Norsk RegnskapsStiftelse

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UK

Oslo, November 30th, 2010

Dear Sir/Madam

ED/2010/8: Insurance Contracts

Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board) is pleased to comment on the Exposure Draft on *Insurance Contracts*.

We support the Board's effort to develop an IFRS for the accounting for insurance contracts and that the Board as a first step considers the issuers accounting for insurance contracts together with the accounting for reinsurance contracts.

While we agree with a large number of the proposals in the exposure draft and the ambition to finalise the proposed standard within the indicated time frame, we would like to bring to the attention of the Board our different point of views relating to inclusion of credit risk in the discount rate, measurement of risk margin, the descriptive use of predefined models for measurement of risk margin, the wording related to measurement of residual margin, the proposed interest calculation on the residual margin, the relationship between incremental acquisition cost and acquisition cost, the prescriptive use of a simplification method for some short duration contracts, the application of insurance accounting to non-insurance discretionary participation contracts and the treatment of financial guarantee contracts.

We would also like to bring to the attention of the Board our concerns related to the proposed transition requirements that will practically eliminate all future gains from current contracts, the definition of discretionary participation features, the definition of an insurance contract, the clarity of the scope exclusion for some fixed-fee service contracts, the criteria used for when unbundling is required, the arguments used for the treatment of treasury shares related to unit link contracts and the use of defined terms throughout the standard.

We stress the importance of giving entities sufficient time for implementing the standard after it has been issued.

Further explanations to our point of views and concerns to the proposals of the Board are laid out in our detailed comments to the questions in the order suggested by you in the appendix to this letter.

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Please do not hesitate to contact us if you would like to discuss any specific issues addressed in our response, or related issues, further.

Yours faithfully,
Norsk RegnskapsStiftelse

Erlend Kvaal
Chairman of the Technical Committee on IFRS of Norsk RegnskapsStiftelse

Appendix - Detailed comments on ED 2010/8

Specific questions

Question 1 – Relevant information for users (paragraphs BC 13 – BC 50)
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?

We believe the proposed measurement model will represent a significant improvement compared to current regulation. A measurement model which is based on fulfilment cash flows and a building block approach, while introducing more estimates, would improve the decision usefulness in accounting for insurance contracts.

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?

(a)
We believe a measurement approach for insurance liabilities that is based on the expected present value of future cash outflows less future cash inflows (fulfilment cash flows) would provide important information to users and to a great extent portray the way many insurance companies manage and measure their insurance contracts. However, we are somewhat uncertain as to whether this business model concept would be the best approach in all circumstances. It is conceivable that some entities could enter into significant trading with insurance contracts, and we would therefore like the Board to clarify whether the fulfilment cash flow model also in such circumstances is the most appropriate to apply.

(b)
We believe the draft application guidance on estimates of future cash flows in appendix B is at the right level of detail.

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

(a)
We believe it is important that the discount rate used by the insurer reflects the factors that have influenced the cash-flows of the insurance contract. Hence we would like the Board to make it more explicit that the discount rate should reflect the characteristics of the liability. The cash-flows of the contract are the cash-flows of expected insurance payments and expected premium payments. We are of the opinion that the discount rate should reflect the credit, liquidity and other characteristics of these cash flows. Since the credit, liquidity and other characteristics of the cash-inflows and cash-outflows differs there should be independent discount curve used for the discounting of the two cash-flows. The discount rate should reflect the characteristic of any assets backing the insurance liability only to the extent that it is reflected in the characteristics of the insurance contract liability.

(b)
We agree that the effect of liquidity influence the cash-flows of the insurance contract and thus should be included in the calculation of the discount rate used to discount insurance payments (cash-outflows). However, we are not sure whether this should be explicitly stated in the standard. We believe the standard should have a more overriding paragraph stating that the discount rate should reflect the characteristics of the liability. We also encourage the IASB to extend the guidance on liquidity.

(c)
We disagree with the conclusion in the exposure draft that the present value of the fulfilment cash-flow (insurance payments) should not reflect the risk of non-performance by the insurer. The risk of non-performance is influencing the cash-flows of the insurance contract and ignoring non-performance risk would thus lead to incomparability of financial figures between insurers of different credit standing. We cannot see the proposed logic of including liquidity while at the same time excluding non-performance risk. Both risks influence the cash-flow of the insurance contract and both risks should be included in discount rates used to discount insurance payments.

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.

We support the more explicit IASB approach compared to the composite margin approach favoured by the FASB. An explicit recognition and measurement of the distinct elements of an insurer's liability provides useful insight into the insurer's view of the uncertainty related to the estimation of future cash flows arising from the insurance contracts.

