The European Insurance CFO Forum
Group of North American Insurance Enterprises
Nippon Life Insurance Company
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International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
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Dear Ladies and Gentlemen

Response to IASB Discussion Paper – Preliminary Views on Insurance Contracts

We welcome the opportunity to comment on your Discussion Paper - Preliminary Views on Insurance Contracts (the Discussion paper). This letter has been drafted by the European Insurance CFO Forum, which is a body representing the views of 20 of Europe's largest insurance companies, the Group of North American Insurance Enterprises (GNAIE), which is a body consisting of the Chief Financial Officers of 16 leading North American insurance companies, and the four largest life insurance companies in Japan.

Each body party to this letter will be issuing individual response letters that provide detailed comments on the proposals in the Discussion paper, including responses to the specific questions raised by the IASB in the paper. As would be expected in a complex global industry there are a variety of views held with regard to some of the proposals in the Discussion paper and these will be expressed in our individual letters such as the fact that GNAIE proposes the development of separate measurement models for life and non-life insurance contracts for the reasons stated in their separate letter. The objective of this letter is to set out the areas of consensus amongst ourselves where we have particular concerns with the Board's proposals. We would hope that this level of global consensus will prove persuasive evidence of the fundamental nature of our concerns in these areas and, as a result, the IASB will reconsider the proposals set out in the Discussion paper.

Estimates of future cash flows

We agree that one of the key building blocks in an insurance contracts measurement model for life insurance contracts is an estimate of future cash flows arising from those contracts. However, we are concerned with some aspects of the Board's proposals in this area. These concerns are most fundamental in the areas of allowance for future premiums and the ability to recognise all expected payments to policyholders under participating contracts. In both these areas we believe that the approach set out in the Discussion paper may well lead to cash flows that would normally be included in an economic value being excluded from the contract value. We are also concerned with the proposal to use market assumptions in particular areas, notably for expenses, rather than those specific to the entity.

The Board's proposed measurement attribute is intended to represent "the amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity". We interpret this to mean an economic transfer value that would include all expected future cash flows arising from the contracts. In contrast, by limiting the cash flow recognition criteria to only those supported by contractual rights and obligations we are of the opinion that the Board is in danger of creating a measurement model that will lead to artificial limits on the cash flows. In our view the recognition criteria should be met by the contract itself and the inclusion or exclusion of particular cash flows should be a measurement issue based on expectations about the outcome of the contract.

Policyholder behaviour and future premiums

We believe that all expected cash flows, including premiums, under an existing life insurance contract should be included in the best estimate of the future cash flows. We have explored the implications of applying the guaranteed insurability criteria across our member companies and believe that, if adopted, it could, in some cases, result in a potentially significant amount of future premiums that an entity would expect to receive, under existing contracts being excluded from the estimates of future cash flows. Consistent with our previous response, the IASB should allow reporting entities to include all cash flows in the measurement of life insurance contracts that would be expected in the outcome of the contract.

The significance of the issue will vary across markets as a reflection of different product designs and market practices but is likely to include contract types such as deferred annuities, universal life policies, various unit linked contracts and pension products in some countries. Contracts with premium holiday features are particularly likely to be affected.

We would like to work with you to develop a set of criteria that should be used to distinguish between existing and new contracts, recognising the variety of contracts written around the globe.

Participating contract bonuses and dividends for life insurance contracts

Similar to our views on policyholder behaviour above, we believe that all anticipated payments to participating policyholders should be fully reflected in the cash flows used to determine the contract value. Again, we believe that once the contract itself is recognised it is appropriate to measure that contract based on all expected future cash flows. We presented detailed arguments to support our view in our joint letter to the IASB dated 21 December 2006 including the fact that, notwithstanding our views on recognising the contract as a whole and measuring it accordingly, we believe that the obligation involved in such contracts is one to declare bonuses over the life of the contract and hence that obligation arises upon inception of the contract.. We would refer the Board to that letter, the views expressed in which are still held by our organisations.

We believe that the definition of a constructive obligation as included in the Discussion paper based on the IAS 37 exposure draft could be used to support our views. However, we are concerned that further developments in the IAS 37 project may result in a narrowing of the definition of a constructive obligation and, hence, a restriction on allowable cash flows should those criteria be applied. We would oppose any narrowing of this definition both in IAS 37 and the Phase II standard.

Market versus entity specific assumptions

We support the use of market data, where applicable, notably in areas where there is clear evidence of the existence of a market and hence the ability to utilise such information without undergoing undue process and analysis. For certain experience assumptions, notably expenses, however, we believe that an entity should reflect, within its cash flow estimates, assumptions that are based on what that entity expects to incur.

In our view, for certain other experience assumptions, again notably expenses, the attempt to create a “market” leads to an approach that is too theoretical that will result in information that is neither understandable nor relevant to users. We believe that the Board should go beyond acceptance of “portfolio-specific” and explicitly allow “entity-specific” for certain other experience assumptions, notably expenses. .

