MAZARS

Stig Enevoldsen
EFRAG
Avenue des Arts 13-14
B1210 Brussels
Belgium

29 November 2007

Dear Stig,

Please find attached the comment letter Mazars has sent to the IASB, as part of the Discussion Paper "Insurance contracts".

Should you have any question related to our comments, please do not hesitate to contact Edouard Fossat or myself.

Best regards,

Jean-Louis Lebrun

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MAZARS

Insurance Contracts DP Comment Letters
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

23rd November 2007

Dear Sir/Madam,

Discussion Paper – Preliminary Views on Insurance Contracts

Mazars welcomes the opportunity to comment on the Discussion Paper – *Preliminary Views on Insurance Contracts* (referred below as the Discussion Paper). Our general comments are given below together with a summary of our main concerns on the solutions proposed by the Discussion Paper. Detailed responses to the specific questions included in the Discussion Paper are attached to this letter.

GENERAL COMMENTS

Overall

Currently, a wide range of accounting treatments are used for insurance contracts, as the current IFRS 4 standard mainly deals with the definition of an insurance contract rather than how to account for it in the financial statements. Thus, two contracts with similar characteristics may be recognised differently by two insurance companies.

We are therefore pleased that this Discussion Paper has been released, in that it demonstrates that the issue of how to account for insurance contracts is now being addressed, and launches a public debate on the content of a standard which is definitely needed.

We nevertheless have strong reservations over the timing of the project and the conclusions reached with regard to certain aspects of this paper.

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Timing of the project

The objective of the Discussion Paper is to define accounting principles for insurance contracts, the main elements of which relate to the measurement of liabilities resulting from insurance contracts.

There are two main issues:
- on what basis should these liabilities be measured?
- which cash flows should be taken into account for this measurement?

Moreover, the issue of insurance liabilities measurement automatically raises that of revenue recognition.

We believe that these questions should be dealt with independently of the specific issues relating to insurance contracts, and in a way which should be consistent with the Board's projects on the conceptual framework, liabilities and revenue recognition.

We therefore believe it is necessary to bring these projects to a conclusion before appropriate decisions can be made on the *Insurance Contracts* project.

Thus:
- phase C of the Conceptual Framework project needs to address the general framework for measuring assets and liabilities; in other words, determine the measurement bases and the circumstances in which they apply;
- the *Fair Value Measurements* project, on which a Discussion Paper was recently published, may have a significant impact on the direction of the *Insurance Contracts* project, particularly on the definition of "current exit value", the measurement attribute which this Discussion Paper appears to favour;
- the draft *Non-Financial Liabilities* standard, which is intended to replace IAS 37, needs to clarify what constitutes a liability, the assessment of constructive obligations, and the measurement bases for liabilities; and
- finally, to the extent that the way of measuring insurance liabilities affects the way in which contract revenue is recognised, the discussions prompted by the IASB's ongoing *Revenue Recognition* project should be taken into account.

We did not find any references in the Discussion Paper to decisions taken in the context of these various projects. We are therefore somewhat concerned as to whether the approaches suggested in the present discussion paper are consistent with changes being considered in other projects which are of more general application. As a consequence, we recommend that the IASB should clarify the extent to which the interim conclusions of ongoing projects are consistent with the principles stated in this Discussion Paper.

Lack of impact study and/or field-testing

We feel that some proposals made in the Discussion Paper are very theoretical, and may not be suitable for certain types of insurance contract. It is thus difficult to give a definite opinion on the content of this Discussion Paper, without having had the opportunity to identify its potential consequences on how different kinds of insurance contracts are accounted for.

We believe it is necessary to provide raw material for the debate by making an inventory of the major categories of insurance contract and analysing the consequences of the proposals for each such category, from initial recognition to final extinction. An analysis of this kind is the only way to gain a proper overview of the implications of the Discussion Paper, and to be able to make an informed judgement on the suitability of its proposals.

KEY COMMENTS ON THE DISCUSSION PAPER'S PROPOSALS

Our detailed answers to the questions raised in the Discussion Paper are attached to this letter. We would like to draw attention here to our main concerns regarding the solutions proposed by the Discussion Paper:

- We concur with the Discussion Paper's proposal to measure insurance liabilities based on the future cash flows generated by the contract, together with a risk margin and a service margin if relevant.

  As regards the definition of these margins and their measurement, we believe that the Discussion Paper is unclear on what is covered by the service margin, and in which circumstances it should be identified. We also do not fully understand the purpose of seeking to dissociate it from a global risk margin covering all "risks and uncertainties" given that, in the very large majority of insurance contracts, providing services is ancillary to the insurance contract and therefore should not reasonably be unbundled.

- We disagree with the Discussion Paper on the definition of the cash flows to be used for this measurement. The Discussion Paper suggests using only cash flows that market participants would incur, excluding all entity-specific input.

