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Schweizerischer Versicherungsverband
Association Suisse d'Assurances
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Comments on the IFRS ED 5

Dear Mr. Clark

The Swiss Insurance Association (SIA) would like to take the opportunity to respond to the questionnaire on ED 5. The SIA represents Swiss insurance companies including subsidiaries and branches of foreign companies in Switzerland, which in total account for approx. 96 % or CHF 55 billion of annual premiums written in the Swiss market. The SIA comments are prepared by the Commission for accounting and reporting. This group is made up of leading finance and accounting executives from various companies including all large and listed companies.

The IFRS framework is of high relevance in Switzerland as the Swiss Stock Exchange requires from all its listed companies the application of either full US GAAP or IAS standards from 2005 onwards. In this respect content and discussions about ED 5 are of utmost relevance for the Swiss insurance industry.

We would like to make some general comments:

1. The SIA fully supports the general concept to introduce international accounting standards that increase and ensure consistency, comparability and transparency of financial reporting.

2. Principles of fair value are widely accepted. However valuation of insurance liabilities, which are of unique nature, is subject to a worldwide controversial discussion among experts on appropriate accounting principles. We think that more considerations are necessary before an ultimate decision on the appropriate accounting standards for insurance contracts is taken (as to be addressed in Phase 2).

3. We appreciate the commitment of the IASB to give the development and implementation of Phase 2 a high priority, as the transition period and the related uncertainty produce disadvantages for both the industry and the financial community.

4. We don't believe that ED 5 proposals in the existing version increase transparency of insurance accounting; in fact, we believe that the opposite is the case. Application of IAS 39 for the assets without having a comparable valuation of the liabilities produces a significant mismatch between asset and liabilities, which ultimately misleads readers and recipients of the financial statements. This is of specific relevance. Technical provisions is one element among others in the balance sheet of an insurance company, but it is the dominant and most material item of the liabilities. We therefore strongly recommend an introduction of a separate investment category of assets held to back insurance liabilities that can be valued at amortized cost in phase 1.

5. The definition and introduction of valuation principles for insurance liabilities is the subject of phase 2. Nevertheless phase 1 of ED 5 requires fair value disclosure of liabilities. This is in our view a contradiction in itself. It leads to both inconsistency and a lack of transparency. Individual models and assumptions developed and applied by the companies without any conceptual guidance will produce a variety of results neither comparable nor meaningful. In addition, the development of complex models requires tremendous efforts and costs which cannot be justified for a short transition period.

6. In general we think that disclosure requirements are too detailed and burdensome, and should be streamlined. We refer to the individual points in our responses and comments to the various questions.

The whole industry supports the improvement of the current standards, however the rapid implementation of the current IASB proposals could lead to huge risks for the industry. On the top of that we want to emphasize that we fully support the comments on the Exposure Draft 5 of the CEA (Comité Européen des Assurances). Therefore the SIA would be grateful if its comments were considered during your deliberations.

Yours sincerely

Lucius Dürr
SVV, Director

End.

Copy to: Sir David Tweedie

Comments on the IFRS ED 5

Question 1 - Scope

(a) The Exposure Draft proposes that the IFRS would apply to insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds, except for specified contracts covered by other IFRSs. The IFRS would not apply to accounting by policyholders (paragraphs 2-4 of the draft IFRS and paragraphs BC4O-BC51 of the Basis for Conclusions).

The Exposure Draft proposes that the IFRS would not apply to other assets and liabilities of an entity that issues insurance contracts. In particular, it would not apply to:

(i) assets held to back insurance contracts (paragraphs BC9 and BC109-BC114). These assets are covered by existing IFRSs, for example, IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 40 *Investment Property.*

(ii) financial instruments that are not insurance contracts but are issued by an entity that also issues insurance contracts (paragraphs BC115-BC117).

Is this scope appropriate? If not, what changes would you suggest, and why?

Answer:

1) a) i)
The result will be a mismatch between insurance assets measured at fair value (available for sale) and insurance liabilities which are measured under existing accounting policies (phase I). We propose to introduce a new category "assets held to back insurance liabilities" in order to avoid a mismatch between assets and liabilities. In some cases this mismatch may be overcome if the assets are held as trading and the policyholder fund takes over the unallocated surplus between assets and liabilities.

1) a) ii
Is appropriate. Also with regard to comparability with bank products.

(b) The Exposure Draft proposes that weather derivatives should be brought within the scope of IAS 39 unless they meet the proposed definition of an insurance contract (paragraph C3 of Appendix C of the draft IFRS). Would this be appropriate? If not, why not?

