To: Ms Françoise Flores
Chairman
EFRAG
35 Square de Meeûs
B-1000 Brussels

Ref: ECO-ACC-10-266

Subject: EFRAG Comment Letter to IASB Exposure Draft on Insurance Contracts

Brussels, 22 November 2010

Dear Madam,

The CEA is the European Federation of insurers and reinsurers, who represents all types of insurance and reinsurance undertakings, accounting for approximately 95% of total European premium income.

We welcome the EFRAG Draft Comment Letter (DCL) and support many of the EFRAG draft responses. We believe that EFRAG raises the fundamental point in closing paragraph of the cover letter. We fully share EFRAG view that the IASB has not sufficiently considered the interaction of the future insurance standard and IFRS 9. It is fundamental that the application of the combination of the two standards permit insurers to reflect their business model while avoiding accounting mismatch. In addition, it is critical that the IASB devotes sufficient time to performance reporting of insurers, which has not been the case so far. Further, it is essential that the final standard is field-tested by preparers in conjunction with detailed assessment by users – as currently drafted, we do not agree with the view of EFRAG that the IASB's ED would improve the financial reporting of insurance contracts to users at a reasonable cost to preparers. Further development of overall model will needed to be made together with re-exposure of relevant aspects of the ED. Accordingly, we do not consider the IASB's objective, to issue a final IFRS by June 2011, is realistic.

We fully agree with a number of EFRAG statements contained in the DCL, including that:

- EFRAG supports a measurement approach for insurance liabilities that is based on the expected present value of the fulfilment cash flows (future cash outflows minus future cash inflows). (Q2).
- EFRAG supports the proposed separate recognition of a risk adjustment and a residual margin and not the recognition of a single composite margin. (Q4)
- EFRAG also believes that the risk adjustment can be reliably measured and therefore can be explicitly included as a separate building block. (Q4)
- EFRAG believes that methods that can be used to measure the risk adjustment should not be limited. Instead, a principle should be developed that drives the selection of an appropriate measurement methodology. (Q5)
- EFRAG disagrees that the confidence level to which the risk adjustment corresponds should be disclosed. The insurer should generally be required to explain the level of prudence applicable in measuring the risk adjustment. (Q5)

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- EFRAG considers that diversification between portfolios should be taken into account in relation to the risk adjustment (Q5)

- EFRAG agrees with the proposed method for measuring the residual margin at inception and agrees that no gain should be recognised at the inception date. However, losses on initial recognition should be recognised immediately. (Q6)

- EFRAG agrees that incremental acquisition costs should be included in the present value of the fulfilment cash flows. We believe the level of measurement is the portfolio as we support a uniform level of measurement. (Q7)

- EFRAG considers the modified measurement approach for the measurement of a pre-claims liability on certain short-duration contracts is an acceptable measurement methodology as it is a reasonable proxy for the full measurement model proposed in the ED. EFRAG does however have concerns as to whether the modified approach represents a simplification over the full measurement model. (Q8)

- EFRAG considers that the modified measurement approach should not be a requirement for short-duration insurance contracts. Instead, an insurer should be able to apply the full measurement model proposed in the ED to all insurance contracts. (Q8)

- EFRAG supports the contract boundary as defined in the ED. (Q9)

- EFRAG considers that all financial instruments with discretionary participation features should be measured consistently (Q10)

- EFRAG disagrees with setting to zero the residual margin for contracts in force at transition. (Q17)

However, there are some significant areas in which we disagree with EFRAG DCL, which we summarise below. Further detail will be given in our joint response with the CFO Forum to the IASB's ED, which we shall forward to you shortly.

- *Definition of portfolio*: We support the definition of the portfolio's reference to broadly similar risks' and 'single pool' as being workable in practice and as being the basis of providing reasonable consistency. (Q2);

- *Liquidity premium*: We support the ED's inclusion of the effects of liquidity being taken into account in the discount rate. Because of the disagreement between the EFRAG and its IAWG, we expand on this point further below. (Q3)

- *Credit spread*: We suggest also that further investigation is needed into how the price of credit is reflected in valuing insurance contracts. The financial crisis has shown widening credit spreads to be important where changes in credit risk became dislocated from the risk of default, and IFRS 9 takes account of credit risk for financial liabilities; (Q3)

- *Premium allocation approach*: We believe that, under a principles-based standard, a simplification of the building block approach is appropriate for relatively straightforward contracts, and so we support the IASB's premium allocation approach as a proxy that may be used but not that it should be compulsory. Accordingly we do not agree with the EFRAG that this approach should be restricted to contracts with a coverage period of one year or less. (Q8)

- *Participating features*: We question the IASB's decision not to address accounting for the unallocated surplus in funds with participating features. This is a significant issue for some European insurers and we consider that the EFRAG's DCL should highlight the IASB's omission. (Q10)

- *Definition of insurance contract*: The definition of an insurance contract in IFRS 4 Phase I has proven to work quite well and should remained unchanged. Furthermore, we do not agree with EFRAG's opinion that the minor changes in the related guidance to the definition of insurance contracts do not change current practice under IFRS, in particular around the requirement to have a loss scenario with commercial substance. (Q11)

- *Unbundling*: We do not agree with the ED's requirement to unbundle. It is unnecessary because the definition of insurance works well to determine the measurement and boundaries, and it would costly to implement and provide little benefit to users. (Q12)

- *Presentation*: We agree with the IASB that the basis of presentation should reflect that of measurement, and most life companies and many composite insurers in Europe support a summarised margin approach to presentation. We therefore do not agree with the EFRAG that volume/revenue information should be shown on the face of the statement of comprehensive income for all types of contracts. (Q13)

- *Disclosures*: We do not agree that the proposed requirements meet the ED's objective. We support instead disclosure requirements that are principles-based. (Q14)

- *Reinsurance:* We do not agree with EFRAG's agreement with the proposals in the ED on reinsurance. In particular, we believe that the measurement of reinsurance ceded as per the ED does not reflect the underlying economics of the business particularly in relation to the measurement of the residual margin of a reinsurance asset. We support an approach by which the measurement of the residual margin of the reinsurance asset is based on the risk transferred from the cedant to the reinsurer. (Q16)

- *Transition*: We agree with the EFRAG that retrospective application is better than what the ED proposes. However, we support the development of an alternative simplified approach to address the a significant practical issues that are likely to arise for many entities .(Q17)

Liquidity premium

The illiquidity spread, highlighted in the recent financial markets turmoil, is reflected in the market valuation of assets and we believe it should also be appropriately reflected in the measurement / valuation of insurance liabilities to faithfully represent the characteristics of the liability. Any buyer of a financial instrument would place a value on the degree of liquidity in their investment. Similarly, a potential policyholder would differentiate between two similar products with varying degrees of liquidity. To this end, liquidity is an important market consistent valuation aspect and provides a consistent measurement of assets and liabilities which is particularly important in a dislocated market.

We believe that the inclusion of an illiquidity premium is consistent with the fulfilment objective that is the basis of the IASB's measurement model. Insurance liabilities are generally retained by the insurance company and are not transferred to a third party and therefore it is appropriate that the discount rate reflects the certainty of timing of fulfilment cash flows where applicable. We believe that the illiquidity premium can be reliably measured as we already use it in the context of our internal risk management, in our embedded value reporting and soon in solvency reporting and there are a number of techniques already in existence to do this

We look forward to further discussing those matters with you as the TEG re-deliberates the Draft Comment Letter. In the meantime, do not hesitate to contact us should you have any questions.

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