  Since financial statements should help their readers understand the entity's future cash flows, it seems inappropriate to ignore for instance, the entity's own level of claim handling expenses in favour of the market rate for such expenses. We believe that measuring this market rate will be difficult in the absence of market and, more conceptually, we believe that a market approach is not relevant given that the entity is not usually in a situation where it is willing or free to transfer the management of its contracts.

- The Discussion Paper concludes that measuring the cash flows and margins which make up insurance liabilities is equivalent to valuing them at the amount a third party would immediately accept in order to take over the contractual rights and obligations relating to the contract. Although this is consistent with the *Liabilities* and *Fair Value Measurement* projects, we dispute this principle as we believe that a liability intended to be settled by the entity itself should not be measured at current exit value. Using this measurement attribute would have a negative impact on the predictability and relevance of future cash flows.

  There is a lack of clarity regarding the consequences, for an insurer, of measuring liabilities at current exit value. In our view, it could lead to the insurer recognising a significant profit at inception, given the differences between the B to C market(s) and the B to B market(s). We believe that these consequences should be laid out in the DP.

- We would like the Board to provide details on the recognition of underwriting income and how it should be "earned" over time depending on the release of risk and in line with the requirements of IAS 18 (or any replacement revenue recognition standard).

- As regards taking into account policyholder behaviour when defining which cash flows should be used for insurance liability measurement, we believe that the "guaranteed insurability" concept used in the Discussion Paper is too restrictive, and does not correspond to the assumptions made by insurers when setting premium rates. Restricting cash flows through this concept would result in many insurers recognising a loss at inception, contrary to the economic reality of their activity. We believe that field testing needs to be carried out on this specific point, in order to identify the consequences of the "guaranteed insurability" principle on different kinds of contracts.

- Similarly, for participating contracts, we feel it is inappropriate to restrict the estimations of policyholder dividends to the contractual or regulatory minimum amount, or even to the constructive obligation as defined in the Discussion Paper. On this specific point, we believe that entity-specific cash flows should be considered alongside market-based flows, given that the level of policyholder dividends paid by other market participants constitutes a commercial obligation for the entity to keep up with its competitors' practices. This point is also linked to policyholder behaviour and particularly to the option policyholders have to surrender their insurance contract if the level of dividends declared is not in line with their expectations.

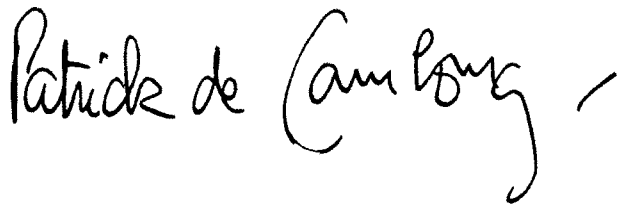
- Finally, as regards the scope of application proposed in the Discussion Paper, we suggest that it should include participating investment contracts, in view of the discrepancies between the Phase II project and IAS 39. Participating investment contracts are covered under the current IFRS 4 standard, but are curiously absent from the issues raised in this second phase of the Insurance Contracts project.

  We are also opposed to any type of unbundling for insurance contracts. Separating components of an insurance contract would lead to the use of different accounting standards for the unbundled elements and different accounting treatments to the extent that the standards are currently non compatible (IAS 39 v. *Insurance Contracts*).

This in turn would lead to accounting mismatches which we believe are economically unjustifiable.

We would be pleased to discuss our comments with you and remain at your disposal should you require further clarification or additional information.

Yours faithfully



Patrick de Cambourg
Chairman of the Group Executive Board

MAZARS

Mazars' response to the questions asked in the IASB's Insurance Contracts Discussion Paper

Question 1

Should the recognition and derecognition requirements for insurance contracts be consistent with those in IAS 39 for financial instruments? Why or why not?

We agree with the proposal of the Discussion Paper that the recognition and derecognition requirements for insurance contracts should be consistent with those in IAS 39 for financial instruments.

IAS 39 requires that an entity recognises a financial asset or a financial liability arising from a contract when it becomes a party to that contract. We do not believe that there exists any conceptual reason why it should be different regarding insurance contracts.

The paper also proposes that an insurance liability should be derecognised when it has been settled, transferred or when it has expired. This proposal is consistent with the provisions in IAS 39 regarding derecognition of financial liabilities, and with other IFRSs dealing with liabilities. We then support this proposal.

As far as derecognition of assets is concerned, we understand why the Board decided not to address this issue in the Discussion Paper. Nevertheless, we believe that the derecognition requirements for insurance assets should be consistent with those for financial assets, whatever the conclusions of the derecognition project are.

Question 2

Should an insurer measure all its insurance liabilities using the following three building blocks:

(a) explicit, unbiased, market-consistent, probability-weighted and current estimates of the contractual cash flows,

(b) current market discount rates that adjust the estimated future cash flows for the time value of money, and

(c) an explicit and unbiased estimate of the margin that market participants require for bearing risk (a risk margin) and for providing other services, if any (a service margin)?

