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30.11.2010

EFRAG's Draft Comment Letter on the IASB's Exposure Draft Insurance Contracts

Dear Françoise,

We appreciate the opportunity to comment on EFRAG's Draft Comment Letter on the IASB's Exposure Draft Insurance Contracts (the "ED").

Overall, we believe that EFRAG provided a very good draft that gave a solid basis for starting the discussion. However, we analyzed that some of EFRAG's positions presented in its draft comment letter are not workable. We believe that EFRAG should rethink its draft comment letter in the following areas:

- The proposed current measurement in the ED will force insurers to fair value assets under IFRS 9. This would effectively preclude insurers from using the amortized cost category under IFRS 9, even where this would be the most appropriate valuation in terms of the business model. This result in short term volatility driven by the illiquidity of the markets which is not adequately reflecting insurers' performance within the net income.
- We believe this can be solved in two way:
 - Introduction of an OCI category in IFRS 4 mirrored by the retention of the available for sale category in IFRS 9; or
 - Introduction of a mixed measurement model in IFRS 4, allowing liabilities to be measured generally using a current value with a locked-in discount rate to reflect their business model. In this regard IFRS 4 should reference back to the business model in IFRS 9 in order to ensure appropriate asset-liability matching. This solution would be consistent with the overall IFRS framework saying that the business model matters.
- In any case, a presentation approach singling out the performance driven by short term market volatility out of the operating profit but keeping it within the net income is not a suitable solution.
- Also the remeasurement of the residual margin on its own cannot solve the mismatch driven by the ED.

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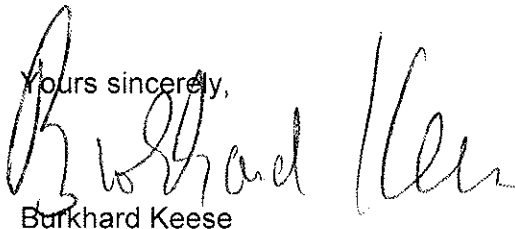
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- We conceptually agree with EFRAG that the residual margin should be remeasured.
- In our view, it is appropriate to adjust the discount rate for the characteristic of the liability, i.e. including an adjustment for illiquidity.
- The one year criterion for the premium allocation approach is not appropriate because it leads to the situation that similar contracts have to be treated differently. EFRAG should rather insist on a principle based approach, i.e. based on the business model with would lead to a distinction in life and non-life.
- We generally support EFRAG's position on presentation. In particular we think that the presentation model for the income statement is not appropriate and needs to be revised once the measurement model is finalized.
- We agree with EFRAG that the proposed transition approach is unacceptable because it excludes future profits of existing business from profit and loss and will therefore distort insurer's performance presentation, particularly in the case of a life insurance portfolio, over a large number of years. We believe a retrospective application according to IAS 8 is possible and should not be prohibited.
- The proposed changes are certainly fundamental and we believe that they require the IASB to re-expose this standard for comments.

Attached you find our comment letter that we sent to the IASB. It may help you to understand the details behind our positions raised above. We included some specific comments in order to highlight aspects where we disagree to EFRAG's draft comment letter.

If you have any queries or questions that you would like to raise in relation to the matters depicted in this letter, please feel free to contact me.

Yours sincerely,



Handwritten signature of Burkhard Keese in black ink, appearing as a cursive script.

Burkhard Keese

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ED/2010/8, Insurance Contracts

Dear Sir David,

We appreciate the opportunity to comment on the IASB's exposure draft 2010/8 – *Insurance Contracts* (the "ED").

As a member of the European Insurance CFO Forum (CFO Forum) we would like to state that we support the comment letter submitted by the CFO Forum and the Comité Européen des Assurances (CEA) dated November 29, 2010. However, Allianz would like to emphasize and further elaborate on some specific issues where we believe that from the perspective of an individual company, we can add more details and practical insights as compared to a document prepared by a group of companies. Furthermore, we would like to emphasize the paramount importance of this standard for us by writing our own comment letter.

Overall we would like to state that the ED is a step in the right direction. We appreciate very much that the IASB has had an intensive dialogue with the industry about the development of the IFRS 4 Phase II. The ED shows how serious the IASB has taken this dialogue as the ED includes many of the concepts supported by the industry. We are in particular pleased that the ED reflects the following aspects:

- Development of a separate accounting standard for insurance contracts;
- Fulfilment value model as opposed to the exit value model;
- Deferral of initial profits as a residual margin;
- Inclusion of acquisition costs in the cash flows;

- Reflection of entity specific assumptions rather than a pure reliance on market assumptions;
- Contract boundary criteria based on the ability to reassess the risk of an individual policyholder;
- Reflection of the specific characteristics of the liability, including liquidity, in the discount rate;
- Explicit risk adjustment; and
- Reflection of expected policyholder behaviour in the cash flows.

While, in the past, we rather discussed single aspects of the measurement model, the ED is now presenting the entire measurement model as a whole. This enables us to consider all aspects of its composition and to judge their interaction and the overall consistency between components. It is natural that this perspective opens again several issues that, in our opinion, do not fit and do not adequately reflect the business model of an insurance company. We refer in particular to the following aspects:

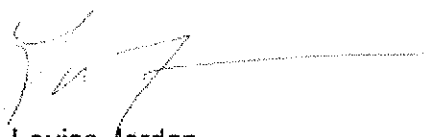
- We are concerned that the proposed current measurement in the ED forces insurers to fair value assets under IFRS 9. This would effectively preclude insurers from using the amortized cost category under IFRS 9, even where this would be the most appropriate valuation in terms of the business model. The result will be short term mark to market movements which does not adequately reflect insurers' performance within net income.
- To avoid this, we consider two alternative solutions:
 - (a) Introduction of an OCI category in IFRS 4 mirrored by the retention of the available for sale category in IFRS 9; or
 - (b) Introduction of a mixed measurement model in IFRS 4, allowing liabilities to be measured using a current value with a locked-in discount rate to reflect their business model. In this regard IFRS 4 should reference back to the business model in IFRS 9 in order to avoid an accounting mismatch.
- In any case, in contrast to the IASB's view expressed in BC 183, the presentation of the insurer's long term performance is key and should not be diluted by short term market movements;
- The lack of remeasurement of the residual margin is inconsistent with the concept of no gain at inception and with the fact that all other building blocks will be remeasured. We therefore advocate the remeasurement of the residual margin. However, if the standard forces insurers into a current-current measurement then it would not be deemed appropriate to remeasure the residual margin for changes in the discount rate. But we would then still advocate remeasurement for change in non-financial assumptions;
- The consideration of diversification only at portfolio level ignores insurers' business model. Diversification should also be considered between portfolios if the insurer is able to realize the diversification effects;
- The presentation model for the statement of comprehensive income is not appropriate and needs to be revised once the measurement model is finalized; and
- The proposed transition approach excludes future profits of existing business from profit or loss and will therefore distort insurer's performance, particularly in the case of a life insurance portfolio, over a large number of years. The standard should not prohibit retrospective application.

In the responses to the questions we kindly would like to make proposals how to solve these issues. As the overall goal is to produce relevant information to users, we use our response to question 1 for giving an overall summary for our proposal. We also would like to refer to our field test results that we submit to the IASB on a confidential basis in order to reinforce our positions with quantitative and qualitative information.

The proposed changes are certainly fundamental and we believe that they may require the IASB to re-expose this standard for comment. However, we still believe that many areas of the standard will remain as currently presented.

If you have any queries or questions that you would like to raise in relation to the matters depicted in this letter, please feel free to contact me.

Yours sincerely,



Louise Jordan
Vice President, Group Accounting
Accounting Policy Department



Dr. Isabell Nehmeyer-Srocke
Insurance Specialist, Group Accounting
Accounting Policy Department

Question 1 – Relevant information for users

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?

