DUTCH ACCOUNTING STANDARDS BOARD (DASB)

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Date : Amsterdam, 22 November 2010
Re : Comment on the Exposure Draft Insurance Contracts

Dear members of the EFRAG Technical Expert Group,

The Dutch Accounting Standards Board (DASB) appreciates the opportunity to comment on your draft comment letter to the IASB regarding Exposure Draft Insurance Contracts (ED). We have included our comments as well as the responses to your specific questions in annex 1 to this letter.
In annex 2 we enclose our comment letter to the IASB.

We will be pleased to give you any further information that you may require.

Yours sincerely,

Hans de Munnik
Chairman Dutch Accounting Standards Board

Comments to the EFRAG letter and responses to specific questions

Question 1.
We agree with EFRAG's conclusions on the measurement model although we have concerns about the volatility in the Statement of Comprehensive Income due to the consequence of remeasurement of the fulfilment value and impact of choices in IFRS 9. We explained this in more detail in our comment letter to the IASB.

Specifically, we disagree or have some additions to comments of EFRAG on the following topics:

- EFRAG recommends adjusting the residual margin with remeasurement of the present value of the fulfilment cash flows that affect future periods (see question 6d) and not including all income and expenses arising from insurance contracts in profit or loss (question 13b) could be considered as one solution to decrease volatility. We are not in favour of offsetting changes in financial assumptions to the residual margin, because this will increase rather than reduce accounting mismatches and will not provide a solution for fluctuating income numbers.
- We do not agree with the concerns that volume information should be presented on the face of the Statement of Comprehensive Income. We consider disclosure in the roll forward of the insurance liabilities sufficient (13a).

Question 2.
2b. In addition to EFRAGs comment we believe that certain overhead expenses should be considered in the determination of estimated cash flows.

Question 3.
3a. We do not agree with EFRAG that the discount rate should reflect the fact that amount, timing or uncertainty of cash flows arising from insurance contract is wholly or partly dependant on the performance of specific assets. In our opinion, the discount rate should reflect the characteristics of the insurance liability and should not be derived from assets backing the liabilities.

3b. Question to Constituents with respect to liquidity adjustment

The majority of members of EFRAG's Insurance Accounting Working Group (IAWG) supported the ED's proposal to consider the effects of liquidity in determining the discount rate when measuring an insurance contract. In their view, the risk-free rate does not faithfully represent the characteristics of the insurance contract.
EFRAG would be particularly interested in understanding constituents' views on whether and why the effects of liquidity should or should not be considered when determining the discount rate to be used in measuring an insurance contract.

We agree with the inclusion of an illiquidity premium in the discount rate.
We do not agree with EFRAG's point of view that an illiquidity premium is inconsistent with the measurement of a fulfilment value. In our opinion illiquidity premium, which is an indication of a lack of market efficiency, can be realised by insurance companies by using the cash flows from interest and redemptions of financial instruments for the fulfilment of insurance liabilities. Therefore, we consider the inclusion of an illiquidity premium consistent with the application of current fulfilment value.

Question 4.
We agree with EFRAGs comment, but we have a concern about the subjectivity of the risk adjustment and encourage the IASB to define the disclosure requirements relating to the risk adjustment.

Question 5.
5a. In addition to EFRAGs comment we like to see an explanation of the definition of "maximum".

5c. Question to constituents with respect to disclosure of confidence level information

Do constituents think that confidence level information provides useful information or do constituents think that other disclosures could provide equal information?

We do not think that disclosing the confidence level information provides useful information. We think that other disclosures (quantitative and qualitative) will be easier to understand and more useful.

Question 6.
6c. In addition to EFRAGs comment about measurement of the residual margin at portfolio level we recommend the IASB to search for simpler methods.

6d. Question to constituents with respect to changes in estimates and residual margin

With respect to accounting for changes in estimates we refer to Appendix 2, which provides a summary of possible accounting mismatches caused by the interaction between IFRS 9 and the proposals in the ED. EFRAG asks constituents' input on this issue.

Accounting mismatches will be mitigated by using the fair value option for financial instruments that back insurance liabilities in combination with current fulfilment value for those insurance liabilities. However, many preparers find that the amortised cost model for financial instruments with basic loan features is most consistent with their business model. This will create a significant accounting mismatch, which we do not believe can be effectively reduced by using the residual margin for balancing changes in estimates.