If not, what approach do you propose, and why?

We concur with the Board's proposed approach for measuring insurance liabilities, given that insurance is a long-term activity. This approach should provide more relevant information, for instance through matching economically assets and liabilities. Moreover, these proposals are generally in line with the projects of insurance regulators and with the economic business models used by insurers.

We would nevertheless recommend more detail on the following points:

- *Block (a): market consistent approach*

Given the lack of observable data in the insurer to insurer market for certain model parameters, such as general costs, we believe it would be more appropriate to use entity specific or portfolio specific parameters. In practical terms, we believe that §62 (*"In practice, the Board expects that an insurer would use estimates of its own servicing costs, unless there is clear evidence that the insurer is significantly more or less efficient than other market participants"*) will be generally (systematically) applied by insurers and we fear they will not be able to clearly position themselves on a market rate scale.

Moreover, even where there is an active market it should be noted that:

- the strong interdependence between portfolio-specific parameters and entity-specific parameters (for example lapse rates compared to servicing costs) means that using market parameters would bias the measurement of liabilities in such cases;
- the effect of using market parameters on the presentation of the financial statements is counter-intuitive: should an insurer be more efficient than other market participants and consequently able to charge lower premiums, it would recognise a "loss" at inception in comparison with other market participants, followed by "profits" spread over the life of the contract.

- *Block (b):*

We concur with the principle of using a discount rate in line with observable current market rates for cash flows whose characteristics match those of the insurance liabilities. However, the concept of liquidity mentioned in §69 requires further explanations, especially as regards measurement, in the absence of a market for insurance liabilities.

- *Block (c):*

We feel that the third block should relate only to the risk margin, which would cover both cash-flow uncertainty and the expected margin market participants would require for bearing risk. This approach is consistent with measurement models such as embedded value which are sometimes used in transactions between insurance companies, although these models use entity-specific parameters as we have recommended in block (a), alongside other assumptions not taken into account by the DP (e.g. in respect of recurring premiums, subsequent premiums).

The concept of the service margin requires further explanations in the light of the conceptual framework and possible changes in other standards.

Question 3

Is the draft guidance on cash flows (appendix E) and risk margins (appendix F) at the right level of detail? Should any of that guidance be modified, deleted or extended? Why or why not?

Generally speaking, we recommend retaining the guidance on cash flows and margins which constitute insurance liabilities.

A) *Guidance on cash flows:*

We agree on the general principles given in Ea) to Ed), i.e. that cash flows should:

- be explicit;
- be as consistent as possible with observable market prices;
- incorporate, in an unbiased way, all available information about the amount, timing and uncertainty of all cash flows arising from the contractual obligations;
- be current, i.e. correspond to conditions at the end of the reporting period.

However, the current guidance needs to emphasize the probabilistic nature of future cash flows. This type of approach has in fact rarely been used for accounting purposes, at least where amounts as large as insurance liabilities are concerned.
In addition, the exclusion of entity-specific cash flows needs to be reconsidered (c.f. our response to question 2).

The recent changes in the methods used to calculate the value of options and guarantees for reporting value or for Solvency II impact studies could be used to develop the guidance. The aim should be to encourage the homogenization of measurement principles and thus to increase the reliability of the calculations.

B) *Guidance on risk margins*

We believe that the current exit value concept (the hypothetical situation in which the rights and contractual obligations would be transferred to a third party, §F3a) needs to be reformulated as insurance liabilities are not usually measured in this context. However, we concur that the risk margin needs to be an explicit parameter of the insurance liability, although we believe the appendices should contain a precise stipulation of the financial statement disclosures to be made in order to make estimates comparable between insurers.

Appendix F provides several approaches to measuring insurance liabilities (F9), which are consistent with the models actually used by insurers. However, some parameters should be revised and clarified by the Board in the context of homogenising measurement principles (particularly in view of Solvency II). These parameters are:

- no consideration of asset-related risks;
- operational risks;
- no consideration of entity-specific cash flows;
- option cost.

Moreover, the sheer number of methods given is likely to lead to a variety of measurements for identical contractual obligations, thus reducing the comparability of financial statements which the Board was hoping to improve. We therefore recommend that:

- the Board indicate the extent to which the liability valuation models may differ from those used for other purposes (EEV, ALM, Solvency II); and
- the financial statements disclosures should describe and justify the choice of model.

Our detailed comments are given in Appendix 1.

Question 4

What role should the actual premium charged by the insurer play in the calibration of margins, and why? Please say which of the following alternatives you support.

(a) The insurer should calibrate the margin directly to the actual premium (less relevant acquisition costs), subject to a liability adequacy test. As a result, an insurer should never recognise a profit at the inception of an insurance contract.