Response

- **Allianz considers the measurement model as proposed in the ED as a step in the right direction. We believe that the proposed measurement model does increase the relevance of information for users since there will be more consistency and comparability in the financial statements of insurers.**
- **The proposed current measurement in the ED will force insurers to fair value assets under IFRS 9. This would effectively preclude insurers from using the amortized cost category under IFRS 9, even where this would be the most appropriate valuation in terms of the business model. The result will be short term mark to market movements which does not adequately reflect insurers' performance within net income.**
- **To avoid this, we consider two alternative solutions:**
 - (c) **Introduction of an OCI category in IFRS 4 mirrored by the retention of the available for sale category in IFRS 9; or**
 - (d) **Introduction of a mixed measurement model in IFRS 4, allowing liabilities to be measured using a current value with a locked-in discount rate to reflect their business model. In this regard IFRS 4 should reference back to the business model in IFRS 9 in order to avoid an accounting mismatch.**
- **Furthermore we are particularly concerned about the subsequent measurement of the residual margin, the consideration of diversification, presentation in the statement of comprehensive income and the transitional rules. Within these areas, changes are necessary in order that the overall standard results in relevant information to users.**

- 2 Allianz sees the ED as a step in the right direction. The ED addresses many concerns expressed in our comment letter to the discussion paper as well as several aspects that the industry had raised to the IASB before the ED was published. We really appreciate this responsiveness of the IASB.
- 3 To some extent we believe that the proposals will result in an increase in the usefulness of information for users of insurer's financial statements. A primary reason for this is that there will be a single regime for insurance contracts under IFRS, resulting in greater consistency in the financial statements of insurers compared to the range of accounting models currently applied.
- 4 We particularly agree that the proposed measurement model provides more relevant information about the amount, timing and uncertainty of future cash flows that will arise as the insurer fulfils its existing insurance contracts.
- 5 However, we have concerns regarding certain aspects of the proposals in the ED which we think reduce the relevance of the information for users. We will outline these aspects in the following paragraphs:

ED forces insurers to fair value measurement which may not be in line with an insurers' long-term business model

- 6 We are concerned that the proposed current measurement in the ED forces all insurers to fair value assets under IFRS 9. This would effectively preclude insurers from using the amortized cost category under IFRS 9, even where this would be the most appropriate valuation in terms of the business model. The result will be short term volatility driven by short term market movements which does not adequately reflect insurers' performance within net income.
- 7 The measurement model requires the building blocks to be remeasured at every reporting period for experience adjustments and changes in estimates. Updating for current and past assumption changes is similar to what we do today, sometimes referred to as claims development or unlocking, and is in line with the principles we support. However, updating for future impacts of assumption changes (such as discount rates) will immediately result in gains and losses, even though there is still a profitable margin. This approach produces artificial volatility and is inconsistent with the underlying principle of no gain at inception and the long-term nature of the insurance contract.
- 8 This issue must also be viewed in relation to the asset side of an insurer's balance sheet. IFRS 9 contains a mixed measurement model permitting an insurer to classify its assets at either fair value or amortized cost based on its business model. If Allianz classifies its assets at amortized cost, because its business model is driven by a long term buy and hold strategy in order to fulfil its obligation to its policyholders, a mismatch will arise.
- 9 This mismatch is rather prominent as the liabilities are long term and rather illiquid. There is no deep and liquid market giving evidence to a possible current measurement as being appropriate. While IFRS 9 gives the possibility to adequately reflect the business model of insurers by providing the amortized cost category, IFRS 4 ignores the nature of insurance liabilities and requires a current measurement. In consequence, the proposed measurement model does not provide relevant information to users. Instead, it is needed to create meaningful transparency, including disclosures, so that users can understand our business and our performance.

Use of OCI or mixed measurement model to appropriately reflect insurers' business model

- 10 We see basically two suitable approaches to appropriately reflect insurers' business model:
 - (a) Use of OCI for both liabilities and assets; and
 - (b) Introduction of a mixed measurement model for insurance liabilities.
- 11 The use of OCI on liabilities and assets means that IFRS 4 and IFRS 9 incorporate a category similar to the available for sale category in IAS 39. For this category the insurer would recognise changes in assumptions in OCI. This would allow the insurer to present the performance of the fulfilment of the insurance contracts in net income while maintaining current measurement of assets and liabilities in the balance sheet. This change certainly needs in parallel the retention of the available for sale category on the asset side.
- 12 The introduction of a mixed measurement model for insurance liabilities means the standard would allow the liabilities to be measured using a locked-in discount rate to reflect the insurer's business model in IFRS 9. To avoid a premium deficiency, the company would regularly perform, on portfolio level, a liability adequacy test. This makes sure that the current present value of future cash inflows is always adequate to cover all future cash outflows. If

such test indicates a deficiency, the company would record an additional liability to reflect that.

- 13 Both approaches are consistent with the ED's proposals for probability-weighted estimate of future cash flows, updating the estimates for changes in assumptions (except for the discount rate in case of the mixed measurement model), measuring a separate risk adjustment and residual margin. As a result, the overall concept of the measurement model of the ED remains in tact.
- 14 In any case, in contrast to the IASB's view expressed in BC 183, the presentation of the insurer's long term performance is key and should not be diluted by short term market movements. Therefore, a presentation approach separating the performance driven by short term market volatility from operating profit but keeping it within the net income would not be a suitable solution.
- 15 We do have sympathy with the approaches decomposing the discount rate in order to avoid artificial volatility, e.g. the Canadian approach. It suggests using a default adjusted asset based rate for the income statement and a risk-free rate plus liquidity premium for the balance sheet. Given our preference for the mixed measurement model or OCI, we have not analyzed these proposals in detail. However, we agree that such proposals are worthy of consideration and would appreciate if the IASB further analyses such discount rate based proposals.

Question to constituents (regarding the appendix 2)

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

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?

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

Do you believe that the effect of changes in assumptions of financial and/or non- financial 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.

Response to EFRAG

We kindly ask EFRAG to consider our proposals to use OCI also for insurance liabilities and reintroduce the available for sale category on the asset side, or to demand for a mixed measurement model. As explained, we believe these are the only reasonable approaches to give insurers a free choice in IFRS 9 in order to reflect adequately its business model. Furthermore, it also allows companies to use a current-current measurement if this is the best way to reflect their business model.

The proposal by EFRAG to remeasure the residual margin is conceptually right but will not solve the mismatch or volatility. (See our response to question 6.) We assume that our residual margin will be consumed once the risk-free interest rates moves down about 100bpts.

In consequence, the current draft of EFRAG's comment letter does not provide a solution for this problem. Therefore, we recommend EFRAG to take over the proposal that we have outlined above.

We agree that shadow accounting adds complexity to the financial statements and it is preferable to avoid this accounting instrument in future. We believe that the new OCI category under IFRS 9 is not appropriate for insurers at all because this category excludes changes in market value from recycling. This leads to the situation that the profit of an insurer is disconnected from the result that the policyholder participates in because the policyholder of certain products participates in all realized profits and losses from the investment management. However, if insurers used this category, shadow accounting would still be necessary.

Locking-in the residual margin does not fit into the measurement model

- 16 The ED proposes to lock-in the residual margin and release it to profit or loss over the coverage period in a systematic way that best reflects the exposure from providing insurance risk.
- 17 We agree to this release pattern but believe that the residual margin has to be updated as with the probability-weighted estimate of future cash flows and the risk adjustment. Otherwise it is inconsistent with remeasurement of the other building blocks and produces counter-intuitive information that will be difficult to understand by the users.
- 18 The proposal could lead to the situation that the insurer has to record current gains or losses due to changes in assumptions which more properly should be reflected in future periods.
- 19 In consequence we propose to remeasure the residual margin. Only, once the residual margin is amortized, changes affect profit or loss immediately. We will outline this proposal in more technical detail in question 6(d).