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 fulfilment 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 (ie 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?

(a)
We agree that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected.

(b)
We disagree. It is our opinion that a principle based standard should state the objective and not limit the practical solution to three arbitrary selected alternatives. Hence we would like the Board to clarify which factors to include in estimating risk adjustments rather than specifying techniques to apply.

(c)
We believe the disclosures should rather be focused on choice of model, assumptions used and input parameters. There is a risk that some entities would choose model based on the requirement of disclosing confidence level information, hence we would ask the Board to reconsider this.

(d)
We disagree. The risk adjustment should be at the level of aggregation actually used when pricing the insurance contract.

(e)
We believe the application guidance is at the right level of detail.

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?

(a)
We agree that an insurer should not recognise any gain at initial recognition of an insurance contract. We are currently not able to see how an insurance entity should be able to isolate and document a pure day 1 profit. Any margin representing or including a compensation for future services or the exposure to future risk does not represent a pure day 1 profit and should not be recognised as a day 1 profit.

(b)
We agree that the composite margin/residual margin should not be less than zero. It is not appropriate to defer losses on loss-making contracts.

(c)
We strongly disagree that the standard is to include a description stating that the insurer shall <u>estimate</u> 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. As a concept the residual margin is a contract by contract calculated residual. How the entity is to calculate this residual is a practical issue that we believe is not to be prescribed by the standard.

(d)
We agree that the residual margin should be recognised over the coverage period in a systematic manner, although we believe this should be a rebuttable presumption. This rebuttable presumption could be overcome in rare circumstances if there would be any other method that would better reflect the exposure from providing insurance.

(e)
We support that the composite margin should be released over the entire claim handling period.

(f)
We do not agree that interest should be accreted on the residual margin. The residual is just a calculated residual. It is most adequately described as a day 1 gain not recognised due to lack of observable market data. It is not a liability. To incur interest charges on a non-existent liability to be able to increase future revenues is contrary to how day 1 gains is treated in accounting for financial instruments and is not a well funded accounting principle.

For much of the same reasons we would reach the same conclusion for the composite margin.

Question 7 - Acquisition costs (paragraphs 24, 39 and BC135–BC140)
(a) 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?

We believe that incremental acquisition costs for contracts issued should be included in the initial measurement of the insurance contract. We would however ask the Board to consider whether this paragraph should be amended to include all directly attributable costs.

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?

(a)
We believe it is important to develop principles, and methods used when applying those principles, which give rise to decision useful information for primary users of the financial statements. One of the main elements in this respect is consistent application both within the financial statements and also between entities. In order to achieve this we struggle to see how applying different approaches both within a group and between entities would increase comparability and give rise to consistent application. We therefore ask the Board to reconsider whether it is beneficial to actually develop a standard which, by allowing for two different recognition and measurement methods, could reduce comparability and consistency.

We believe one of the most crucial hurdles to pass for every new standard is whether the right level of practical ability has been reached. As such we believe other proxy models could be developed which to a greater extent would accomplish the objective of comparability and consistency.

(b)
See our answer under (a). If the Board decides to keep this approach we believe that the Board should reconsider the proposed presentation in order to try to align it as much as possible with the presentation format for the main approach.

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?

We agree with the proposed boundary principle and we think that insurers will be able to apply it consistently in practice. This is because the defined boundary principle follows the contract period, which have been agreed by both the insurer and the policyholder.

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?

(a)
We believe elements which are integral to the insurance contract should be included in the measurement of insurance contracts.

(b)
We believe financial instruments with discretionary participation features should only be within the scope of the insurance standard if they fulfil the definition of insurance contracts.

(c)
As we do not support defining financial instruments that do not include significant insurance risk as being insurance contracts, we do not see a need to define discretionary participation features.

If a discretionary participation feature is to be defined, the definition should be amended so that a pure financial risk does not constitute a discretionary participation feature. We see the reference in (c) (ii) and (iii) of the definition of discretionary participation feature to be references to potential financial risks.

(d)
We do not have objections to the proposed modifications, but believe it is possible to reduce the number of paragraphs in the standard. This can be done by including paragraph 65 in 50 (can be done by adding a new point (c)) and paragraph 64 into paragraph 27.

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?

(a)
We have some concerns with regards to the definition of an insurance contract. We acknowledge that the proposal include a definition of an insurance contract which is consistent with the current definition of an insurance contract in IFRS 4, however, we believe the wording “adversely affects the policyholder” in certain circumstances could give rise to different accounting treatment of similar contracts. We would therefore ask the Board to consider whether this would constitute a problem and whether it is possible to amend the definition in order to avoid this.

