Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

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Danish Insurance Association
Philip Heymans Allé 1
DK-2900 Hellerup
Phone +45 41 91 91 91
Fax +45 41 91 91 92
fp@forsikringogpension.dk
www.forsikringogpension.dk

Helle Gade

Dir. +4541 91 90 91
heg@forsikringogpension.dk

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Dear Sir David,

Comments on the IASB Exposure Draft on Insurance Contracts

The Danish Insurance Association (DIA) welcomes the opportunity to comment on the IASB Exposure Draft, Insurance Contracts (ED).

General Comments

The DIA is pleased that IASB has addressed a number of the concerns expressed in a number of answers to the Discussion Paper, Insurance Contract that IASB issued in 2007.

We have contributed to the draft response from EFRAG and we do think this draft response represent our views with some of the amendments and clarifications mentioned in this response. We have also been following the development of the comment letter from the CEA/CFO Forum and agree with this comment letter with the following addition.

We support a single measurement model for all insurance contracts based on a current measurement and with the possibility to take changes through profit or loss. Correspondingly we support a measurement of the investments assets covering the insurance liabilities at fair value through profit or loss.

We support the possibility to use simplifications within this single measurement model such as a premium allocation approach for short duration contracts.

We believe that the approach proposed by IASB in the ED using building blocks forms an appropriate basis for the continued work towards a final standard.

The DIA thinks that the following comments should be considered in the process of finalising the revised standard for insurance contracts.

Clarity of the proposal

The current ED contains a number of areas where we recommend further clarity of the proposal to enable a more comprehensive evaluation of the proposal. Also we believe that this may be essential to the full understanding of the proposed model and consequently for the ability to provide a qualified response. We consider the areas concerning unbundling and the understanding of participating contracts to be most essential for the interpretation of the model.

Further consideration should be given to the development of a clear and unambiguous standard.

We believe that the timing of the proposal should be secondary to the quality of the proposal. On this basis we will welcome additional possibility to comment on the further deliberations concerning the final standard, even if this would mean a delay in implementation of the revised standard for insurance contracts.

Measurement model

We believe that the measurement approach which bases the measurement of rights and obligations on the payments which the insurer is entitled to receive and is expected to pay under the insurance contract provide more relevant information than the previously proposed models.

The proposed approach in the ED using building blocks forms an appropriate basis for the continued work towards a final standard. We would suggest that IASB consider the actual application of those building blocks further.

In the Danish market, the insurance liabilities have been reported on a market consistent approach basis since 2004 using current estimates. In the present form with a lock-in effect in the residual margin approach, the ED may create accounting mismatches that do not reflect the actual performance of the underlying life and pension contracts.

Although we to a large extent support the views expressed in the draft response from EFRAG, we also recommend a further investigation of presentation models which reflects the actual performance of participation contracts more properly. We consider this to be a major area to be further investigated as actual setup and regulatory systems differ across jurisdictions. The definition and remeasuring of the residual margin would be key for the further deliberations of the final standard.

We think that emphasis should be on the business models also in the circumstances where this may involve interpretation of other IFRS standards e.g. that an insurer shall unbundle only to the extent that the insurer actually manages and reports on components of a product.

The proposal in the ED is to lock in the residual margin at inception and for this margin to be released over the coverage period in a systematic way that best reflect the exposure from providing insurance coverage. We support that all margins including the residual margin should be remeasured over the covering period using all relevant parameters. This will ensure that changes in estimates

relating to current or past periods would more consistently be recognised in profit and loss.

In contracts with discretionary participating feature (DPF) the regulation may specify the residual part of the performance element to be allocated to policyholders. The residual margin would therefore not be a residual element, but would be the part of the performance element expected to be contributed to own funds. We consider it most important that the measurement model reflect actual performance considering this interaction and would allow for remeasurement to reflect changes in expectations. We would be happy to explain further the Danish contribution principle.

Also we would suggest that the level of aggregation and basis for the calculation of the residual margin should be aligned to the principles used for risk margins.

Finally a clarification of the basis of release of the residual margin on the basis of the expected timing of incurred pension benefits will be appreciated. We suggest that the residual margin may also be released considering the expected fulfilment value or customer account balance, corresponding to the proposed release of residual margin for financial contracts with DPF on the basis of the fair value of assets under management in ED.

These areas would need further consideration in the finalising of the standard to clarify the principles.

Premium allocation model

We support the Premium Allocation model and would like to point out that we would expect this model to be most relevant for non-life insurers and composite insurers, which manages a significant proportion of short duration contracts. This should be reflected in deliberations of the final standard.

Hence the DIA believes that a modified measurement approach should be permitted but not required for short-duration contracts with a coverage period of 1 to 3 years (short duration).

We believe this proposal to be a more pragmatic approach for short duration contracts. As we understand that the intention is to provide a reasonable simplification, we consider that this should be an option rather than a requirement.

Also we would suggest that premium allocation model would be permitted for short duration insurances e.g. 1 to 3 years. This would enable the use of the model for insurers writing the same type of insurance risk (non-life and reinsurance) with varying durations.

Transition rules

We do not support the transition proposal as presented. The proposal in the present form may lead to an inconsistency as the difference between insurance liabilities measures under the current accounting principle and under the new ED is proposed transferred to retained earnings.

The effect will be that future profits on business in force will not be recognised in residual margin and as consequence the profits deferred over the period after transition will not reflect the actual performance of the insurer.

Depending on the definition of the residual margin and the cash flows included and the duration of the portfolios this may lead to significant misstatements of the performance.

The transitional rule should allow a full retrospective approach in accordance with IAS 8, Accounting policies, Changes in Accounting Estimates and Errors.

We have noted that it is concluded that a full retrospective determination of a locked-in residual margin will be impractical or may cause costs disproportionate to the benefits for users.