Consideration of diversification at portfolio level is neglecting insurers' business model

- 20 We do not agree that diversification can only be considered within a portfolio because it is inconsistent with the insurer's business model. An insurer generates diversification benefits from risks matching each other, such as the negative correlation between term assurance and annuity books. We propose that diversification between portfolios should also be considered when measuring the risk adjustment, but only when:
 - (a) Insurers manage their portfolios in such a way that risks are offset (or increased) across portfolios; and

- (b) The insurer is able to legally and practically take advantage of the risk diversification. This means, there should be no legal or practical impediment to realizing the diversification effects.

21 In other words, diversification should be considered wherever it exists and it is possible to realize.

Proposed presentation model does not reflect the measurement model adequately

22 Conceptually we support a presentation model that reflects the measurement model and we accept that the current basis of reporting performance, particularly for life insurance, does not provide decision useful information to users. Accordingly, in principle we support a margin approach but believe it should be improved in a way that it also provides more than just changes in the balance sheet line items.

23 However, this approach does not fit for short duration business and we assume that the IASB acknowledged this by introducing the summarized margin approach only for the life business and allowing volume information in the income statement for insurance contracts accounted for under the premium allocation approach. We believe that the IASB should allow continuation of the traditional presentation approach for property and casualty business, supplemented by the presentation of volume information and calculation of key ratios, such as the combined ratio.

Transition rules will have a dramatic effect on future income

24 The proposed transition rules would have a dramatic effect on future income from insurance contracts in force at the time of transition and, simply put, do not work. The result of the ED's transition rules would be that the performance statement presents only the performance of new business underwritten after transition.

25 From our perspective the best approach is the retrospective application according to IAS 8. This would certainly include that simplifications apply. However, companies can find adequate approximations in order to make this possible.

Question 2 – Fulfillment cash flows

- (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?

Response

- **Allianz supports a measurement approach for insurance liabilities that is based on the expected present value of the fulfillment cash flows.**
- **We believe that the guidance regarding the definition of future cash flows is at the right level of detail. However, we have a couple of technical concerns that we raise below.**

Question 2(a) – It is appropriate to measure insurance liabilities at the expected present value of future cash flows

- 26 As we indicated in our response to Question 1, information about the amount and timing of future cash flows are important elements of a measurement model that provides relevant information to users and reflects the way insurers measure and manage their insurance contracts.
- 27 Allianz therefore agrees 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.
- 28 We particularly agree that the measurement of an insurance contract should be based on a fulfillment value rather than an exit value for the following reasons:
- (a) An insurer generally has the intention to fulfill insurance contracts and is usually not able to sell or transfer them. Consequently the fulfillment concept better reflects the business model of an entity that issues the insurance contract;
 - (b) The use of fulfillment value entails the use of entity-specific information. In our view, the economic characteristics of an insurance liability are determined by the way the insurer manages these liabilities in combination with its other assets and liabilities. Therefore, the use of entity specific data is appropriate in the measurement of the insurance liability.
- 29 Conceptually we agree that the first building block should constitute an explicit, unbiased and probability-weighted estimate (i.e. expected value) of future cash flows (paragraph 22(a), paragraph 55(b), paragraphs B38-B39). However, we agree that "in practice, it is not always necessary to develop explicit scenarios" (paragraph B39). Deterministic methodologies sometimes come to as good results in effect equivalent to results of stochastic techniques and even more robust than the expected value as a stochastic approach.
- 30 Deterministic valuations are sometimes more reliable than the explicit stochastic measurement of an expected value. Therefore we would like to highlight that we understand the measurement model of the ED in that way that we still can use other than explicit stochastic methodologies to estimate the expected values where these methods have been proven sufficient in practice. In consequence we understand the ED in that way that all projection models should be calibrated in the sense of determining an expected value even when not based on simulated scenarios or other stochastic techniques providing a full distribution of potential outcomes.

Comment to EFRAG

Please note our comment in paragraphs 30-28 that is in contrast to paragraph 15 in EFRAG's DCL. Furthermore, this is an argument against EFRAG's demand for disclosing the maturity analysis based on the expected maturity rather than based on the actual maturity (paragraph 175 (c) of EFRAG's DCL). If deterministic methodologies are used instead of stochastic approaches, the expected maturity is not estimated and can therefore not be the basis for this disclosure requirement.

Question 2(b) – Some technical concerns regarding the application guidance

- 31 We believe that the guidance regarding the definition of future cash flows is at the right level of detail. However, we have a couple of technical concerns that we raise in the following:

- (a) We believe that the current wording in paragraph B61(j) is inconsistent with the definition of discretionary participation features in appendix A. It is missing the third element in the definition of discretionary participation features in (c) (iii) "that are contractually based on the profit or loss of the company, fund or other entity that issues the contracts". Without this third element being included in the application guidance, an unintended consequence could occur whereby cash flows associated with contracts where the policyholder participates in the profit or loss of the company would be excluded from the first building block.
- (b) We believe that taxes which are not based on the taxable profit of the insurer, but owed by the insurer should be included in the cash flows. Therefore, we think that the wording in B 61(h) is not clear. Taxes that the insurer is only collecting from third party, i.e. the insurer is collecting the tax and passing it through to tax authorities, should not be included: An example for the latter one is the German premium tax for insurance contracts which is not owed by the insurer, but the insurer collects the tax and pass it through the tax authorities. In contrast to that the US premium taxes should be included in the cash flows because the insurer owes the tax. They have rather the character of a license fee. We support that taxes which are based on the taxable profit should be excluded from the cash flows as stated in B62(g).
- (c) We are concerned about the treatment of general overheads as B62(f) states that these should be excluded. We believe that cash flows should include both overhead expenses and expenses which are directly assignable to individual claims, policies or transactions. For example, this would make sure that all costs that relate to a contract will be considered. Not to do so would understate the present value of fulfilment cash flows and overstate the residual margin as premiums are set up to recover such expenses. The inclusion of such overheads would also be consistent with other IFRSs such as IAS 36 *Impairment of Assets*. Not to include them may also encourage outsourcing of activities due to accounting reasons not necessarily on the basis of sound economics. Having this in mind it becomes visible that the limited consideration of overhead costs contradicts the IASB's view on the residual margin in BC125. In this paragraph the IASB sees the residual margin as a compensation for the cost and effort of originating the contracts and assembling them into the portfolio. Overhead costs are one part of this kind of cost and effort and should therefore be included in the cash flows.

- 32 Generally, we disagree with the level of measurement regarding cash flows. We believe that the level of measurement is an operational aspect that should not be ruled in a principle based accounting standard. The way each company measures those costs should be left to the individual company based on the management of the pooled risks. Some expected cash flows are not measured at portfolio level, e.g. some premium refund clauses refer to wider groupings than one portfolio. However, the expected premium refund is clearly a cash flow stream that should be considered in the present value of fulfillment cash flows. Therefore, it is not appropriate to require a certain level of measurement.

Question 3 – Discount rate

- (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?

Response

- **Allianz 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.**
- **Allianz agrees that the effects of liquidity should be taken into account in determining the discount rate.**
- **We agree that the effects of an entity's own credit risk should not be included in the measurement of an insurance liability.**

Question 3(a) – Discount rate should reflect the characteristics of the liability

- 33 We agree that the future cash flows should be adjusted for the time value of money and that the discount rate should be consistent with observable current market prices for cash flows whose characteristics match those of the insurance liability at initial recognition.
- 34 We believe that it is fundamental to include factors such as timing, currency and liquidity in the discount rate as these are relevant characteristics of the liability that reflect the economic substance of the contract at initial recognition.
- 35 We also believe that the discount rate should be adjusted for country specifics for business written in that country knowing that a market consistent rate varies within one currency from country to country. As paragraph 30(a) of the ED is an exemplary enumeration we see this as granted.

