rather, for phase I, we propose to refer to the loss recognition test for securing sufficient reserving of the contracts affected, such that these conditions will never apply.

Fair value of maturity and surrender guarantees in equity-linked products: We agree with DIG 2.7, i.e., that guarantees of minimum maturity and surrender benefits in equity-linked life insurance policies should be fair valued. We note that some unit-linked products contain units that are based on a mix of equity and fixed-income or other investments. We intend to subject these to the same treatment as DIG 2.7's equity-linked products.

Question 4 (b) (ii) - Loss recognition test

While we expect that Swiss insurers using US GAAP will also use the loss recognition test (LRT) of US GAAP, that we understand, is acceptable under phase I, we have specified a Swiss LRT. It's salient features are:

- the discount rate: we currently suggest a value at some spread above risk-free (IAS37.45 IAS37.47 It should be noted, that a guideline or a decision relating to the spread remains to be determined. This approach implies that the technical interest rate is expected to be lower or equal to the risk free rate as defined in the LRT, thus ensuring that it is not necessary to fair value maturity value guarantees.

- the cash flows to be included in the LRT: basically best-estimate cash flows are to be used (IAS37.36 In particular, work previously done by the SAV's Accounting Committee applies, i.e., the mandatory 7.2% conversion rate at annuitization in the BVG business must be reflected.

Question 6 - Unbundling

General intention to leave bundled: We take a conservative attitude in this question and generally intend to leave Swiss insurance contracts bundled, except if the considerations in EDS of avoiding the recognition of obligations (ED5.7, DIG 3) apply.

Unbundling FAS 97 and FAS 91 business during phase I - to be left to insurers: Some insurers currently use US GMP or IAS in their consolidated accounts. For phase I, we propose to leave it to the insurers to decide on the unbundling of their products that they currently unbundle under US GMP, or IAS, according FAS 97 or FAS 91.

Question 13 - Other comments

Inflation pools for BVG and UVG annuities (Teuerungsfonds BVG bzw. UVG): Disability and survivor annuities in payment under the Swiss BVG (occupational pensions) and UVG (workers' compensation) are protected against inflation through periodic adjustments determined by the

Swiss government. These adjustments are financed on a pay-as-you-go basis through the BVG pool (Rentendeckungs-Umlageverfahren) and the UVG pool (Umlageverfahren), respectively. Each insurer administers its funds allocated to the respective pool itself, and normally these funds suffice to pay insurers' ongoing inflation adjustments of the respective annuities in payment. If required, however, pool-funds may flow between insurers. As the two pools are basically mandated by law, i.e., there is little to no discretion left to insurers in their handling, we intend to value these liabilities by their respective statutory book values, as under current accounting.

<u>Renewal patterns (phase II) - Swiss insurance contracts onerous through to maturity</u>: We see no particular issues in applying tentative conclusions for phase II regarding renewal premiums, BC6(d), to Swiss individual life contracts: we generally intend to reflect renewal premiums in valuations up to contract maturity consistently with observed lapse rates. The BVG (group) business is somewhat different in that an initial contract period of typically 5-10 years, is followed by successive shorter-term renewals of, say, typically 3 years. The conditions of BC6(d) are satisfied, both during the initial phase and during the renewal-periods.

<u>Timeline</u>: It should be considered that in addition to the identified issues to be decided upon and implemented, time will be needed to adapt IAA Guidance, that has not yet been issued.