We also believe the wording in B28 should be amended. The word “non-derivative” in the last sentence of this paragraph does not seem to have any content, in other words we believe it could be deleted without altering the meaning of the sentence. Also with regards to B28, we do not believe the mere fact that contracts are entered into simultaneously should define them as single contracts since they actually could be interdependent. The principle is whether they are interdependent or not, and not whether they are entered into at the same time.

(b)
We basically agree with the scope exclusions in paragraph 4, but we have some concerns with fixed fee contracts as described in paragraph 4(e). We are uncertain as to whether this could give rise to different accounting treatment for similar contracts, hence we would like the Board to consider whether this scope exemption is justified.

(c)
We support the proposal to eliminate the accounting option for financial guarantee contracts as either being insurance contracts or financial instruments. However we are of the opinion that it will be a more consistent accounting solution to consider credit to be a financial variable, thus all credit risk to be financial risk. We believe this will have both conceptual and practical merit as most non-insurance entities will be more comfortable with finding the accounting solution for all credit risk in IFRS 7 and IFRS 9 instead of applying IFRS 4, IFRS 7 and IFRS 9 as they might apply to different variants of credit risk.

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?

We believe separating components of a contract that are insurance contracts from components of a contract that are not insurance contracts give rise to increased decision useful information in the financial statements of insurance and non-insurance entities. We are however not convinced that the Board has found the best and most appropriate criteria for when this separation or unbundling is required. The basis for unbundling should be that similar contracts are accounted for in the same manner, ie it should not be possible to "engineer" contracts in such a manner that a desired accounting effect could be achieved. In this respect we believe it would be advantageous to use the same approach as in exposure draft ED/2010/6 Revenue from Contracts with Customers with regards to identifying separate performance obligations.

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?

(a)
We believe the proposed summarised margin presentation would be useful to users of financial statements.

(b)
We believe all income and expenses from insurance contracts should be recognised in profit and loss.

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.

(a)
We agree with the proposed disclosure objective to provide information that enables users to understand the amount, timing and uncertainty of future cash flows arising from insurance contracts.

(b)
We broadly agree with the proposed disclosure requirements, however, as commented in our answer to question 5 c) we have some concerns with regards to paragraph 90(b)(i).

(c)
We are not aware of any additional disclosures that would be useful.

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?

We agree with the proposed approach for separate presentation of unit linked contracts to the extent that assets supporting such contracts are not to be derecognised by the entity. However we would like the Board to fully explain the rationale for presenting treasury shares as asset of the entity and recognising in profit or loss the insurers interest in the those treasury shares.

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?

(a)
We support an expected loss model for reinsurance assets since this is consistent with ED/2009/12 Financial instruments: Amortised cost and Impairment.

(b)
We do not have any other comments on the reinsurance proposals.

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.

(a)
We have some concerns regarding the transitional requirements since it would practically eliminate all future gains from current contracts. We question whether such an approach would represent decision useful information for users of the financial statements of insurance entities. We would therefore ask the Board to reconsider this approach and as a minimum allow retrospective application for those entities that would like to adopt such an approach.

(b)
Given that the Board were to adopt the composite margin approach we would not have any objections to FASB's tentative decision on transition.

(c)
We prefer the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9. However, we believe it is important to not delay the implementation of IFRS 9 longer than necessary. We do not support a solution which would result in an effective date of IFRS 9 being postponed more than 18 months due to the IFRS on insurance contracts.

We also do not support a solution where entities are allowed to re-designate assets at the time of implementation of the new insurance standard.

(d)
We believe that insurance entities would need approximately three years to prepare for implementation of the proposed IFRS for insurance contracts.

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

We recommend that the Board have another look at whether they have found the right level of defined terms, the right use of appendix A versus the body of the standard to define terms and the consistent use of terms. An example might be the term "Claims handling period" defined in Appendix A and only used in IN13. Another example is the definition of pre-claims liability with different definitions in paragraph 56 and in Appendix A. We also recommend the Board to consider the definition and use of incremental acquisition cost versus acquisition cost.

We believe that the Board should develop a need for guidance on what represents a modification of an existing insurance contract as opposed to a cancellation of a contract and initial recognition of a new contract.

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.

We believe a change in the current IFRS regulation with regards to accounting for insurance contracts is warranted due to the wide diversity in practice (as a consequence of IFRS 4 allowing entities to continue to use pre-existing accounting policies for their insurance contracts). Hence we offer strong support to a more comprehensive standard which would lead to more consistent accounting for insurance contracts. As such we agree with the Boards assessment of the benefits and costs of the proposed accounting for insurance contracts.