As included in annex 2 we have concerns with respect to the presentation of all changes in the current fulfilment value in the income statement **in combination to measurement under IFRS 9**. We therefore believe that it is necessary to develop alternative solutions that segregate short term market fluctuations from underlying business performance and avoid accounting mismatches between related assets and liabilities **but have not identified one final solution**. Potential directions for finding solutions are (a combination of) presenting changes in financial assumptions in Other Comprehensive Income, consideration of a locked-in discount rate, recalibrating the residual margin for changes in non-financial assumptions, and / or enhancing explanatory disclosures on the nature of the presented annual fluctuations.

Question 8.
8a. In addition to EFRAGs comment we have some concerns about unintended implications for group-life contracts being classified as short term and basic health contracts not being classified as short term, or multi-annual reinsurance contracts being different classified from contracts they relate to.

Question 9.
In addition to EFRAGs comment we have some concerns with respect to the word "fully" in the ability to fully change the risk profile and premium. Especially for health insurance in the Netherlands we are concerned because the premium for the basic contracts is not based on the risk and determined by the government although the insurer accepts the risk.

Question 10.
10b. We have no preference for including financial instruments with discretionary participation features in either IFRS 4 or IFRS 9 as long as the participation feature is measured in accordance with IFRS 4.

Question 11.

11b. Question to constituents with respect to scope

The ED proposes to exclude fixed fee service contracts from the scope of the standard if the primary purpose of the contract is the provision of services. EFRAG supports the Board's reasoning, however EFRAG does not find the criteria to assess whether or not a contract is in the scope of the standard to be clear enough.

Do you agree with the Board's intent that contracts whose primary purpose is the provision of services should be out of the scope of the standard, even if they meet the definition of the insurance contract?
Do you share EFRAG's concerns about the wording of the scope exclusion

We agree with EFRAG that the criteria of scope are not clear enough. We refer to our comments to the ED.

11c. Question to constituents with respect to scope

The proposals in the ED will bring financial guarantee contracts that meet the definition of an insurance contract within the scope of the new insurance standard.
Do you think there could be a reason to exclude financial guarantees from the scope of the insurance standard?
Financial guarantees are currently in the scope of IAS 39, except for those contracts that are explicitly 'selected' and treated as insurance contracts. IAS 39 requires such contracts to be measured at the higher of the amount determined in accordance with IAS 37 and the initially recognised amount less cumulative amortisation.
The proposed amendments to IAS 39 mean that a financial guarantee contract that does not meet the definition of an insurance contract should be measured as a derivative in accordance with IAS 39. Do you agree with these classification and measurement requirements?

Although conceptually financial guarantee products contain insurance risks, we agree that financial guarantees that are not issued by insurers should for practical reasons remain in the scope of IAS 39 . In this way, non-insurers can measure financial guarantees without having to implement a financial reporting standard that is basically not intended for their business.

Question 12.

12. Questions to constituents with respect to unbundling

Do you agree that unbundling can enhance the usefulness of information by increasing transparency and comparability?
Do you agree the underlying principle should be further clarified especially how the terms closely related and interdependent should be interpreted in the context of unbundling?
Do you believe the guidance and examples in the ED change the current practice of unbundling?
Do you think the way a product is structured and monitored may present an appropriate basis for deciding if components of the insurance contracts should be unbundled?

We are not convinced that unbundling will improve the usefulness of information. We agree that more guidance is needed for the underlying principle of “closely related” as meant in par. 8d of the ED and of “interdependent”. We agree that the way a product is structured and monitored can be an appropriate basis for deciding which components should be unbundled, however we are not sure that this information is available for all legacy products that are still in force. Based on the current guidance in the ED there is much confusion with different constituents with respect to this topic.

Question 13.
13a. We do not necessarily agree with EFRAG to include volume information in the face of the income statement. We consider disclosure in the roll forward of the liabilities a good alternative. However, the DASB would welcome a satisfactory solution for an extended margin model, if this would be developed.

13b. As indicated under 1 and 6d we have concerns about the volatility in the Statement of Comprehensive Income. We advise to investigate a solution for the total picture including valuation of financial investments and also explore possibilities matching changes in OCI.

Question 14
14a. In addition to EFRAGs comment we have some additional comments on the disclosures. We refer to annex 2.

14b. We do not agree with EFRAG that volume information should necessarily be included in the face of the statement of other comprehensive income, see also 13a.

Question 15.
We find the requirements with respect to unbundling not clear and had asked for clarification.

Question 16.
With respect to reinsurance we do not agree to recognise no loss at inception if the residual margin on the reinsurance contract exceeds the residual margin of the underlying insurance contract. Contrary we do not agree to recognise a gain at inception if the gain exceeds the initial loss of the corresponding insurance contract.

Question 17.
We do not see full retrospective application as a solution for transitional rules as for many insurers it will be practically impossible to get this information for contracts that were sold many years ago.