Question 3(b) – Liquidity adjustment should be considered in the discount rate

- 36 We believe that it is appropriate to allow for a liquidity premium adjustment in the estimation of discount rates.
- 37 We believe that the liquidity premium can be reliably measured as we already use it in the context of our internal risk management, in our embedded value reporting and soon in solvency reporting. There are a number of techniques available to calculate such a liquidity adjustment.

Question to Constituents

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.

Response to EFRAG

Allianz agrees that it is appropriate to allow for a liquidity premium adjustment in the estimation of discount rates.

Question 3(c) – Own credit risk should not be included

38 Allianz has previously stated that own credit standing of an insurance contract should not be considered in the valuation of insurance liabilities. We continue to support this view on the basis that introducing own credit standing into liability valuation would result in a misleading accounting profit in the event of a downgrade of an insurer.

Question 4 – Risk adjustment versus composite margin

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 favors)? Please explain the reason(s) for your view.

Response

- **Allianz prefers the proposed separate recognition of a risk adjustment and a residual margin.**
- **Allianz also believes that the risk adjustment can be reliably measured and therefore can be explicitly included as a separate building block.**

Question 5 – Risk adjustment

- (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?

Response

- **Allianz believes in the concept of the separate risk adjustment but thinks that the definition of the risk adjustment could be misinterpreted.**

- Allianz believes that methods that can be used to measure the risk adjustment should not be limited as certain developments may make it necessary that companies will develop new methods over time. Instead, a principle should be developed that drives the selection of an appropriate measurement methodology.
- We disagree that the confidence level to which the risk adjustment corresponds should be disclosed.
- Allianz believes that diversification between portfolios should be taken into account under specific circumstances.
- Additionally, Allianz believes that the accounting standard should not rule a rather operational aspect as the level of measurement.
- The level of application guidance in Appendix B on risk adjustments is sufficiently detailed.

Question 5(a) – Definition could be misinterpreted

- 39 As stated in question 4, we believe an explicit risk adjustment is an important component in presenting an economic valuation of the insurance contract liability.
- 40 However, the definition of the risk adjustment could potentially lead to misinterpretation as it implies the inclusion of prudence which we do not believe is intended by the ED. It would be in contrast to paragraph 29 of the Framework to the IFRS where it is stated that any over- or understatement have to be avoided.
- 41 Apart from that we agree that the risk adjustment shall be the amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected.
- 42 However, we tend to disagree to paragraph B69 saying that the risk adjustment “shall not reflect risks that do not arise from the insurance contract, such as investment risk (except when investment risk affects the amount of payments to policyholders), asset-liability mismatch risk or general operational risk relating to future transactions.”
- 43 We agree that the risk adjustment shall reflect all risks associated with that contract only. (This is in line with what we have supported in the CFO Forum’s letter on “Measurement of risk adjustments” on June 2, 2010.)
- 44 Nevertheless we believe this includes non-hedgeable market risk for long duration business reflecting reinvestment risk inherent in a particular contract as it cannot be avoided. The same for the operational risk. The operational risk is associated with a particular insurance contract and should therefore be considered in the risk adjustment.
- 45 Maybe the IASB has considered these exclusions only regarding “general” operational risk and “future transactions”. Certainly, the risk adjustment of the in force business should not consider the asset-liability mismatch risk and operational risk inherent in contracts that will be underwritten in future. Also, it should only consider operational risk that is related to the management of insurance contracts or obligations from insurance contracts.
- 46 In summary we would like to reiterate that the risk adjustment should represent all non-hedgeable risk that are associated with an insurance contracts. This includes underwriting risk (e.g. mortality, morbidity, longevity, claims ratios in property and casualty business),

unavoidable market risk (e.g. asset-liability mismatch risk inherent in long duration business), and operational risk. Paragraph B69 should be clarified accordingly.

Comment to EFRAG

We kindly ask EFRAG to consider our response to this sub-question.

We do not follow EFRAG's argument that the proposed definition is in line with the fulfilment notion. We do not understand how a prudent measurement of the risk adjustment and the ignorance of certain risks that can also influence the cash flows is in line with the fulfilment notion.

We believe that in particular for the fulfilment notion all possible risk that are associated to a contract have to be considered. Furthermore, we believe that the measurement of the "maximum" amount is not in line with the overall concept of the IFRS.

Question 5(b) – Principle should drive the selection of an appropriate measurement methodology

- 47 Whilst we agree that the three techniques set-out in paragraphs B73-B90 would enable an entity to measure the risk adjustment reliably, we do not agree that it is necessary to limit the measurement to these techniques.
- 48 Allianz would recommend limiting measurement techniques only on the basis of a stated principle. Stating a principle, rather than prescribing specific techniques would allow for the use of techniques that may be developed in the future.
- 49 However, we recognize that limiting the choice of methods that can be used for measuring the risk adjustment enhances comparability. Therefore, we suggest that there should be a rebuttable presumption that an entity will use one of the three methods prescribed in the ED unless an entity can prove that a different method would be more appropriate as it better reflects the risks of its portfolio in the notes.
- 50 The principle should be accompanied by the clear disclosure requirement to state why the different method meets the measurement objective and how the methodology works.

Question 5(c) – Disclosure of the confidence level should not be required

- 51 We do not believe that the standard should generally require the disclosure of confidence levels. We believe it is right that the standard should allow for a range of methods for calculating the risk adjustment as different products may make it necessary to use a different approach. However, requiring a disclosure information based on a certain approach contradicts this appropriate variety of methods because it forces companies to use a specific approach. In this case companies would have an incentive using the percentile approach because otherwise they need to calculate the risk adjustment twice in order fulfil the disclosure requirement. This creates an additional workload for companies that we do not believe adds any benefit to the user and is not in line with a principle based standard approach.
- 52 We believe that the disclosures required around the technique employed in terms of measurement and the sensitivity analysis should provide sufficient transparency to the users.

Question to constituents

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

Response to EFRAG

We agree that that confidence level information does not provide useful information. We could agree to the disclosure requirements proposed by EFRAG.

Question 5(d) – Diversification between portfolios should be considered; the level of aggregation has no relevance

- 53 Similar to our response to question 2b, we also do not believe that a certain level of measurement should be required regarding the risk adjustment. The standard should define the level of diversification that should be considered in measuring the risk adjustment but there is no need to require a certain level of measurement for actually calculating the diversification. Certain risks are measured at different levels. Financial options and guarantees, for example, are considered on fund level at which assets are managed. This may be above the portfolio level while a risk of changes in insurance assumptions are considered based on each line of business. This is independent of the diversification.
- 54 Allianz considers that diversification between portfolios should also be considered when measuring the risk adjustment, but only when:
- (a) Insurers manage their portfolios in such a way that risks are offset (or increased) across portfolios because this is in line with the business model; and
 - (b) The insurer is able to legally and practically take advantage of the risk diversification. This means, there should be no legal or practical impediment to realizing the diversification effects.
- 55 Where the above criteria are met, Allianz considers that including the diversification effects between portfolios and between risks would more faithfully reflect how insurance contracts are managed. It is actually the insurer's business model, generating diversification benefits from risks being uncorrelated or even off-setting each other, such as the negative correlation between term assurance and annuity books. It would also reflect better the financial position of the company.
- 56 Allianz considers that if diversification across portfolios has been taken into account when measuring the risk adjustment, the amount and nature of that diversification should be disclosed.

Question 5(e) – Level of detail of application guidance is sufficiently detailed

- 57 We consider that the level of application guidance in Appendix B on risk adjustments is sufficiently detailed but it describes a definition of a risk adjustment that is not acceptable. See our response under 5(a).

Question 6 – Residual/composite margin

- (a) Do you agree that an insurer should not recognize 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 recognized 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?