Answer:

1) (b)
Is appropriate

Question 2 — Definition of insurance contract

The draft IFRS defines an insurance contract as a ‘contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary’ (Appendices A and B of the draft IFRS, paragraphs BC1O-BC39 of the Basis for Conclusions and IG Example I in the draft Implementation Guidance).

Is this definition, with the related guidance in Appendix B of the draft IFRS and IG Example 1, appropriate? If not, what changes would you suggest, and why?

Answer:

(2)
The definition is appropriate. The examples in the implementation guidance are helpful. With regard to “pure endowments”, these contracts do not seem to fulfill the definition of insurance contracts under ED 5 (lack of adverse event). However, there is insurance risk involved in terms of mortality risk. Therefore it should be clear that also endowment policies meet the definition of insurance contracts.

It would be helpful if the term “significant” would be specified in more detail (para. BC 24). The same applies to the term “net cash flows” (para. *B21).*

Question 3 - Embedded derivatives

(a) IAS 39 Financial Instruments: Recognition and Measurement requires an entity to separate some embedded derivatives from their host contract, measure them at fair value and include changes in their fair value in profit or loss. This requirement would continue to apply to a derivative embedded in an insurance contract, unless the embedded derivative:

(i) meets the definition of an insurance contract within the scope of the draft IFRS; or
(ii) is an option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate).

However, an insurer would still be required to separate, and measure at fair value:

(i) a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in an equity or commodity price or index; and

(ii) an option to surrender a financial instrument that is not an insurance contract.

(paragraphs 5 and 6 of the draft IFRS, paragraphs BC37 and
BCI I 8-BCI 23 of the Basis for Conclusions and IG Example 2 in the
draft
Implementation Guidance)

Are the proposed exemptions from the requirements in IAS 39 for some embedded derivatives appropriate? If not, what changes should be made, and why?

(b) Among the embedded derivatives excluded by this approach from the scope of IAS 39 are items that transfer significant insurance risk but that many regard as predominantly financial (such as the guaranteed life-contingent annuity options and guaranteed minimum death benefits described in paragraph BC123 of the Basis for Conclusions). Is it appropriate to exempt these embedded derivatives from fair value measurement in phase I of this project? If not, why not? How would you define the embedded derivatives that should be subject to fair value measurement in phase I?

Answer:

3) (a) and (b)
Is appropriate

(c) The draft IFRS proposes specific disclosures about the embedded derivatives described in question 3(b) (paragraph 29(e) of the draft IFRS and paragraphs IG54-IG58 of the draft Implementation Guidance). Are these proposed disclosures adequate? If not, what changes would you suggest, and why?

Answer:

3)(c)

IASB should abandon this disclosure requirement in the implementation guidance because the effort in phase I would be inadequate regarding our experience in view of the result.

All derivatives that meet the definition of an insurance contract need not to be separated and measured at fair value.

(d) Should any other embedded derivatives be exempted from the requirements in IAS 39? If so, which ones and why?

Answer:

3) (d)
No.

Question 4 — Temporary exclusion from criteria in IAS 8

(a) Paragraphs 5 and 6 of [the May 2002 Exposure Draft of improvements to] IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* specify criteria for an entity to use in developing an accounting policy for an item if no IFRS applies specifically to that item. However, for accounting periods beginning before 1 January 2007, the proposals in the draft IFRS on insurance contracts would exempt an insurer from applying those criteria to most aspects of its existing accounting policies for:

(i) insurance contracts (including reinsurance contracts) that it issues; and

(ii) reinsurance contracts that it holds.
(paragraph 9 of the draft IFRS and paragraphs BC52-BC58 of the Basis for Conclusions).

Is it appropriate to grant this exemption from the criteria in paragraphs 5 and 6 of [draft] IAS 8? If not, what changes would you suggest and why?

(b) Despite the temporary exemption from the criteria in [draft] IAS 8, the proposals in paragraphs 10-13 of the draft IFRS would:

(i) eliminate catastrophe and equalisation provisions.

(ii) require a loss recognition test if no such test exists under an insurer's existing accounting policies.

(iii) require an insurer to keep insurance liabilities in its balance sheet until they are discharged or cancelled, or expire, and to report insurance liabilities without offsetting them against related reinsurance assets (paragraphs 10-13 of the draft IFRS and paragraphs BC58-BC75 of the Basis for Conclusions).

Are these proposals appropriate? If not, what changes would you propose, and why?

Answer:

4) (a)
The exemption rule of IAS 8 is appropriate. However, it seems odd that it only applies until 1 January 2007. Unnecessary uncertainty is created by this limit.
It would be reasonable to have an exemption rule until phase II is implemented.