(b) There should be a rebuttable presumption that the margin implied by the actual premium (less relevant acquisition costs) is consistent with the margin that market participants require. If you prefer this approach, what evidence should be needed to rebut the presumption?

(c) The premium (less relevant acquisition costs) may provide evidence of the margin that market participants would require, but has no higher status than other possible evidence. In most cases, insurance contracts are expected to provide a margin consistent with the requirements of market participants. Therefore, if a significant profit or loss appears to arise at inception, further investigation is needed. Nevertheless, if the insurer concludes, after further investigation, that the estimated market price for risk and service differs from the price implied by the premiums that it charges, the insurer would recognise a profit or loss at inception.

(d) Other (please specify).

Assuming that liabilities are being measured at current exit value, approach (c) seems most appropriate to us.

In the absence of an active market for insurance liabilities, there may be a difference between the premiums paid and the current exit value of the insurance liabilities. This discrepancy is highlighted for instance by life insurers when reporting new business value (EEV).

Question 5

This paper proposes that the measurement attribute for insurance liabilities should be the amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity. The paper labels that measurement attribute 'current exit value'.

(a) Is that measurement attribute appropriate for insurance liabilities? Why or why not? If not, which measurement attribute do you favour, and why?

(b) Is "current exit value" the best label for that measurement attribute? Why or why not?

We believe that measuring a liability in the context of a (hypothetical) transfer is not appropriate for insurance business. Most insurers underwrite and administer contracts over time, from inception to extinction, and this is central to their operations.

Although the measurement attribute proposed by the Board is consistent with the *Liabilities* and *Fair Value Measurement* projects, measuring liabilities on the basis of a hypothetical market does not, in our view, provide any useful information regarding financial transparency. The absence of a market would also lead insurers to use a variety of heterogeneous practices, thus reducing the comparability of financial statements. What constitutes the adequate value for an insurance liability is a key question, which will have to be addressed during the conceptual framework project. The current exit value attribute does not currently appear appropriate for all the elements in an insurance company's balance sheet.

We favour using a model which can draw on:

- Market parameters as far as financial parameters are concerned; and
- Portfolio-specific / entity-specific parameters as far as non-financial parameters are concerned.

In particular, since an objective of financial statements is to provide information on a company's future cash flows, we believe that the entity's own cost structure should be modelled.

To a larger extent, we think the Board should provide further details on how the profit margins are earned over time. We believe that profits should be recognised in the same way as for any other contract - in particular, profits should be earned over the term of the contract. This would be consistent with IAS 18, pending the outcome of the revenue recognition project.

Question 6

In this paper, beneficial policyholder behaviour refers to a policyholder's exercise of a contractual option in a way that generates net economic benefits for the insurer. For expected future cash flows resulting from beneficial policyholder behaviour, should an insurer:

(a) incorporate them in the current exit value of a separately recognised customer relationship asset? Why or why not?

(b) incorporate them, as a reduction, in the current exit value of insurance liabilities? Why or why not?

(c) not recognise them? Why or why not?

In our opinion, when valuing insurance liabilities, future cash flows relating to this kind of option should be taken into account in the overall insurance contract cash flows in accordance with detailed guidance provided by the Board.

An economic approach to measuring insurance liabilities requires such cash flows to be taken into account, as they form part of the insurer's economic value and would be taken into account when determining the purchase price if there were to be a transfer.

Furthermore, we do not believe it would be possible to measure this economic value separately as a customer relationship asset, as this would conflict with the rules on recognising internally-generated intangible assets.

Question 7

A list follows of possible criteria to determine which cash flows an insurer should recognise relating to beneficial policyholder behaviour. Which criterion should the Board adopt, and why?

(a) Cash flows resulting from payments that policyholders must make to retain a right to guaranteed insurability (less additional benefit payments that result from those premiums). The Board favours this criterion, and defines guaranteed insurability as a right that permits continued coverage without reconfirmation of the policyholder's risk profile and at a price that is contractually constrained.

(b) All cash flows that arise from existing contracts, regardless of whether the insurer can enforce those cash flows. If you favour this criterion, how would you distinguish existing contracts from new contracts?

(c) All cash flows that arise from those terms of existing contracts that have commercial substance (ie have a discernible effect on the economics of the contract by significantly modifying the risk, amount or timing of the cash flows).

(d) Cash flows resulting from payments that policyholders must make to retain a right to any guarantee that compels the insurer to stand ready, at a price that is contractually constrained,
(i) to bear insurance risk or financial risk, or
(ii) to provide other services. This criterion relates to all contractual guarantees, whereas the criterion described in (a) relates only to insurance risk.

(e) No cash flows that result from beneficial policyholder behaviour.

(f) Other (please specify).