17. Question to constituents with respect to time needed for transition

We do not refer to a specific transition date as requested in question 17d.
Can you provide an indication of the time needed for changing insurance processes and policies and implementing the new requirements?
What is in your opinion a feasible transition date?

We do not have specific insight in the time needed for an insurance company to make changes in the organisation and processes.

Question 19.

19. Question to constituents with respect to retrospective application

In our response to question 17 we have stated that we believe IAS 8 should be required.
IAS 8 requires retrospective application (unless impracticable). Could you provide an assessment of the benefits and costs of applying IAS 8?

We do not see full retrospective application as a solution for transitional rules as for many insurers it will be practically impossible to get this information for contracts that were sold many years ago.

Appendix 2 - accounting mismatch

App. 2. Question to constituents with respect to accounting mismatch

Do you consider that the IASB should address the interaction of IFRS 9 and the proposals in the ED? In particular:

1. *Do you agree with the view held by some insurers that they are unable to reflect their business model in the measurement of their financial assets and/or insurance liabilities?*

2. *Do you think the IASB should address the accounting mismatch for insurers that measure financial assets at amortised cost? If so, how?*

3. *Do you believe that the effect of changes in assumptions of financial and/or nonfinancial variables should be accounted for in the residual margin? How do you believe the IASB should address the resulting mismatch for insurers that account for financial assets at fair value?*

   Do you think that the IASB should allow or require shadow accounting in the cases described in paragraph 18? Do you support the arguments presented by the IASB to reject shadow accounting? Please explain why or why not.

In our opinion, the IASB did not properly explain why the differences between IFRS 9 and IAS 39 did not lead to reconsidering the measurement model for insurance liabilities. It is fair to say that the amortised cost model may very well reflect the long-term nature of the business model of insurers. However, we are concerned about the additional complexity and unclarity in situations where amortised cost would be used for certain financial instruments and the resulting accounting mismatch would be “repaired”.

In the period between the deliberations on the Discussion Paper for insurance contracts and the issuance of the DP, IFRS 9 has been developed and issued. IFRS 9 provides increased opportunities for consistency between an entity’s business model and its accounting results by measuring financial instruments with basic loan features at amortised cost. Many insurers consider the business model that aligns with amortised cost measurement akin to their operations. However, measuring financial instruments with basic loan features at amortised cost would create a serious accounting mismatch when applying the ED for insurance contracts. Some are concerned that the insurance industry will be the only industry that applies full current value in its financial statements and request further explanation why the IASB still thinks that this is in the interest of users of financial statements.

We share the concerns with respect to the accounting mismatch in valuation principles for insurance liabilities and underlying financial instruments with basic loan features and we advice the Board to investigate other solutions

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Re : Comment on IASB Exposure Draft Insurance Contracts

Dear members of the International Accounting Standards Board,

The Dutch Accounting Standards Board (DASB) appreciates the opportunity to comment on the Exposure Draft Insurance Contracts (ED). We have included our reactions to your questions in annex 1 to this letter.
The DASB is pleased to see that many of the concerns expressed by the many respondents to the earlier Discussion Paper have been addressed in the ED. We agree that measurement of insurance liabilities at current fulfilment value is relevant to the users of financial statements. In addition, current fulfilment value can be implemented by preparers and is auditable under the condition that there is sufficient time for implementation and certain issues are further clarified and aligned to other developments that affect reporting by insurers, e.g. Solvency II.
Below, we highlight the issues that we consider particularly important:

1. The DASB is concerned about the fact that the ED is very technical and complex and, in certain areas, represents a move from principle-based standards to specific rules. The ED includes examples that may be better situated in the application guidance and includes specific rules about the use of specific models as outlined below. Furthermore, due to its complexity and very specific nature, we believe that any application outside the insurance industry to contracts that technically meet the definition of an insurance contract must be carefully considered. In this context, we do not believe that fixed fee contracts and financial guarantees not issued by insurance companies should be in scope of the ED. In order to make this work in practice, the standard should include a clear definition of an insurance company that is more robust than the definition in the present ED. We refer to our response to question 11.
2. We have concerns with respect to the presentation of all changes in the current fulfilment value in the income statement. This will create fluctuations in income which do not faithfully represent the underlying business performance of the insurance business, especially in relation to the long-term character of this business. In addition, we are concerned about comparability with other industries (like banks) where measurement is to a greater extent based on amortised cost, in accordance with their business model and following IFRS 9. We therefore believe that it is necessary to develop alternative solutions that segregate short term market fluctuations from underlying business performance and avoid accounting mismatches between related assets and liabilities. Potential directions for finding solutions are (a combination of): presenting changes in financial assumptions in Other Comprehensive Income, making use of a locked-in discount rate, recalibrating the residual margin for changes in non-financial assumptions,

and / or enhancing explanatory disclosures on the nature of the presented annual fluctuations.