Response

- **Allianz agrees that no day one gain should be recognized. However, losses on initial recognition should be recognized immediately.**
- **Allianz believes, the level of measurement should be principle based and not be ruled in the accounting standard.**
- **In Allianz's view the residual margin should be remeasured.**

Question 6(a) – No gain at initial recognition should be recognized

- 58 Allianz agrees that an insurer should not recognize any gain at initial recognition of an insurance contract, because:
- (a) This is in line with the selected measurement attribute of fulfillment value and the fact that the insurer is not earning any profit at inception but over the coverage period;
 - (b) The residual margin represents the estimated profit that will be earned during the term of the contract.

Question 6(b) – Losses at initial recognition should be recognized

- 59 We agree with the proposals in the ED that a loss at initial recognition of an insurance contract should be recognized immediately in profit or loss when the present value of the

expected future cash outflows plus the risk adjustment exceeds the present value of expected future cash inflows. It would not be appropriate to defer losses over the coverage period. A loss on initial recognition is different to a residual margin as an initial loss does not relate to the reward the insurer earns from bearing risk and fulfilling the contract.

Question 6(c) – Level of measurement should not be ruled in the accounting standard

- 60 Allianz agrees that measuring the residual margin at cohort level, i.e. grouping within a portfolio of contracts by similar date of inception and by similar coverage period, is in many cases the most appropriate level of measurement for the residual margin. However, in the case of property and casualty contracts, this approach may not always be consistent with the accident or underwriting year basis of accounting. Most of this business would be handled by using the premium allocation approach as discussed in question 8. Nevertheless, we believe that the standard should not rule the level of measurement for measuring the residual margin.
- 61 Furthermore, we would like to make clear that similar inception date does not mean a grouping of cohorts on daily basis.

Question 6(d) – Residual margin should be remeasured

- 62 Allianz agrees that the residual margin generally should be released in a systematic way that best reflects the exposure from providing insurance coverage.
- 63 In Allianz's view the residual margin should be remeasured to offset changes from the remeasurement of the present value of the fulfillment cash flows. Any expense arising from a remeasurement of the present value of fulfillment cash flows that exceeds the residual margin should be recognized immediately in profit or loss. Thus, the residual margin cannot become negative.
- 64 Our reasons for this view are detailed below:
- (a) In Allianz's view, not allowing income and expenses resulting from the remeasurement of the fulfillment cash flows to be offset against the residual margin can lead to counterintuitive results. For example, under the proposals in the ED, an adverse change in the estimate of fulfillment cash flows arising from a portfolio of insurance contracts will result in a loss being recognized immediately in profit or loss. However, profit from the residual margin attributable to that same portfolio of contracts will continue to be recognized through the release of the residual margin.
 - (b) We consider that recalibrating the residual margin for changes in estimates of future fulfillment cash flows is consistent with the methodology used at initial recognition of the insurance contract. At initial recognition the residual margin was calculated as the difference of these future estimates and the future premiums receivable. At a point in time estimates of future cash flows will change and therefore it seems consistent with the calculation at initial recognition, to recalibrate the residual margin in line with these re-estimates. We believe that the remeasured residual margin would better reflect the insurer's view of the profitability of the contract given current information. The adjustment should be both positive and negative up to the 'unearned' amount of the residual margin.
 - (c) Furthermore, it is consistent with the measurement of the other building blocks. All building blocks will be remeasured and adjusted for assumptions. In consequence it is appropriate also to do this for the residual margin.

- 65 In line with our proposal to introduce a mixed measurement model into IFRS 4, this remeasurement would apply to changes in assumptions other than changes in discount rate.
- 66 In parallel to the remeasurement, the residual margin should be amortized systematically. When remeasuring the residual margin, the increase of the residual margin should be limited up to the premium at inception less any amortization. The residual margin is zero at the end of the amortization period.
- 67 In order for subsequent measurement of the residual margin to be consistent with its measurement at initial recognition, Allianz believes that changes in the assumptions relating to the current period or prior periods should be distinguished from changes impacting the insurance contracts future/expected profitability. As a result changes in assumption that have an impact on the current period or prior periods should be reflected in profit or loss. Changes in assumptions that have an impact on future periods should lead to an adjustment in the residual margin such that the residual margin represents the expected future profitability of the contract at the reporting date.

Question to Constituents

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.

Response to EFRAG

We completely agree to EFRAG that the residual margin should be remeasured in order to offset changes in assumptions / estimates.

However, we would like to highlight that the remeasurement of the residual margin will not be sufficient in order to avoid any accounting mismatch that may result of the application of the ED. We believe it is conceptually right to remeasure the residual margin, as EFRAG has outlined very well in paragraph 78 of its draft comment letter.

Moreover, we would like to ask EFRAG to reconsider its sentence of paragraph 80 stating that "the residual margin should be recalculated as if the change had been known at the time of the contracts inception." This approach is not going to work because changes that relate to past periods have been already impacted the P&L.

For example, we have assumed for certain contracts a mortality rate of 10%. Each year we discover that our insurance liability was not sufficient. This was recorded in P&L immediately once the claims occurred. After a couple of years, the mortality table changes officially. This is a change in assumption that will impact only future years. Therefore, it should be treated prospectively. A retrospective application, as EFRAG suggests in its draft comment letter, is not practicable. Furthermore, regarding IAS 8, this would be a change in estimate which also requires a prospective application and not a retrospective application.

Question 6(e) – A composite margin is generally not supported

- 68 As we indicated in our response to Question 4, Allianz does not support the composite margin approach. On this basis and in line with our response to question 6(d) above we do not support the method of accounting proposed for the release of the composite margin.

Question 6(f) – We have no comment on the accretion of interest on the residual margin

Question 7 – Acquisition costs

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 recognized as expenses when incurred? Why or why not? If not, what do you recommend and why?

Response

- **Allianz agrees that acquisition costs should be included in the present value of the fulfillment cash flows.**
- **We also agree that acquisition costs should be defined as “incremental costs of selling, underwriting and initiating a contract”.**
- **However, we discovered that not all incremental acquisition costs are incremental at individual contract level. Therefore, we do not believe the standard should require a certain level of measurement for measuring the acquisition costs.**

- 69 Allianz agrees that acquisition costs should be included in the initial measurement of the insurance contract as contract cash outflows for the following reasons:
- (a) Acquisition costs are a necessary and unavoidable part of the fulfillment costs of the contract;
 - (b) On the basis that acquisition costs are compensated by the premiums paid under an insurance contract, expensing acquisition costs on initial recognition would be inconsistent with recognizing the attributable compensation when the residual margin is released. In Allianz's view recognizing a day one loss on an otherwise profitable contract does not provide useful information.
- 70 We also agree that acquisition costs should be defined as “incremental costs of selling, underwriting and initiating a contract”.
- 71 However, we are concerned about the level of measurement. Limiting acquisition costs to those that are incremental at individual contract level may lead to a divergence in valuation of contracts sold through different distribution channels. An insurer who sells through a direct sales force may incur similar total acquisition costs to one selling through an agent yet the latter will incur incremental acquisition costs whereas the former will not.
- 72 Moreover, the level of measurement at individual contract level is also problematic regarding commissions that are paid as an incentive to reach a certain volume. For example, some commissions are paid annually based on the premiums for new business sold or once the agent has reached a certain scale (e.g. after the sale of 100 policies and again after the next 50 policies). We understand these commissions are incremental as those costs had not been incurred if the insurer did not issue the particular contract. These costs are also directly attributable to an individual contract. However, in practice, these costs will not be measured at individual contract level. If these costs were not considered as acquisition costs, entities would incur a loss in years with strong growing business. This would not be appropriate and would not produce useful information for the users of financial statements.

- 73 In consequence we believe that the level of measurement should not be ruled in the standard. All incremental costs of selling, underwriting and initiating a contract that relate to new business sold should be considered as acquisition 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?