4) (b)
Is appropriate.
The loss recognition test isn't yet perfect in our view. More guidance on this subject would be useful. Otherwise the accounting methods vary company by company. The IASB states that phase I should not create new inconsistent accounting policies

Question 5 - Changes in accounting policies

The draft IFRS:

(a) proposes requirements that an insurer must satisfy if it changes its accounting policies for insurance contracts (paragraphs 14-17 of the draft IFRS and paragraphs BC76-BC88 of the Basis for Conclusions).

(b) proposes that, when an insurer changes its accounting policies for insurance liabilities, it can reclassify some or all financial assets into the category of financial assets that are measured at fair value, with changes in fair value recognised in profit or loss (paragraph 35 of the draft IFRS).

Are these proposals appropriate? If not, what changes would you propose and why?

Answer:

5) (a)
Is appropriate

5) (b)
The inconsistency of the consolidation injures the acceptance of international established consolidation standards. The application of non-uniform accounting policies of subsidiaries will be allowed during Phase I and in our opinion this doesn't support the general credibility of financial reporting of insurance entities. However, we see the practical problems of a harmonisation at short notice and can accept this for a transition period only.

Question 6 - Unbundling

The draft IFRS proposes that an insurer should unbundle (i.e. account separately for) deposit components of some insurance contracts, to avoid the omission of assets and liabilities from its balance sheet (paragraphs 7 and 8 of the draft IFRS, paragraphs BC3O-BC37 of the Basis for Conclusions and paragraphs 1G5 and 1G6 of the proposed Implementation Guidance).

(a) Is unbundling appropriate and feasible in these cases? If not, what changes would you propose and why?

Answer:

6) (a)
It is appropriate.

(b) Should unbundling be required in any other cases? If so, when and why?

Answer:

6) (b)
In principle we do not favour unbundling of insurance contracts. Insurance contracts should be measured as a whole, as they are designed, priced, processed and managed as packages of benefits. In consequence, any unbundling required only for accounting purposes seems to be artificial and should not be prescribed in any other cases. On the top of that unbundling causes a lot of implementation issues for which the time frame for the introduction of Phase I is too short.
As a possible solution for certain contracts we propose to apply deposit accounting, which allows handling assets and liabilities in the same way.

c) Is it clear when unbundling would be required? If not, what changes should be made to the description of the criteria?

Answer:

6)(c)
The description of the criterion when to unbundle, "if the cash flows from insurance component do not affect the cash flows from the deposit component", seems odd. It would seem intuitive that the components do not affect each other.

Question 7- Reinsurance purchased

The proposals in the draft IFRS would limit reporting anomalies when an insurer buys reinsurance (paragraphs 18 and 19 of the draft IFRS and paragraphs BC89-BC92 of the Basis for Conclusions).

Are these proposals appropriate? Should any changes be made to these proposals? If so, what changes and why?

Answer:

7)
We do not believe that these proposals are appropriate in the sense that the proposed treatment of certain aspects of the reinsurance of insurance contracts under phase I do not consider in detail the entire reinsurance accounting, which will be realized in phase II. In our view it is adequate to keep today's accounting principles rather than proposing only a few elements of new accounting measurements.

Question 8 - Insurance contracts acquired in a business combination or portfolio transfer

IAS 22 *Business Combinations* requires an entity to measure at fair value assets acquired and liabilities assumed in a business combination and ED 3 *Business Combinations* proposes to continue that long-standing requirement. The proposals in this draft IFRS would not exclude insurance liabilities and insurance assets (and related reinsurance) from that requirement. However, they would permit, but not require, an expanded presentation that splits the fair value of acquired insurance contracts into two components:

(a) a liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues; and

(b) an intangible asset, representing the fair value of the contractual rights and obligations acquired, to the extent that the liability does not reflect that fair value. This intangible asset would be excluded from the scope of IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets.* Its subsequent measurement would need to be consistent with the measurement of the related insurance liability. However, IAS 36 and IAS 38 would apply to customer lists and customer relationships reflecting the expectation of renewals and repeat business that are not part of the contractual rights and obligations acquired.

The expanded presentation would also be available for a block of insurance contracts acquired in a portfolio transfer (paragraphs 20-23 of the draft IFRS and paragraphs BC93-BCI 01 of the Basis for Conclusions).

Are these proposals appropriate? If not, what changes would you suggest and why?

Answer:

8)
This proposal is appropriate

Question 9 - Discretionary participation features

The proposals address limited aspects of discretionary participation features contained in insurance contracts or financial instruments (paragraphs 24 and 25 of the draft IFRS and paragraphs BC102-BC108 of the Basis for Conclusions). The Board intends to address these features in more depth in phase II of this project.

Are these proposals appropriate? If not, what changes would you suggest for phase I of this project and why?