3. The DASB finds the transition proposal unacceptable. The proposal would lead to not recognising profit margins on business in force at transition and a gradual increase in the release of residual margins as new business is created in the years after implementation. Consequently, insurers will show a non-existing growth in underwriting margins for a long period of time, because they will not show any residual margin on the in-force business that existed at transition, which is misleading. We encourage the IASB to work together with the industry in order to find more satisfactory alternatives.
4. We would recommend using the portfolio as a unit of account for acquisition costs, such that acquisition costs that are incremental at the portfolio level are reflected in the estimated cash flows. This would make the unit of account for acquisition costs consistent with the unit of account in the remainder of the ED. It would furthermore reduce the different treatment for direct writers and make them more comparable with entities that use agents and brokers for distribution.
5. The proposals with respect to contract boundaries will need modification in order to prevent unexpected and undesired situations with respect to basic health insurance policies in the Netherlands. Under the present proposals in the ED these contracts would be classified as long-duration, which is not consistent with their economic substance. We have included a proposed solution in our response to question 9.
6. We disagree with the restriction to 3 methods for measuring the risk adjustment. In our opinion, the standard should be principle-based at this point. Imposing specific rules will make the standard too rigid and will preclude entities to implement newly developed methods and models that may be superior to the presently prescribed methods.
7. Notwithstanding this concern, the DASB is in favour of a separate risk adjustment as a building block of current fulfilment value. In order to address potential concerns on subjectivity in assessing the risk adjustment and to increase transparency to the users, we would recommend to align the measurement of the risk adjustments to governance, risk management, capital management and the "use test" of the models used through relevant disclosures.
8. We generally agree with the proposals for discounting cash flows including the concept of illiquidity premiums, but we have concerns about the assessment of illiquidity premium in practice. In addition, we do not think that par. 32 properly reflects the IASB's intentions on how to measure the parts of insurance contract liabilities that depend on the performance of a pool of assets.
9. The DASB does not believe that the proposed different treatment for short-duration contracts is an improvement. The proposal does not reduce complexity because current fulfilment value still has to be assessed in order to perform the onerous contract test prescribed in paragraph 60.

As a general remark, we believe that it is key that, where relevant, the final requirements under IFRS and those under Solvency II are aligned as much as possible. Furthermore, it would be advisable to perform a full scope field test on the ED, in conjunction with the ongoing field testing of Solvency II. This would reduce the risk of undesired effects and ensure full understanding of the model before a final standard is issued.

We will be pleased to give you any further information that you may require.

Yours sincerely,

Hans de Munnik
Chairman Dutch Accounting Standards Board

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?

Comments DASB:

The proposed measurement model is a step forward in achieving consistent measurement and more comparability of insurance liabilities within the industry. We have expressed our concerns in our answers to your questions below and summarised them in our cover letter.

As explained earlier in our letter, we have concerns with respect to the presentation of all changes in the current fulfilment value in income. This will create fluctuations in income which do not faithfully represent the underlying business performance of the insurance business, especially in relation to the long-term character of this business. In addition, we are concerned about comparability with other industries (like banks) where measurement is to greater extent based upon amortised cost, consistently with the business model under IFRS 9. We therefore believe that it is necessary to develop alternative solutions that segregate short term market fluctuations from underlying business performance and avoid accounting mismatches between related assets and liabilities. Potential directions for finding solutions are (a combination of) presenting changes in financial assumptions in Other Comprehensive Income, consideration of a locked-in discount rate, recalibrating the residual margin for changes in non-financial assumptions, and / or enhancing explanatory disclosures on the nature of the presented annual fluctuations.

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?

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

Comments DASB:

2a. In our opinion current fulfillment value, and the building blocks that form the current fulfillment value, result in a measurement of insurance contracts in the balance sheet that is relevant to the users of financial statements.

2b. In our opinion, the application guidance would need further clarification. Examples are:

– The unit of account. We understand that the default for the unit of account is the portfolio, which is defined as a pool of insurance *contracts* that are subject to broadly similar risks. Many insurance contracts include separate riders with a different risk profile. In such case we would expect that the unit of account could also be a pool of riders instead of a pool of contracts. In addition, in some paragraphs of the ED reference is made to contracts instead of a portfolio. We agree that certain characteristics of individual contracts (like age, gender, size and specification of the insured object) are relevant for measurement purposes. However, we would expect clarification on which unit of account prevails under which circumstances.
– Overhead expenses: In our opinion, consideration should be given to standard overhead expenses that are allocated to insurance contracts based on regular force in order to determine the best estimate of future cash flows. We advice to give more detailed guidance to what extend certain overhead costs can be allocated to insurance contracts.