Response

- **Allianz welcomes the introduction of a simplified measurement approach.**
- **We disagree to the one year criterion and propose that the application of the premium allocation approach should be principle based.**
- **We are concerned about some aspects of the premium allocation approach as being too complex.**

Question 8(a) – The premium allocation approach should be optional

- 74 We support a single measurement model for all insurance contracts. However, we believe that, under a principles based standard, it is appropriate to introduce a simplification of the single model that allows insurers with relatively straight forward contracts to avoid detailed building block determination by using a proxy method.
- 75 Accordingly, we support view (ii) whereby an insurer is permitted, but not required, to apply such an approach. As the premium allocation approach is a simplification of the building block model it should not be mandated for particular types of contracts. It is illogical that companies who would want to apply a full model would be precluded from doing so.

Question 8(b) – “Approximately one year or less” is an inappropriate criterion and the premium allocation approach is too complex

- 76 We are concerned that the requirement to use the premium allocation approach for all contracts with an approximate duration of one year or less may lead to arbitrary accounting because it leads to the situation that similar contracts have to be treated differently.
- 77 For example, some typical one year property and casualty contracts are sometimes underwritten for a few years. Some of those renew annually after this initial longer period. These contracts would have to be accounted for differently although contracts are similar. Furthermore, some reinsurance contracts ceding typical one year P&C contracts may have durations of more than one year. In result those reinsurance contract would be accounted for differently compared to its underlings, and compared to the same reinsurance, which have for whatever reasons, a shorter duration.
- 78 In consequence we believe that the application of the premium allocation approach should be driven by a general principle rather than an arbitrary rule based on a one year contract duration.

- 79 Generally we believe that the use of the premium allocation approach should be driven by the business model. This would be in line with our overall demand to consider the business model.
- 80 Alternatively we consider it also as a reasonable criterion to allow the premium allocation approach for all contracts for which the premium allocation approach provides a reasonable proxy compared to the building blocks approach. This will fit to contracts that have no embedded options or derivatives, and most of them will have a rather short duration. This should also apply to rather simple reinsurance contracts.
- 81 Additionally to the application principle, we are concerned that the premium allocation approach requires accretion of interest on the carrying amount of the pre-claims liability. We believe that this is over-sophisticated for a simplified method. Furthermore it can be assumed that it is not material, even if the duration of a small portion of the contracts has longer durations than one year.
- 82 Following this business model approach, it would be consequential that discounting the claims reserves is only appropriate if, within the management reporting, the time value of money is also considered. This is not the case for most of the property and casualty business. Therefore we question whether discounting claims reserves would provide relevant information to users.
- 83 Also regarding the onerous contract test, we understand paragraph 60 in that way that we have to perform an onerous contract test only if certain triggers indicate a premium deficiency.

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?

Response

- **Allianz supports the contract boundary as defined in the ED.**

84 Allianz supports the proposed definition of a contract boundary. We support the incorporation of criteria based on the insurer's "ability to reassess the risk of the particular policyholder" and in consequence having the ability to "set a price that fully reflects that risk". We believe that these two criteria are the key elements in determining the contract boundary.

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?

Response

- **Allianz agrees that the liability for discretionary participation benefits should be measured on an expected present value basis.**
- **We agree that financial instruments with discretionary participation features should be within the scope of the insurance contracts standard because this allows a consistent treatment of contracts with similar features.**
- **We understand that investment contracts with discretionary participating features issued by non-insurers should be excluded from IFRS 4. We propose that the standard should make this distinction based on the business model.**
- **The modification regarding the contract boundary is appropriate while the modification regarding the release of the residual margin is not necessary.**

Question 10(a) – Measurement of insurance contracts includes participating features

85 Allianz agrees that the expected present value of cash outflows from discretionary participation features should be included in the estimation of future cash flows of an insurance contract for measurement purposes, because they are integral to the contract.

Question 10(b) – Financial instruments with discretionary participation features should be in the scope

86 We believe that financial instruments with discretionary participation features (DPF) should be within the scope of the IFRS on insurance contracts and hence accounted for on a consistent basis to insurance contracts. This will provide a single point of reference for how such features should be treated under IFRS. Such treatment reflects the fact that such contracts are economically similar and, in our view, applying a consistent and comparable measurement basis to both would provide decision useful information to the users. The Insurance Contracts project has specifically considered the basis of measurement for discretionary features whereas financial instrument accounting has not.

Question 10(c) – Distinction from investment contracts with discretionary participating features issued by non-insurers should be made based on the business model

87 We agree to the definition of discretionary participating features, except for the provision that there should also exist insurance contracts that provide the same profit participation, namely that the investment contract has to provide 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. We believe that this new condition could result in different accounting treatment for contracts with identical or very similar contract features.

88 For example, it is common to find investment contracts with discretionary participation features invested in segregated funds where no insurance contract participate in the

performance of the same contracts, the same pool of assets or the profit or loss of the same company, fund or other entity. Indeed certain jurisdictions require the use of a segregated fund without the participation of insurance contracts, for example in Italy. These contracts would be accounted for under IFRS 9 whereas similar contracts held by the same company where there are insurance contracts participating in the performance of the same contracts, the same pool of assets or the profit or loss of the same company, fund or other entity would be accounted for under IFRS 4.

- 89 We agree that investment contracts with discretionary participating features written by non-insurers should be excluded from IFRS 4. We propose that the standards should make this distinction based on a business model concept rather than a rule.

Question 10(d) – Modification regarding the release of the residual margin is not necessary

- 90 We agree with the modifications to the boundary of the contract for investment contracts with discretionary participation features.
- 91 We agree that with the principle that the residual margin shall be recognized over the life of the contract in a systematic way that best reflects the asset management services. However, we do not believe the proposed criteria for the pattern of release of the residual margin is necessary and propose that paragraphs 65(a) and (b) are deleted.

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?

Response

- Allianz agrees to the definition of an insurance contract.
- Contracts that meet the definition of an insurance contract should not be excluded from the scope of IFRS 4.
- Trade credit insurance should be in the scope of IFRS 4.

Question 11(a) – Allianz agrees to the definition of an insurance contract

Question 11(b) – Contracts that meet the definition of an insurance contract should not be excluded from the scope

- 92 We do not believe that contracts that meet the definition of an insurance contract should be specifically excluded from scope. For example, if within a fixed-fee service contracts significant insurance risk is assumed by the insurer, this contract should be classified as an insurance contract. No other criterion should be introduced for such a contract.

- 93 As stated in (a) we support the definition of insurance contracts and believe that once it has been established that a contract meets this high level principle, it is therefore appropriate to measure it according to the insurance contracts standard.

Question 11(c) – Trade credit insurance should be in the scope of IFRS 4

- 94 We agree that it is appropriate to include trade credit insurance within the scope of insurance contracts accounting.

Question to constituents

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?

Response to EFRAG

We believe a fixed-fee service contract that transfers significant insurance risk should be classified as an insurance contract. We do not see the need to introduce an additional criterion in order to decide whether fixed-fee service contracts should be within the scope of IFRS 4 or not. It is simply not necessary.

However, we do believe that the condition, whether the primary purpose of the contract is service or insurance, would lead to the same result. A contract that provides primarily services would presumably not meet the significant insurance risk test.

Question to constituents

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?

Response to EFRAG

We agree to the proposed wording in the ED. It is important that credit insurance, that has the character of a typical insurance product, such as trade credit insurance, is in the scope of IFRS 4.

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?

Response

- **The proposed unbundling criteria need clarification.**

- 95 Unbundling is a critical topic and has extensive implications for the industry. Currently, we are not convinced that unbundling provides meaningful and useful information to users of financial statements and in most circumstances as it adds complexity.
- 96 In relation to the proposed criteria, we believe that the wording is unclear and is open to interpretation what contract types would be required to be unbundled or not. In particular, the term "closely related" requires definition and the examples provided are also open to interpretation.