The guaranteed insurability criterion as defined in (a) seems too restrictive, in that it only takes into account cash flows linked to insurance risk. Investment contracts with discretionary participation features also need to be considered, since lacking any element of insurance risk, a loss at inception could be recorded due to acquisition costs being written off in full when incurred and it not being possible to recognise future premiums. This would not be consistent with the economic reality of the activity.

We believe that further consideration of this point is required given the range of different types of contracts. Insurers currently deal with this complex issue in many different ways in their reporting, which shows the need to create an ad hoc think tank on the issue. In the meantime, we recommend an economic approach to recognising future cash flows: in other words, approach (c).

Question 8

Should an insurer recognise acquisition costs as an expense when incurred? Why or why not?

Given the proposed measurement attribute for insurance liabilities, we are not opposed to recording acquisition costs as an expense when they are incurred.

Insofar as the measurement of insurance liabilities takes into account the future cash flows relating to gross premiums, then acquisition costs should be recognised as an expense when incurred. There is an issue, however, with contracts where future premiums cannot be taken into account in the valuation of the insurance liability, as a loss could be recorded at inception, which is not economically justified in view of the fact that the contracts are serviced over the long term (and some of the contracts may not have a surrender option).

Question 9

Do you have any comments on the treatment of insurance contracts acquired in a business combination or portfolio transfer?

If there is a discrepancy between the accounting treatment of contracts and the expanded presentation under the current IFRS 4 standard (§31), we believe it would be appropriate to continue measuring liabilities at fair value, as stipulated under the IFRS 3 standard. This would involve recognising an intangible asset corresponding to the difference between the "fair value" and "book value" of the relevant insurance liabilities.

Question 10

Do you have any comments on the measurement of assets held to back insurance liabilities?

We agree on the principle that assets and liabilities should be measured in a consistent manner, so as not to create an accounting mismatch between them.

Question 11

Should risk margins:

(a) be determined for a portfolio of insurance contracts? Why or why not?

If yes, should the portfolio be defined as in IFRS 4 (a portfolio of contracts that are subject to broadly similar risks and managed together as a single portfolio)? Why or why not?

(b) reflect the benefits of diversification between (and negative correlation between) portfolios? Why or why not?

a) We agree with the Board on the fact that:
- aggregating contracts into a portfolio should not affect margin levels (§186) and thus their estimated release over time;
- the risk margin should be measured for each portfolio of contracts, as detailed in §190(a), i.e. by pooling contracts which have similar risk profiles and are managed together. This approach is consistent with that currently used by insurers for ALM management, EEV calculations and Solvency 2. Moreover, we believe it is essential that the contracts are managed together by the insurer. Contract pooling should thus be based on the unit of account used in the company's risk management. We believe these criteria comply with the Board's principles, according to which the transferee would have the same objective of retaining contracts, client relations and settlement of contractual obligations as the insurer itself.

It should be underlined that aggregating similar risks will statistically lead to:
- on the one hand, a higher risk margin for large portfolios; and
- on the other, a lower risk margin than the arithmetical sum of risk margins calculated for each individual contract

even if objective statistical parameters are used (mortality rates, frequency, etc.).

We believe the Board's proposition regarding the portfolio definition is relevant. However, it could raise difficulties as regards financial statement comparability in that the proposed definition is sufficiently wide as to give insurers a virtually free hand in deciding the unit of account for insurance contracts (and consequently on the measurement of liabilities).

(b) We concur that the risk margin should not take into account the effects of correlation or diversification between portfolios:
- from a theoretical point of view (what effects should be considered: market ones (and which market?) or entity-specific ones (inconsistent with the definition of current exit value)?);
- and from a practical point of view.

Question 12

(a) Should a cedant measure reinsurance assets at current exit value? Why or why not?

(b) Do you agree that the consequences of measuring reinsurance assets at current exit value include the following? Why or why not?

(i) A risk margin typically increases the measurement of the reinsurance asset, and equals the risk margin for the corresponding part of the underlying insurance contract.

(ii) An expected loss model would be used for defaults and disputes, not the incurred loss model required by IFRS 4 and IAS 39.

(iii) If the cedant has a contractual right to obtain reinsurance for contracts that it has not yet issued, the current exit value of the cedant's reinsurance asset includes the current exit value of that right. However, the current exit value of that contractual right is not likely to be material if it relates to insurance contracts that will be priced at current exit value.

(a) We concur with the Board's approach of :
- measuring reinsurance assets using the same method as for the underlying liabilities
- not taking into account cash-flows arising from reinsurance contracts in the valuation of the insurance liability.

However, as regards the choice of the current exit value as the measurement attribute, see our comments on question 5.