In our considerations with respect to this question, we have regarded the specific nature of insurance contracts, especially the fact that insurers manage large portfolios of contracts with similar risks, where the law of large numbers is particularly relevant. In our view, this justifies measurement according to an explicit, unbiased and probability-weighted estimate of future cash flows. As regards other single liabilities, in accordance with IAS 37, we maintain our comments on the proposed changes in IAS 37 that single liabilities should be recognised subject to the probability threshold and measured at best estimate of future cash outflows.

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

Comments DASB:

3a. We agree that the discount rate should reflect the characteristics of the insurance contract liability and should not be derived from assets backing the liabilities. However, we are not sure about the IASB's intentions as to whether the current fulfillment value should be as market consistent as possible; par. 23b and par. 30a would suggest this. In this case, par. 31 should not only be applicable to non-participating contracts, but also to participating contracts. With respect to participating contracts, the asymmetry of the payoff for the insurer due to the profit sharing should either be considered in the best estimate of future cash flows or in a separate measurement of options and guarantees. The projections of future cash outflows from profit participation and the discount rate should be mutually consistent. However, reflecting the performance of specific assets in the discount rate as par. 32 in combination with BC 97, suggests, will seldom meet the condition of a market consistent measurement.

We find par. 32 particularly confusing. Par. 32 addresses the measurement of insurance contracts in situations where the amount, timing or uncertainty of the cash flows depends wholly or partly on the performance of specific assets. We do not understand why this has to be part of the section with respect to time value of money. We stated above that applying this paragraph to participating contracts may not meet the IASB's intentions. In addition, we are not sure that par. 32 meets the intentions for unit linked contracts. The fund component in unit linked contracts is normally measured based upon the linked assets and not upon the performance thereof. For other components in unit linked insurance contracts, like mortality riders, future margins, minimum guarantees, etc. we see no reason to use the performance of the underlying assets instead of the characteristics of the insurance contract cash flows as a basis for measurement. Finally, par 32 states that "in some circumstances, the most appropriate way to reflect that linkage might be to use a replicating portfolio". We are not sure this is placed in the right context. Replicating portfolios relate to a technique rather than a measurement principle, so we would expect it to be addressed in the application guidance rather than the standard. Furthermore, replicating portfolios may have a broader use than suggested in par. 32, as it may also be used to find the yields that best fit the characteristics of the liability as suggested in par. 31.

3b. We agree with the proposal to consider the effect of illiquidity, but only to the extent that there is sufficient reference to current observable market inputs. However, we encounter the following issues with respect to the illiquidity premium:

- Not all are convinced that the illiquidity premium can be identified sufficiently reliable. In particular there is concern about the ability to separate the illiquidity premium from other components in the yields of relevant instruments like a credit default premium.
- Par. 34 suggests that the illiquidity premium found in a process as described above should be further adjusted to the exact characteristics of the liabilities. We find this

difficult in practice because it may be impossible to find such an adjustment in a reliable way and the relevance of such an adjustment would be highly disputable.

Although we agree that the standard should remain principle based in this area, we believe that, in order to ensure comparability, more emphasis should be given to the disclosure about the methodology to capture illiquidity premium, the size of the illiquidity surcharge and the degree of model uncertainty.

3c. We agree that the discount rate used in the current fulfillment value shall not reflect the insurer's own credit risk.

We have concerns about the implication of using current discount rates for long-duration contracts; We refer to our answer on question 1 with respect to these concerns.

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.

Comments DASB:

We support using a risk adjustment and a residual margin as we find a separate risk adjustment giving relevant information regarding the uncertainty of estimated future cash flows. In addition, we consider an insurance contract onerous if the premium is less than the current fulfillment value, including the risk adjustment. Without a separate risk adjustment, onerous contracts cannot be properly identified. Furthermore, the insurance industry has gained the appropriate experience in quantifying the risk adjustment in insurance liabilities during the past decade.

Nevertheless, there is some concern about the degree of subjectivity relating to the risk adjustment that is included in the current fulfillment value. Therefore, we encourage the IASB to further refine the disclosure requirements relating to the risk adjustment, with a particular focus on the relation with risk governance, management, pricing and elements of the "use test" relating to the models involved.

Our answer to this question gives regard to the specific nature of insurance contracts, which are explicitly designed to assume risk. Consequently, the measurement and presentation of a separate risk adjustment is relevant to the users of financial statements. With respect to other single liabilities, in accordance with IAS 37, we maintain our view on the proposed changes in IAS 37 that presenting a separate risk adjustment has no rationale.