Question to Constituents

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?

Response to EFRAG

Unbundling can enhance the usefulness of information. However, it also adds complexity. This could even reduce transparency and comparability.

We believe the IASB should further clarify the wording of the respective paragraphs.

As the paragraphs are not clear it is even difficult to say whether the proposed guidance would change current practice.

Yes, we agree that unbundling should be driven by the way the company manages those products.

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?

Response

- Any presentation approach should clearly communicate the performance of the insurer.
- Conceptually we support a presentation model that reflects the measurement model; a summarized margin approach may provide useful information but for life only.
- We believe that the IASB should finalize the measurement model first; in a second step, a presentation model should be developed.

Question 13(a) – Proposed presentation approach should clearly communicate the performance of the insurer

- 97 We believe that the final standard should provide a clear communication tool to users of our financial statements on our business performance. In this respect it is essential that the interactions of assets and liabilities that underlies our business is fully considered in the development of the standard. Accordingly, short term market movements that are not representative of long term performance should be clearly distinguished such that underlying key performance indicators are not overshadowed by short term market volatility.
- 98 Conceptually we support a presentation model that reflects the measurement model and we accept that the current basis of reporting performance, particularly for life insurance, does not provide decision useful information to users. Accordingly, in principle we support a margin approach but believe it should be improved in a way that it also provides more than just changes in the balance sheet line items.
- 99 However, this approach does not fit for short duration business and we assume that the IASB acknowledged this by introducing the summarized margin approach only for the life business and allowing volume information in the income statement for insurance contracts accounted for under the premium allocation approach. We believe that the IASB should allow continuation of the traditional presentation approach for property and casualty business, supplemented by the presentation of volume information and calculation of key ratios, such as the combined ratio.
- 100 Furthermore, we believe that the IASB should clarify the relationship between the presentation proposals included in this ED and the ongoing Financial Statement Presentation project.

Question 13(b) – Not all income and expense arising from insurance contracts should be presented in profit or loss

- 101 As we have already stated, we believe that users of an insurer's financial statements want to understand the underlying long term performance of an entity's operations without "market noise" confusing the picture. In consequence we do not believe that the insurer should present all income and expense arising from insurance contracts in profit or loss, in particular

if this is not in line with the overall business model of the insurer. However, in any case, current measurement information should then be presented in the notes.

102 In contrast to that we would like to reiterate our discontent about the new OCI category in IFRS 9. This category excludes changes in market value from recycling even when the instrument is sold and the profit or loss is realized. We believe that all realized profits and losses have to be recognized in the income statement.

103 Furthermore, we would like to state that, in our opinion, shadow accounting adds complexity to the financial statements and it is preferable to avoid this accounting instrument in future. We believe that the new OCI category under IFRS 9 is not appropriate for insurers with participating business because this category excludes changes in market value from recycling. This leads to the situation that the profit of an insurer is disconnected from the result that the policyholder participates in because the policyholder of certain products participates in all realized profits and losses from the investment management. However, if insurers used this category, shadow accounting would still be necessary.

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.

Response

- **We agree with the proposed disclosure principle.**
- **Overall, we believe that most of the proposed disclosure requirements comply to this principle. However, we have some concerns regarding certain disclosure requirements as explained below.**
- **No additional disclosure requirements are necessary.**

Question 14(a) – Disclosure objective is appropriate

104 Allianz agrees to the proposed disclosure principle that the disclosures should help to understand the amount, timing and uncertainty of future cash flows arising from insurance contracts.

Question 14(b) – Not all disclosure requirements are appropriate

105 Overall, we believe that most of the proposed disclosure requirements are acceptable and comply to this principle. However, we have some concerns regarding certain disclosure requirements as explained in the following:

- (a) To present portfolio information on the face of the balance sheet as required in paragraph 69 is not practical as an insurer will have several portfolios. Furthermore, segment information is already required by IFRS 8. This should be sufficient; no further split is necessary in order to present relevant information to users.

- (b) Regarding the requirement to disclose acquisition costs that are not incremental at the level of an individual contract (paragraph 72(c)) we would like to reiterate, that we disagree to specify the level of measurement in the accounting standard (see our response to question 7). We believe that all incremental costs of selling, underwriting and initiating an insurance contract that have incurred because the insurer has issued new business should qualify as acquisition costs and should therefore be included in the cash flows. As we have explained above, another distinction would lead to an arbitrary split of acquisition costs depending on the distribution channel used and the way commissions are structured. This arbitrary split of acquisition cost would indeed make it necessary for users to get information about non incremental acquisition costs. Otherwise the user would not be able to compare financial statements across companies. However, if all acquisition costs that relate to selling, underwriting and initiation a contract would be included in the cash flows there would be no need for this disclosure.
- (c) We believe it is inappropriate to require a separate disclosure of interest on insurance contract liabilities (paragraph 72(e)). We do not think that this separate information is decision useful for the user. In consequence we strongly recommend to not require this as a separate information.

Comment to EFRAG

We kindly ask EFRAG to consider our response under (b) referring to paragraph 170 (b) in EFRAG's draft comment letter. We believe that EFRAG is actually asking for separately disclosing the interest on the insurance liability. As we have explained above, we believe that this is very onerous. Therefore we believe this requirement should be dropped.

- (d) Paragraph 73 requires to disclose the changes in estimates of discount rates and the interest on insurance liabilities in a way that highlights their relationship with the investment return on the assets backing those liabilities. As mentioned in our comment on paragraph 72(e) we believe that this is very onerous. The effort necessary in order to disclose this information, at least for non-participating business, cannot be justified by the benefit for the users. The users should be informed about the discount rate used and the average return on investment. But explaining the link between the discount rate and the investment return will be too difficult for many contracts.
- (e) Paragraph 78 requires to disclose separately income and expenses related to unit-linked contracts. We agree that unit-linked assets and unit-linked liabilities should be presented separately. But we do not see the benefit in disclosing related income and expenses separately. Many activities under such a contract are performed in the same way and with the same resources as other contracts. Therefore it would mean a lot of effort for generating this information. We do not think that this can be justified by adequate benefit for the users.
- (f) According to paragraph 83, disclosures shall be split into reportable segments, as defined in IFRS 8 *Operating Segments*. This means in practice that all information in the notes has to be presented, in Allianz case, split up into five business segments and several reportable segments. Currently, information is split into property/casualty, and life/health where this information is relevant. We are not convinced that the more detailed presentation is useful and justifiable by the cost created by the additional work. We believe the insurer should be able to decide on a case by case basis which splits are relevant for the user.
- (g) We believe that paragraph 87 is far too detailed. It is not clear how the line items prescribed in the reconciliation of insurance contracts in paragraph 87 apply to the

reconciliation of the risk adjustment and residual margin. We understand that it is important for the users to understand how the respective line items of paragraph 86 have been developed of the reporting period. However, it would not help the user if information is too detailed. We suggest to formulate the requirement by a principle based saying that the insurer shall disclose a reconciliation of these items by showing the most important movements.

- (h) The same principle should apply to short duration contracts instead of paragraph 88.
- (i) Regarding the requirement to disclose the confidence level to which the risk adjustment corresponds (paragraph 90(i)) we have raised our concerns already in question 5. We believe this information does not provide helpful information and should not be required.
- (j) Paragraph 90(d) requires a sensitivity analysis similar to that proposed in the Fair Value Measurement project. The detail likely to be required, particularly around the correlation of inputs, would be extremely onerous if not impossible to do in practice taking all scenarios into consideration. We are unsure conceptually why this would be required in a probability-weighted measurement model which allows for uncertainty in best estimate liability and includes a risk adjustment. In addition, the sensitivity analysis wording from IFRS 7 has been pasted into paragraph 96(a) and the sensitivity to insurance risk requirements in paragraph 92(e) (i) have been retained from IFRS 4 although the option to disclose qualitative information as an alternative has been removed. We are unclear why this new disclosure requirement has been added and how it is linked to existing sensitivity requirements.
- (k) Regarding the information required about the nature and extent of risks arising from insurance contracts we would like to refer to our comment letter on Management Commentary as of March 1, 2010. We believe that the IASB should conceptually re-think the placement of information either in the notes or in the management commentary, and therefore decide about the conceptual nature of these two documents.