In summary, we believe that insurance contracts should be measured using estimated cash flows that would be taken into account when developing true economic valuations. We believe that the three restrictions outlined above will not result in such an economic value and hence will lack any real relevance to users.

A failure to address these fundamental measurement issues risks putting the industry through significant costs to produce a result that is of no benefit to insurance companies themselves or external users such as analysts.

Unit of account

We support the proposal in the Discussion paper that the unit of account for measurement should be a portfolio of insurance contracts. However, we do not agree with the definition proposed, based on that in IFRS 4, which refers to a portfolio of contracts that are subject to “broadly similar risks”. In our view a portfolio should be defined based solely around the “managed together” criteria in order to reflect the economic reality of our business. Since the benefits of diversification are an integral part of an insurer’s business model we consider this is an area to which greater focus should be given.

Unbundling

We do not support the proposals in the Discussion paper for mandatory unbundling of the insurance and deposit components of both Life and Non-life insurance contracts. Having established a definition of insurance contracts, the IASB has provided appropriate distinction between insurance and investment contracts. We do not consider it necessary, therefore, to introduce a new sub-category of insurance contracts requiring different treatment.

We do not believe that the unbundling proposals in the Discussion paper will provide meaningful and useful information to users of financial statements in most circumstances. Furthermore, in the absence of greater clarity over the definitions of the terms “interdependent” and, in particular, “arbitrary”, we do not believe that the proposals can be practically or consistently implemented. We struggle to see any real benefit to users of disclosure of the component parts, given that the underlying measurement model is the Phase II insurance standard and the ultimately meaningless nature of the insurance “plug” element, which could easily be an asset through application of the deposit floor in the IAS 39 measurement of the deposit element.

Own credit standing

We do not support the Board’s proposals for reflection of own credit characteristics in the value of Life and Non-life insurance liabilities. In this regard we do not believe there to be a valid distinction between the credit rating of an entity and that of an instrument. As an industry we believe it would be counterintuitive in nature, and hence wholly inappropriate, to recognise within our income statement amounts that have arisen due to the fact that the credit standing of our business has changed. From our perspective this would be a misleading representation of the profitability and the financial position of our business.

Avoiding accounting mismatches

We believe that elements of the change in insurance liabilities should be permitted to be recognised directly to equity in order to avoid potentially significant accounting mismatches.

The most significant of these relates to Available For Sale (AFS) assets held to back insurance liabilities where the changes in fair value of the assets are recorded in equity (or "Other comprehensive income" under revised IAS 1 requirements). We believe that the insurance contracts standard should include an option to take changes in insurance liabilities backed by AFS assets directly to equity to match the change in assets treatment. If such an option is not included then the IASB would effectively be ruling out the use of the AFS category for the insurance industry, which would be out of line with all other preparers of IFRS.

Principles versus guidance

We support a principles-based accounting standard and, in that regard, we do not support the provision of increased guidance in the final standard beyond that already provided both in the body of the Discussion paper and in appendices E and F. We are concerned that the inclusion of increased levels of guidance in the standard may be seen as prescriptive requirements in some areas and may lead to impractical implementation issues and concerns over auditors' interpretations of the "requirements". Thus, for example, we would not want the "probability-weighted" definition of cash flows to be interpreted as requiring detailed stochastic modelling in cases where existing practices, such as mortality tables, could be used to fully address the underlying principles of the model.

In our view the industry should be permitted to develop guidance over time as the new standard is developed and subsequently embedded into insurance accounting. This will also enable valuation techniques and methodologies to be enhanced over time as experience develops.

Ongoing process to develop final standard

The development of the insurance standard will result in a fundamental change to the way insurers account for their business. We believe that, given such a significant change, the IASB should establish an on-going robust and transparent process for engaging with preparers and users prior to the issue of both the exposure draft and the final standard. We would envisage that the process would be similar, in terms of its iterative nature, to the impact studies performed under Solvency II. As the proposals are developed this process should be augmented by quantitative field testing. An important outcome of this testing will be to consider the practicability and auditability of these proposals.

As indicated above, we support a principles-based standard with minimum additional guidance in the standard itself. Accordingly, in order to achieve a workable solution that meets the requirements of all the relevant constituents, it will be essential to introduce a comprehensive plan of ongoing dialogue with preparers and users of accounts. We are happy to work with you in this regard to arrive at an effective solution.

Other IASB projects

We are concerned that the IASB is looking to use the insurance contracts project to introduce, and potentially "test", a number of concepts that are also being reviewed in a number of other ongoing IASB projects, most notably revenue recognition, financial instruments and financial statement presentation. The views expressed by the Board in other projects may not always be reflective of what has been concluded for insurance contracts. For example the Board has split views on revenue recognition, with the resulting impact on profit recognition, but has indicated a single initial view on profit recognition within the insurance contracts standard. We believe that a close link should be maintained across all these standards during their on-going development.

Further response
If you have any queries or questions that you would like to raise, please feel free to contact us.

Yours sincerely

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