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 fulfillment cash flows exceed those expected? Why or why not? If not, what alternatives do you suggest and why?
(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?
(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?
(d) Do you agree that an insurer should measure the risk adjustment at a portfolio level of aggregation (i.e. 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?
(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?

Comments DASB:

5a. There should be as much as possible a single point of measurement of the risk adjustment, but one can easily associate the “maximum amount an insurer wants to pay to be relieved from risk” with a current exit value. We encourage the IASB to explain better why this definition (especially the explicit reference to “maximum”) of the risk adjustment is relevant to the fulfillment of insurance contracts.

5b. We do not agree that only these three methods should be allowed. Other appropriate methods might develop over time and these should not be excluded. We would prefer enhancing the disclosure requirements relating to the risk adjustment; we refer to our reaction to question 4.

5c. We are not sure that the disclosure of a single confidence level will give relevant insights. In addition we have concerns about the implementation of this disclosure, e.g. the method used to aggregate the risk margins at a portfolio level. We observe that in accordance with par. 72, the risk adjustment and the changes therein shall be separately presented. This gives the user insight in the amount of the risk margin relative to the best estimate. Together with our suggested enhancements in the relating disclosures, this will in our opinion give more relevant information than a single confidence level for which the comparability between entities may be deceptive.

5d. We do not fully agree to measure the risk adjustment strictly at the level of a portfolio. In our view, diversification effects between portfolios should be permitted as well to the extent insurers make use of diversification between portfolios in managing their risks. This would be consistent with emerging practices regarding risk and capital management.

5e. We have no additional suggestions regarding the level of the guidance other than our comments made earlier in this letter with respect to the disclosures.

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?
(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?
(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?
(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)?

(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?
(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?

Comments DASB:

6a. We agree that an insurer should not recognise any gain at inception, because this is consistent with other industries and other IFRSs. The unavoidable consequence of this approach is that a residual margin is recognised in the balance sheet that may not be a liability according to the Framework. We would propose that for the subsequent measurement of this "balancing item" the administrative burden is minimized to the greatest extent by using pragmatic methods.

6b. We agree that the residual margin cannot be less than zero and that a loss at inception should be recognised immediately. This principle is consistent with IFRS requirements for other types of transactions and contracts.

6c. We have great concerns about the level of granularity of the proposed method and would recommend searching for simpler methods.

6d. We have concerns about the meaning par. 50b, i.e. release according to the expected timing of claims and benefits. Especially for life contracts, this may not lead to a reasonable pattern of the margin release.
Finally, we are not convinced that the complexity of the proposed release rules of the residual margin is justified by the relevance of it.

6e.We do not agree with the proposed methods to release the composite margin for the same reasons as mentioned under 6c for the release of the residual margin.

6f. We do not agree to accrete interest on this margin because it just adds complexity without giving any additional relevant insights.

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?

Comments DASB:

Although we agree that only incremental acquisitions costs are taken into account as this is consistent with other standards, we believe that the incremental acquisition costs must be assessed at a portfolio level. This would be more consistent with the unit of account that is commonly applied in the ED. In addition, less differences as a consequence of the business model (e.g. broker distribution versus direct writing) will occur.

Question 8 – Premium allocation approach

(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?

Comments DASB:

8a. We recommend permitting, but not requiring the modified approach although we realise that this will lead to more diversity in practice. In addition, we observe that the premium allocation method does not reduce complexity because an onerous contract test using all three building blocks of the current fulfilment value must still be carried out.

8b. We have some concerns regarding unexpected consequences, like some group life contracts being classified as short-term contracts and some multi-annual reinsurance contracts being classified differently from the primary insurance contracts they relate to.

Question 9 – Contract boundary principle
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?

Comments DASB:

Although we basically agree with the principles of contract boundary there is a need for additional guidance (e.g. health contracts and group pension contracts).

For certain Dutch health insurance contracts (´basic health insurance´) the principles as proposed for the boundaries of the contracts may have a substantial impact because premiums are not set based on the risk of the individual policyholder. For these contracts, premium differentiation is legally not allowed and is combined with a legal requirement to accept each policyholder. The claims on these insurance contracts are equalised between insurers for the Dutch population of policyholders in total (by means of the so called ´Zorgverzekeringsfonds´). Therefore, the insurer is not exposed to additional risk for the portfolio in total and premiums are set at a level adequate for the portfolio.