Comment to EFRAG

Please note our earlier comment that it should be also appropriate to use simpler, yet reliable methods instead of stochastic approaches with explicit cash flow projections. This is an argument against EFRAG's demand for disclosing the maturity analysis based on the expected maturity rather than based on the actual maturity (paragraph 175 (c) of EFRAG's DCL). If simpler methodologies are used instead of stochastic approaches, the expected maturity might not be estimated explicitly and can therefore not be the basis for this disclosure requirement. We therefore ask EFRAG to drop this additional disclosure requirement.

Question 14(c) – No additional disclosure requirements are necessary

106 Generally, we do not believe that the IASB needs to require any further information. However, once the IASB has taken up the use of OCI or the mixed measurement model this will certainly require additional information. Generally speaking, an insurer that measures its insurance liabilities using a locked-in discount rate, because this best reflects its business model, will need to disclose current values in the notes.

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?

Response

- **Allianz agrees with the proposed approach for unit-linked contracts.**

107 Allianz agrees to the proposed approach, as it is a pragmatic way to avoid creating an accounting mismatch.

108 We welcome the presentation of unit-linked assets backing unit-linked liabilities in a separate single line item. We believe that all related balances backing unit-linked liabilities, be it assets or liabilities, should be reflected in this single line item.

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?

Response

- **Allianz supports an expected loss model for reinsurance assets assuming this will be in line with the final outcome of IFRS 9.**
- **Allianz has no further comments on the reinsurance proposals.**

Question 17 – Transition

(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 favored 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.

Response

- **We disagree with setting the residual margin to zero for contracts in force at transition.**
- **The standard should not prohibit retrospective application in accordance with IAS 8.**

- **In order to minimize the operational burden it is crucial that insurance companies will have the opportunity to apply IFRS 9 and the final insurance contracts standard at the same time.**
- **We believe that we need at least three years for transition.**

Question 17(a) – Retrospective application should not be prohibited

- 109 Allianz disagrees with the proposal in paragraph 100(a) of the ED to set the residual margin to zero for insurance contracts reported at the transition date. In our view, such treatment prevents insurers from reporting a potentially significant part of the profits on existing contracts through profit or loss.
- 110 After transition, profit arising from the release of the residual margin would only relate to insurance contracts entered into after the transition date. Regarding the in-force business reporting would not fairly reflect the performance of the insurer. These transitional rules will reduce the usefulness of financial statements for many years in the case of long-term insurance contracts.
- 111 We believe that the most appropriate conceptual approach to transition is a retrospective application in line with IAS 8 and such an approach should not be prohibited. We agree that retrospective application is difficult as this may lead back many years. However, we believe that the retrospective application will reach reasonable results assuming some simplifications.
- 112 For example for life business, we would calculate the first three building blocks based on today's portfolio in-force. Then, on cohort level, we would project those back to the date of inception. Where possible, we would use original assumptions as of the inception date. We assume, for example, that we have mortality rates for many years in the past and would include these original mortality assumptions in these calculations. However, we do not know lapse assumptions of all previous periods. Here we would assume the lapse rate as of today for the backwards projection.
- 113 One reason for this approach is that today's best estimate assumptions are actually derived from past experience. When we have estimated the first three building blocks then we are able to estimate the residual margin at inception date. Having this, we can again project and release the residual margin from inception until transition date. We believe that these simplified assumptions are appropriate and lead to a result that best reflects the economic situation of the insurer at transition date and for the future. The described approach should reflect the principles and requirements of the ED in a meaningful and adequate way achieving comparability between companies.
- 114 However, we acknowledge that this approach still might be very burdensome. Accordingly, we support the development of an alternative simplified approach for those companies that are unable to apply the retrospective approach which could represent a suitable proxy. One possible approach would consist of:
- (a) A comparison of the liability under current GAAP with the present value of fulfilment cash flows measured under the new IFRS 4.
 - (b) The difference between the old method and the new method fundamentally consists of the residual margin and differences between the two methods, e.g. different treatment of acquisition costs and different discounting.

- (c) The part that is driven by the difference between the two methods should be recorded in retained earnings. The remaining part represents the residual margin, which would be recorded as a liability and released to profit or loss over time.

115 This approach will probably also come to good results allowing sufficient comparability over time and across companies. But we still believe that this can only be a fall back solution and the retrospective application is always preferable as it will come to better results.

116 IAS 1.39 requires, in a case of retrospective restatement of items in its financial statements, to disclose, at a minimum, three statements of financial positions. This means comparative information of two prior years has to be presented. We believe that this would be too burdensome. It would mean that our new systems have to be online one year earlier and must run in parallel to the old system. We therefore suggest to simplify this requirement and ask only for one prior year comparative data.

Question 17(b) – No support for the composite margin

117 We do not support the composite margin as set out in our response to question 4.

Question 17(c) – Effective dates of IFRS 9 and IFRS 4 should be aligned

118 We believe that a fundamental aspect of insurers' business models is asset-liability matching and therefore the measurement basis for insurance contracts must be developed concurrently with the proposals for financial instruments. We therefore support the Board's considerations to delay the effective date of IFRS 9 in order to align with IFRS 4 Phase II.

119 If the effective date of both standards cannot be aligned, it is important that companies are allowed to redesignate financial assets. But this is clearly inferior compared to the alignment of the effective dates.

Question 17(d) – Three years for transition are needed

120 We believe that the two years usually applied to new standards is very ambitious given the fundamental changes the proposals will bring to the insurance industry. Allianz would need three full calendar years after publication of the ED. If the standard comes out mid 2011, then we could use IFRS 4 Phase II in 2015 for the first time (with comparative figures of 2014).

121 However, we acknowledge that other companies may face more difficulties as the transition effort always depend on the existing systems and data situation.

Question to constituents

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?

Response to EFRAG

See our response above.

Question 18 – Other comments

Do you have any other comments on the proposals in the exposure draft?

Response

- **Allianz questions whether the benefits of the recognition principle set out in paragraph 14 outweigh the operational costs of recording and remeasuring contracts before the coverage period begins.**

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.

Response

- **Allianz is of the opinion that this standard is very important and we are convinced that the benefits will exceed the costs of the implementation of this standard.**
- **This is also expected in case of retrospective application.**
- **However, this implies that the IASB introduces a mixed measurement or OCI model.**

122 Allianz considers that a consistent and comprehensive IFRS for insurance contracts is urgently needed. Currently IFRS 4 allows insurers to keep using pre-existing accounting policies for their insurance contracts. The financial impact of these policies is included in IFRS financial statements. This means that some entities use local accounting standards such as US GAAP. This significantly impedes the comparability of companies within the insurance sector.

123 Given this current situation, we strongly support the development of a new IFRS 4 and believe that the ED is a step in the right direction. However, we expect the IASB to consider carefully our comments that we have raised in this comment letter. Not considering the interaction with IFRS 9 adequately would not provide decision useful information to the users. Therefore, further work is needed to produce a standard that meets the Board's objective of providing decision useful financial information.

124 The implementation of this new standard will certainly create high costs and a lot of effort for all companies. However, we question whether the benefit of the recognition principle set out in paragraph 14 outweigh the operational costs of recording and remeasuring contracts before the coverage period begins. But, once the standards really means an improvement to the current situation, we are fully committed to make this effort.

Question to Constituents

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?

Response to EFRAG

It is impossible at this stage to make a cost projection for the retrospective application. However, we believe it is the only way that makes good sense.