(b)(i) We agree with the Board insofar as a risk margin should be calculated for the reinsurance asset and that it should increase its measurement. Nevertheless, we don't think the asset risk margin would automatically equal that of the corresponding part of the underlying insurance contract for the following reasons :
- the cash-flow timing might be different
- there might be specific contractual obligations to the reinsurance contracts (profit sharing clause)

Moreover, practical difficulties have to be tackled. Thus for a non-proportional reinsurance contract (which covers several insurance contracts), or for a reinsurance contract covering several risks, it will be difficult to value the risk margin corresponding to each underlying contract and/or to each risk.
DP §210 gives further details on non-proportional insurance, stipulating that insurers could take into account reinsurance cash-flows when measuring insurance liabilities and then gross them up to estimate the value before reinsurance. The Board should plan to give Application Guidance on the ways to distinguish in these specific cases gross liabilities from reinsurance assets.

(b)(ii) As we see it, this is not a case of asset impairment, where an incurred loss model would be used in line with the other standards; rather, it is about measuring a reinsurance asset at current exit value. The default or dispute risk of a reinsurer should be assessed in the context of measuring the risk margin of the reinsurance asset, as a complement to the risk margin relating to the underlying insurance contract (see preceding paragraph (b)(i)). Taking this risk into account would better meet the purpose of the risk margin as defined in chapter 3 (communicating useful information on the uncertainty relating to future cash flows).

With this in mind, the title of §211-214 ("Reinsurance assets: impairment") seems inappropriate and should be replaced by something along the lines of: "Risk of default or dispute: impact on the risk margin / or on the current exit value".

(b)(iii) We believe that the inception of a reinsurance contract depends of the existence of the underlying insurance contracts. Without them, the right to reinsurance exists (legally) but there is no incurred or estimated financial impact [with the exception of a possible fixed commission of a negligible amount]. Thus we consider that the value of this right is zero when measuring the reinsurance asset.
Furthermore, the Board should emphasise the reference transaction to be used for reinsurance contracts. As a matter of fact, if the reference transaction is the simultaneous transfer of both the reinsurance contract and the related underlying contract(s) (as quoted in §209) then it is only the reinsurance asset relating to underlying contracts in existence that should be valued at current exit value

Question 13:

If an insurance contract contains deposit or service components, should an insurer unbundle them? Why or why not?

We are not in favour of this principle as we believe each insurance contract should be viewed as a whole, taking into consideration all its characteristics, guarantees and options, as well as insureds' behaviour towards the whole .

We feel that the Board's preliminary views render the measurement process more complex without significantly increasing the reliability and comparability of financial statements (as the use of several different models could lead to a variety of mutually inconsistent approaches for assessing different components). Moreover, they reintroduce issues relating to discrepancies between the insurance standard and IAS 39 (so if a contract meets the definition of an insurance contract, it should, as a whole be accounted for with the IFRS4 standard, without having to consider individual components possibly subject to different standards).
We therefore favour using a unique valuation method for the various components of an insurance contract.

Question 14

(a) Is the current exit value of a liability the price for a transfer that neither improves nor impairs its credit characteristics? Why or why not?

(b) Should the measurement of an insurance liability reflect (i) its credit characteristics at inception and (ii) subsequent changes in their effect? Why or why not?

(a) The Board has defined current exit value as the amount the insurer would expect to pay to transfer its liabilities to a third party. As a consequence, we do not believe that it should reflect the insurer's credit risk as this would be tantamount to the third party paying the insurer's lower credit spread / benefiting from the insurer's higher credit spread, which is not likely in practice (in the first case for prudential reasons, in the second for commercial reasons) and it reduces the comparability of information between insurers.

It is also not relevant to take account of a hypothetical market credit spread (in the absence of such a market). Moreover, the spreads of the insurer and the buyer will not be identical.

Taking the credit spread into account when measuring liabilities would equate to recognising a profit / loss for the buyer at the transfer of liabilities, which runs counter to the idea of a single current exit value. It would also introduce entity-specific parameters into the measurement of liabilities, which contradicts the definition of cash flows in appendix E2 (e): *"exclude entity-specific cash flows. Cash flows are entity-specific if they would not arise for other entities holding an identical obligation."*

Should the Board consider a credit risk specific to a given liability, then the criteria for determining it should be stipulated.

(b) i and ii) We do not believe that a credit risk should be taken into account in the measurement of liabilities (either at inception or later) as this would effectively maximise the value of liabilities for insurers in a healthy financial situation (low credit spread) and minimise it for an insurer with payment difficulties (high credit spread); this is counter- intuitive and runs counter to prudential constraints and impairs financial statement comparability.

Question 15

Appendix B identifies some inconsistencies between the proposed treatment of insurance liabilities and the existing treatment under IAS 39 of financial liabilities. Should the Board consider changing the treatment of some or all financial liabilities to avoid those inconsistencies? If so, what changes should the Board consider, and why?

We favour an identical treatment for insurance contracts and investments contracts, which in our opinion would require (as a minimum) the removal of the deposit floor.