The contractual term of these contracts is one year. As premiums are not set based on the risk profile of the individual policyholder, the proposals in the ED could lead to the situation that these contracts have to be accounted for based on their estimated renewals (thus longer than the contractual term). We do not believe that this is the intention of the ED.

Proposed alternative wording
We therefore suggest adding the following wording in par 27 (in italic):
(b) has the right or the practical ability to reassess the risk of the particular policyholder and, as a result, can set a price that fully reflects that risk *or if premium differentiation is legally not allowed a price for the portfolio of contracts that fully reflects that risk.* In assessing whether it can set a price that fully reflects the risk, an insurer shall ignore restrictions that have no commercial substance (i.e. no discernible effect on the economics of the contract) *and restrictions that, based on legal requirements, are applicable to all contracts which forces the insurer to reprice the risk at a portfolio level.*

Question 10 – Participating features
(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?
(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?
(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?

Comments DASB:

10a. We agree to include all expected cash flows.

10b. We have no preference for including these products in IFRS 4 or IAS 39/IFRS9. But we do agree that they should be measured in accordance with the principles outlined in the ED. Therefore the most practical approach is to include these in the scope of the ED as otherwise IAS 39 would have to be amended to introduce a similar model for financial instruments with discretionary participation features (DPF)

10c. We do not agree with the addition. All investment contracts should be valued consistently and only the DPF element is similar to the DPF element in the insurance contracts with DPF. The DPF should be measured consistently for both insurance and investment contracts.

10d. We see no reasons for these modifications.

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

Comments DASB:

11a. We basically agree with the definition of an insurance contract, but hesitate whether in practice a new product definition is necessary. In our opinion, the benefits of the changed definition do not outweigh the risk of unexpected product reclassifications.

11b. We understand why product warrantees, employee benefit plans and fixed fee service contracts that are carried by entities that never had any relationship to insurance, have been excluded.
However, there is a circular reasoning within paragraph 4a, 4e and 5. Despite the scope-out, he ED is applicable to insurers that provide goods and services and to coverage on product warranties that are issued by insurers. According to par. 5, any entity that issues insurance contracts is an insurer. In order to break this circle, the IASB needs to define *insurer* in a more robust way.

11c. By analogy to par. 11b, financial guarantee contracts that meet the definition of an insurance contract should only be within the scope of the standard if issued by an insurance company. This prevents that non-insurance companies are suddenly confronted with implementation issues when having to apply the standard for insurance contracts. We repeat that insurer needs to be defined in a more robust way.

Question 12 – Unbundling 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?

Comments DASB:

We do not fully understand the need for unbundling in the current ED. Unbundling was a mechanism in the current IFRS 4 to prevent inappropriate use of the current IFRS 4 model to non-insurance components. Under the proposals in the ED, unbundling would primarily impact the balance sheet presentation as measurement will not be affected. We are not convinced that unbundling –and the related operational complexities- is warranted for a presentation impact only. Having said that, if unbundling is required, we agree that unbundling is appropriate in the circumstances outlined in par. 8.
However, we are not sure we understand how the unbundling criteria explained in par. 8 should be applied in relation to par. 32. According to par.32 contracts where amount and timing of the cash flows depend wholly or partly on the performance of specific assets the measurement of insurance contracts should reflect that dependence. If there is complete dependence on the performance of specific assets, this contract may meet the requirements of par 8 to unbundle and par. 32 should not apply.

We would recommend giving more guidance on which parts of insurance contracts should be measured according to par. 32 that would not qualify for unbundling in accordance with par. 8.

In addition, we do not understand par. 9. We are not sure as to whether the application of a cross-subsidy in the crediting rate or charging fees against an account balance leads to different measurement. Is this paragraph intended to deal with *expected future* charges, fees and cross-subsidies in the crediting rate relating to the contract?

Question 13 – Presentation
(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?
(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?

Comments DASB:

13a. We consider the proposed summarised margin presentation more useful than the traditional presentation, because it gives insight in the sources of earnings and in the differences between actual cash flows and previous periods' estimates. Volume indicators as premium, claims, and expenses are not presented in the Statement of Comprehensive Income, but in the roll forward of insurance liabilities as addressed in par. 87, which makes this statement almost as important as the primary statements. Furthermore, the summarised margin presentation may be appealing with respect to insurance contracts, but is not necessarily the best model for other types of contracts and instruments.

We have some comments on the presentation:

- We note that the use of two presentations, one being the short duration contracts model, is confusing and in our view adds little information, while not providing much simplification. If both short-duration and other contracts are reported, the gross figures on short-duration contracts "overshoot" the summarised margin information on other contracts. Therefore, it may be appropriate to provide more guidance on when to include the gross information in the footnotes and when in the income statement.
- Par. 69, in combination with BC156, may be intended to evaluate for each portfolio whether it represents an asset or a liability and to aggregate all portfolios that represent an asset and all portfolios that represent a liability. However, the text of par. 69 suggests that each portfolio should be separately presented in the statement of financial position. We recommend clarifying this text.