Answer:

9)
These proposals are appropriate and find our support. More clarification is needed with regard to the treatment of investment contracts with discretionary participation features whether they are generally exempt form IAS 39 and if deposit accounting should be applied

Question 10 - Disclosure of the fair value of insurance assets and insurance liabilities

The proposals would require an insurer to disclose the fair value of its insurance assets and insurance liabilities from 31 December 2006 (paragraphs 30 and 33 of the draft IFRS, paragraphs BC138-BCI4O of the Basis for Conclusions and paragraphs 1G60 and IG6I of the draft Implementation Guidance).

Is it appropriate to require this disclosure? If so, when should it be required for the first time? If not, what changes would you suggest and why?

10)
The determination of fair value of an insurance contract is still subject to discussion. It is therefore not appropriate to stipulate disclosure of fair values of insurance contracts as long as significant issues have not been resolved. Transparency is not enhanced if each enterprise uses its own definition of fair values of insurance contracts. The same applies to comparability (one of the principles of the IASB Framework). Therefore we would propose instead of stipulating 2006 as the date for disclosure the fair value to require this in the last year of phase I. This will ensure that phase 2 will be available in final form and, in the event of a delay for phase 2, will avoid 'interim solutions'.

Answer:

Question 11 - Other disclosures

(a) The Exposure Draft proposes requirements for disclosures about the amounts in the insurer's financial statements that arise from insurance contracts and the estimated amount, timing and uncertainty of future cash flows from insurance contracts (paragraphs 26-29 of the draft IFRS, paragraphs BC124-BC137 and BCI4I of the Basis for Conclusions and paragraphs 1G7-1G59 of the draft Implementation Guidance).

Should any of these proposals be amended or deleted? Should any further disclosures be required? Please give reasons for any changes you suggest.

Answer:

11) (a)
The requirements for disclosures are too broad and are therefore much too burdensome for entities if the implementation guidance is not carefully considered together with the wording of the proposed IFRS.
In addition, we question the additional value for the reader of the annual report if the disclosures are required in this detail.
We understand the intention of the Board to oblige the insurance industry to publish more information, but info in this detail will neither be useful for the industry nor for the public. The main aim of more transparency will not be achieved. For example, the disclosure on projected cash flow is similar to a debt maturity schedule. But unlike debt, the projected cash flows are estimated and can be quite volatile, whereas for debt, we know contractually when the debt matures and when the amount involved must be paid. There is a risk, then, that a wrong impression of the value of a company will be given using these 'volatile' cash flows.

To a large extent, the proposed disclosures are applications of existing requirements in IFRSs, or relatively straightforward analogies with existing IFRS requirements. If you propose changes to the disclosures proposed for insurance contracts, please explain what specific attributes of insurance contracts justify differences from similar disclosures that IFRSs already require for other items.

Answer:

11) (a)
It is appropriate

(b) The proposed disclosures are framed as high level requirements, supplemented by Implementation Guidance that explains how an insurer might satisfy the high level requirements.

Is this approach appropriate? If not, what changes would you suggest, and why?

Answer:

11) (b)
It is appropriate.

(c) As a transitional relief, an insurer would not need to disclose information about claims development that occurred earlier than five years before the end of the first financial year in which it applies the proposed IFRS (paragraphs 34, BC134 and BC135).

Should any changes be made to this transitional relief? If so, what changes and why?

Answer:

11) (c)
It is appropriate.

Question 12 — Financial guarantees by the transferor of a non-financial asset or liability

The Exposure Draft proposes that the transferor of a non-financial asset or liability should apply IAS 39 *Financial Instruments: Recognition and Measurement* to a financial guarantee that it gives to the transferee in connection with the transfer (paragraphs 4(e) of the draft IFRS, C5 of Appendix C of the draft IFRS and BC4I-BC46 of the Basis for Conclusions). IAS 39 already applies to a financial guarantee given in connection with the transfer of financial assets or liabilities.

Is it appropriate that IAS 39 should apply to a financial guarantee given in connection with the transfer of non-financial assets or liabilities? If not, what changes should be made and why?

Answer:

12)
It is appropriate.

Question 13 - Other comments

Do you have any other comments on the draft IFRS and draft Implementation Guidance?

Answer:

13)
We strongly support the suggestions for exemption from certain IAS 39 requirements until Phase II of the project is complete. These suggestions should be helpful to avoid mismatch measurement of assets and liabilities for insurance contracts:

1. Create a new category of assets carried at amortised cost: assets held to back insurance liabilities.
   The IAS 39 criteria with regard to tainting of financial assets as held-to maturity should be disburdened.
2. No introduction of the fair value in phase I whilst the definition of the fair value of the insurance liability is not determined.
3. The disclosure should not be introduced at this level of detail.
4. Permit hedge accounting when a non-derivative is used as hedging instrument to hedge interest-rate risk.