Question 16

(a) For participating contracts, should the cash flows for each scenario incorporate an unbiased estimate of the policyholder dividends payable in that scenario to satisfy a legal or constructive obligation that exists at the reporting date? Why or why not?

(b) An exposure draft of June 2005 proposed amendments to IAS 37 (see paragraphs 247-253 of this paper). Do those proposals give enough guidance for an insurer to determine when a participating contract gives rise to a legal or constructive obligation to pay policyholder dividends?

We believe that future cash flows should incorporate the insurer's best estimate in these various market scenarios.

In each of these scenarios, the insurance liability should incorporate future cash flows in line with IAS 37. However, we believe the concept of a constructive obligation should be extended for insurance contracts.

As soon as an insurer anticipates that in a given scenario, he will pay the insured more than the contractual minimum, to maintain consistency with market practice and without having made an explicit statement to the insured (which, for example, is representative of the policy employed by French insurers on most participating contracts), this additional dividend should, in our opinion, be incorporated into the liability measurement.

Any limitation on what is included would require changes to the other parameters of the model (such as the surrender rates, which, in the absence of additional dividends, would increase significantly). Moreover, this would necessarily introduce a bias into the model (as the adjusted surrender rate would no longer be an observable parameter which could be calibrated to the market).

Such a limitation would also not be consistent with current economic valuation models (Solvency II and EEV) or with the purchase price of the portfolio for an external buyer.

Question 17

Should the Board do some or all of the following to eliminate accounting mismatches that could arise for unit-linked contracts? Why or why not?

(a) Permit or require insurers to recognise treasury shares as an asset if they are held to back a unit-linked liability (even though they do not meet the Framework's definition of an asset).

(b) Permit or require insurers to recognise internally generated goodwill of a subsidiary if the investment in that subsidiary is held to back a unit-linked liability (even though IFRSs prohibit the recognition of internally generated goodwill in all other cases).

(c) Permit or require insurers to measure assets at fair value through profit or loss if they are held to back a unit-linked liability (even if IFRSs do not permit that treatment for identical assets held for another purpose).

(d) Exclude from the current exit value of a unit-linked liability any differences between the carrying amount of the assets held to back that liability and their fair value (even though some view this as conflicting with the definition of current exit value).

This question highlights the issues relating to consistency of measurement between an insurer's assets and liabilities. As we said in response to question 15, we favour a consistent approach to measurement of assets and liabilities.

The question on unit-linked contracts cannot be answered without reference to other IFRS projects that are currently under way.

Question 18 :

Should an insurer present premiums as revenue or as deposits? Why?

We agree with the Board in so far as presenting all premiums as revenue would be consistent with existing practices for many contracts but would not be consistent with the way banks account for deposits received in relation to investment contracts (without DPF).

Presenting all premiums as deposits could be pertinent for long-term insurance, especially life contracts but this does not seem appropriate for the non-life - and especially short-term - business. For instance, we do not consider non-life premiums to be conceptually equivalent to a collective "deposit" made by policyholders in so far as it would later be repaid in aggregate to some of the policyholders and not on a one-to-one basis. Because of the probability factor, these premiums cannot be likened to a bank deposit.

We favour an approach that would consider different treatments depending on the classes of insurance contracts as set in §316 (b). In the first approach (i.e. for insurance contracts that meet specified criteria, presenting all premiums as deposits) it might be difficult to draw up an exhaustive inventory of existing contracts and this might lead to some extent,

to inappropriate guidance in some cases. This is why we would prefer the second option which consists of leaving insurers the choice between a revenue presentation or a deposit one, depending on the characteristics of each contract. However, this would require specific guidance from the Board on disclosure content so as to maintain comparability.

We think the entire premium should be seen as a deposit up to the time when the insurer is actually obliged to provide the services and bear the corresponding risks.

Questions 19 & 20 :

Which items of income and expense should an insurer present separately on the face of its income statement? Why?

Should the income statement include all income and expense arising from changes in insurance liabilities? Why or why not?

We do not think now is the appropriate time to give an opinion on the presentation and contents of the income statement for there are many issues/projects still to be concluded which could have a potentially significant impact on accounting for insurance contracts (cf. cover letter). In particular, further guidance is needed on the recognition of underwriting income and how it should be earned over time. In relation to this, the final definition of the risk margin might have an impact on the financial statement presentation chosen.

APPENDIX 1

QUESTION 3 : IS THE DRAFT GUIDANCE ON CASH FLOWS (APPENDIX E) AND RISK MARGINS (APPENDIX F) AT THE RIGHT LEVEL OF DETAIL ? SHOULD ANY OF THAT GUIDANCE BE MODIFIED, DELETED OR EXTENDED ? WHY OR WHY NOT ?