13b. As noted earlier, we have some concerns with the potential fluctuations in income. We believe that further work is needed in order to develop an appropriate accounting model that is capable of both representing the fulfilment value of insurance liabilities in the balance sheet and of appropriately distinguishing between short term market volatility and long term business performance.

Question 14 - Disclosures
(a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?
(b) Do you think the proposed disclosure requirements will meet the proposed objective? Why or why not?
(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.

Comments DASB:

14a. Although we agree with the proposed disclosure principles, some issues need further clarification:

- We like to see more explanation on the level of disclosures. We do not understand why all disclosures relating to insurance contract should be at least as detailed as the segmented information (par. 83), while this is not required in other IFRSs.
- Par. 88 requires disclosing the reconciliation of contract balances separately for pre-claims liabilities, additional liabilities for onerous insurance contracts and claims liabilities. Although it can be argued from the context of the ED, it is not exactly clear that risk adjustments shall be separately disclosed for claims liabilities (like required in par. 86) and that the change in the relating risk adjustment is a separate line-item in the underwriting result.
- Once the previous point has been made clear, claims and expenses incurred during the period will automatically be presented in the income statement, or disclosed. Hence, there may be no need for par. 89, unless the IASB has something else in mind with this paragraph.

14b. In our opinion, the proposed disclosure requirements will meet the proposed objectives of transparency.

14c. We advise reconsidering the relevance of the general format of the cash flow statement for insurers. For example the investment of cash flows received from policyholders constitutes an operational activity rather than an investments activity.

Question 15 – Unit-linked contracts
Do you agree with the proposals on unit-linked contracts? Why or why not? If not what do you recommend and why?

Comments DASB:

In our opinion, the requirements with respect to unbundling are not clear; reference is made to our response to question 12. However, if a unit linked contract is treated as an unbundled insurance contract, we agree with these requirements as the risks in these portfolios are different from the non-linked insurance liabilities.

Question 16 – Reinsurance
(a) Do you support an expected loss model for reinsurance assets? Why or why not? If not, what do you recommend and why?
(b) Do you have any other comments on the reinsurance proposals?

Comments DASB:

16a. Conceptually, we agree with the proposed expected loss model.

16b. We understand that recognising a gain at inception of reinsurance contracts is the mirror of the accounting for insurance contracts with a loss at inception. However, it would be difficult to understand that a loss at inception of a reinsurance contract that exceeds the residual margin of the corresponding primary insurance would not be recognised, respectively that a gain at inception of a reinsurance contract that exceeds the initial loss on the corresponding primary insurance would be recognised.

Question 17 – Transition and effective date
(a) Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?
(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)?

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

Comments DASB:

17a. We do not agree with the proposed transition requirements. According to par. 100, no residual margin will be included in the insurance contract liabilities in the opening balance sheet at the moment that the ED is adopted for the first time. Effectively, this means that the release of residual margins will be close to zero in the first period after adoption and will gradually increase in the years that the enterprise builds new business. Consequently, the underwriting result, being a key performance indicator in the presentation of the income statement, will give a flawed pattern (i.e. a too low amount in initial periods and a non-existing improvement in subsequent periods) during a long period of time. We suggest investigating alternatives that have less fundamental disadvantages, e.g. exploring as to whether the new requirements could be applied retrospectively or a pragmatic solution that would be a fair proxy for retrospective application.

17b. We are not in favour of a composite margin approach but would have the same concerns as with the proposed transition as commented under 17a.

17c. We would find it necessary to align the implementation dates of the ED and IFRS 9 in order to minimise the impact on the operations and to enable alignment between the accounting choices.

17d. Answering this question would require a survey amongst insurers. In any case, the proposals would represent a fundamental change to the insurance industry and hence would require a significant implementation period. We refer to our response on Question 18 that refers to the need for an adequate pre-implementation field test period.

Other comments

Question 18 – Other comments
Do you have any other comments on the proposals in the exposure draft?

Comments DASB:

18. We advise the IASB performing more field testing and evaluating the results of those field tests before issuance of the final standard. This will provide insight in the time needed for implementation and enable remediation of unintended effects.

Question 19 – Benefits and costs
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.

Comments DASB:

In order to keep the administrative burden at an acceptable level, we believe that the final requirements under IFRS should, where relevant, be as much as possible aligned to those in Solvency II.