Since we support remeasurement of the residual margin on a current basis the requirements to establish original data and basis for calculation of a locked-in residual margin will not apply.

We have in the following chosen to contribute to IASB's due process in a summarised form. The summarised form further details our general comments above.

Yours sincerely,

Peter Skjødt Helle Gade

Answers to selected questions

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?

We refer to our General Comments above.

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)/(b) Further attention to the definition of cash flows which are included and those not included would be needed as the exclusion of general overhead costs in B62(f) and the reference B63 need to be revised. The wording may result in the exclusion of costs being incremental on a portfolio basis but considered general overhead costs in other contexts.

We would suggest a more broad principle based wording prescribing principles against double counting and/or interaction with other specific IFRSs concerning expenses.

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?

(a) The DIA agrees that the discount rate should reflect the characteristics of the liability. In case the amount, timing or uncertainty of the cash flows arising from an insurance contract depends wholly or partly on the performance of specific assets, the discount rate should reflect that.

We appreciate the guidance issued in the IASB Staff paper of 8 November 2010 on Discount rate for participating contracts. This paper indicates a level of unbundling which is depending on the actual link between assets and the portfolio of insurance contracts and an unbundling within the individual portfolio which may need further clarification.

(b) The DIA does consider that the effects of liquidity should be taken into account in determining the discount rate since a liquidity adjustment would be appropriate given the fact that policyholders cannot liquidate their investments (insurance contracts) without incurring significant costs.

Illiquidity spread will be reflected in the market valuation of assets as market participants will price instruments considering the liquidity of those. To obtain a market consistent approach it should be assumed that a policyholder similarily will consider the liquidity of products.

We do consider that the illiquidity can be measured and note that it has been included in the Quantitative impact study for the future European Solvency calculations.

(c) We agree that the effects of an entity's own credit risk should not be included in the measurement of an insurance liability as this would not be in line with fulfilment approach.

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) The DIA believes that a modified measurement approach should be permitted but not required for short-duration contracts. This view is based on a support of a single measurement model for all insurance contracts.

(b)The DIA do not agree with the proposed criteria for short-duration as a criterion of 1 year either could result in inconsistentcy as risk may be underwritten on a 1 year basis as well as on a 2-3 year basis or cannot be used.

We suggest a principle based approach defining short duration insurance contracts rather than setting a specific timeline of 12 months.

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?

The DIA basically agree with the proposed boundary principle but would like to make the Board aware of the fact that the proposal in the ED will cause misstatement of the performance of unit link contracts for some life insurance companies.

This is the case when the insurance company receive a fee from the portfolio asset manager depending on the size of the total investments of the insurance customers placed by that manager. Because of this fee the price of asset management in the insurance contract is set lower than it would otherwise be causing these contracts to create a loss at inception when measured according to the

ED. This is because fee income does not stem directly from the insurance contract and hence is not part of the cash inflows.

We find it misleading to report a loss at inception for these contracts when the related fee income would actually make these contracts profitable if the fee was included in the cash inflows. Further, some of the insurance contracts entitles the customer to a portion of this fee which will be part of cash outflow according to ED.

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) The DIA agrees that the measurement of insurance contracts should include participating benefits on an expected present value basis to be consistent with the measurement model.

(b) The DIA agrees that financial instruments with DPF should be within the scope of the Insurance Contracts standard.

(c) The DIA would not consider the proposed definition to ensure a robust reporting model considering the differences concerning DPF type products. Due to constraint in Danish regulation of DPF investment contracts with insurance features, some contracts may not participate in the same pool of assets as insurance contracts. However, these are underwritten in the insurance company in Denmark.

We believe that DPF in the final standard shall properly reflect the regulatory requirements in the given jurisdiction.

The ED only mentions DPF in the context of investment contracts but a lot of insurance contracts also contains DPF. We therefore find the definition of DPF in the ED confusing particularly regarding the wording:

"provided that there also exist insurance contracts that provide similar contractual rights to participate in the performance of the same insurance contracts, the same pool of assets or the profit or loss of the same company, fund or other entity"

since this makes no sense for insurance contracts with DPF.

Therefore we do think that the definition will need careful consideration within the IFRS Insurance contract standard.

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?

The DIA does not support the proposed criteria for unbundling since we believe that the wording is unclear and is open to interpretation. In particular the term "closely related".

Seen in conjunction with the examples given in ED 8(a) of the components that are not closely related to the insurance coverage it may require or not require unbundling separate elements which may not increase the relevance of the information. Further we do not think that the examples given in ED 8(a) could always been said not to be closely related to insurance coverage. For example we find that the investment component of an unit-linked contract could be closely related to a life insurance coverage in the contract set to pay out in the case of death the account balance or a specified minimum amount, if this amount exceeds the account balance at the time of death.

The underlying principle should be further clarified as unbundling can appear contradictory to the decision in the proposals not to split insurance contracts into different components.

The DIA supports the notion that an insurer shall unbundle only to the extent that the insurer actually manages and reports on components of a product separately for example in segment reporting according to IFRS 8. If managed together they may be considered as one contract.

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) The DIA does not support the transition proposal as presented. The proposal in the present form may lead to an inconsistency as the difference between insurance liability measures, under the current accounting principle and under the new ED, is proposed transferred to retained earnings.

The effect will be that future profits on business in force will not be recognised in residual margin and as consequence the profits deferred over the period after transition will not reflect the actual performance of the insurer.

Depending on the definition of the residual margin and the cash flows included and the duration of the portfolios this may lead to significant misstatements of the performance.

The transitional rule should allow a full retrospective approach in accordance with IAS 8, Accounting policies, Changes in Accounting Estimates and Errors.

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