APPENDIX E : draft guidance on cash flows	right level of detail ?	to be modified ?	to be deleted ?	to be extended ?	Commentary
E1 : The guidance applies to all forms of insurance liability (e.g. life and non-life, direct insurance and reinsurance).	No			Yes	it should be specified that it relates to reinsurance assets too
E2 : In estimating the current exit value of insurance liabilities, an insurer should develop estimates of cash flows that: (a) are explicit.	Yes				OK
(b) are as consistent as possible with observable market prices.	Yes				OK
(c) incorporate, in an unbiased way, all available information about the amount, timing and uncertainty of all cash flows arising from the contractual obligations.	Yes				OK
(d) are current, in other words, they correspond to conditions at the end of the reporting period.	Yes				OK
(e) exclude entity-specific cash flows. Cash flows are entity-specific if they would not arise for other entities holding an identical obligation.		Yes		Yes	In § 57, the Board specifies that the cash flows must not be entity-specific but can be portfolio-specific (for instance mortality rates). In §58, it highlights that many variables are not observable in market prices and that eventually the distinction between entity-specific estimates and market estimates has little practical significance. This stance should be sustained insofar as today such market prices do not exist (for management expenses for instance). In the event, we understand this paragraph might leave an opportunity for insurers to use entity-specific parameters, which is not in the spirit of the Discussion Paper as it stands today. Notwithstanding, we believe it would not be relevant to disregard the entity's servicing costs, contrary to §59. The Board points out that liability valuation relies on a transfer value so that the costs have to be standardised ("standard" to be specified given the lack of market). This could trigger a shortfall in the liability transferred either for the insurer or for the third party (for example if the expense structure of the third party is different (for instance direct/indirect business)). What should then be done with the price discrepancy ? Furthermore, there would not be any liability transfer should the price be insufficient to release the contractual obligations and in the end, there would be no efficient market for the insurance liabilities. The Board's position according to which the calculation should not "capture cash flows generated by other assets and liabilities or arising from synergies between the insurance liability and other assets or liabilities" should be extended/specified or deleted. Besides : 1) the examples given (§E27) mainly concern servicing costs and tax. It should be specified if other parameters are in this scope and which ones. 2) what should be done with the discrepancy between the liability calculated with standard servicing costs ant that calculated with entity-specific servicing costs (and which takes into account the company's efficiency) ? in another asset/liability ? in the service margin ? in P&L ? in OCI ? 3) in practical terms, how should one value the expenses linked to the sheer characteristics of the contracts and that generated by (in-)efficiency as in §E27c) ? 4) this approach in not consistent with Solvency 2 (use of entity specific servicing costs) 5) is it relevant as regards financial information, to present liabilities which do not reflect the expected future cash flows by the entity ? (and even if in the end, the company's performance will be recorded over time) ? 6) could it be mentioned, as in IAS39-AG75, that we have to use a "valuation technique that makes maximum use of market inputs, and relies as little as possible on entity-specific inputs" ? It seems to us that §62 is not totally in line with the previous points because this paragraph in the end enables insurers to use estimates of their own servicing costs, what will probably be systematically done in practical terms. Furthermore, how does the Board quantify the "significantly more or less efficient than other market participants" aspect ? (this raises the issues of financial statement comparability and theoretical standard values for servicing costs)

APPENDIX E : draft guidance on cash flows	right level of detail ?	to be modified ?	to be deleted ?	to be extended ?	Commentary
Uncertainty and the expected present value approach (E4, E5, E6)	Yes				these principals are consistent
E7	Yes				OK
Market variables (E8, E9)	No			Yes	it should be specified which parameters
Non-market variables (E10 à E14)	No			Yes	OK but give more examples on market data
Source of estimates (E15)	Yes				OK
Using current estimates (E16 à E18)	Yes				OK
Future events (E19 à E23)	Yes				OK
Which cash flows? (E24 à E26)					
E24b claim handling expenses (expenses that the insurer will incur in processing and resolving claims under existing contracts, including legal and adjuster's fees and internal costs of processing claim payments).	No				Specify if it should be market variables or entity-specific
E24c the direct and indirect costs that market participants would incur in providing contractual benefits that are paid in kind. If market participants would require a service margin for providing those contractual benefits, the current exit value of the	No		Yes		- for contractual benefits paid in kind, there can't be any reference to an expense market. - the Board should specify the meaning of a service margin for benefits paid in kind and give examples.
E24h policy administration and maintenance costs, including all direct and indirect costs that market participants would consider in assessing the acceptability of a price for taking over the contractual rights and contractual obligations.			Yes		- event if direct market expenses could be computed, how would the indirect costs be measured in practical terms ?
E24i transaction-based taxes (such as premium taxes, value added taxes and goods and services taxes) and levies (such as fire service levies and guarantee fund assessments) that arise directly from existing insurance contracts, or can be attributed to the			Yes		- not consistent with Solvency 2 as regards guarantee fund assessments - ok for the other elements quoted
E25a (iii) increased by the costs that market participants would incur in providing investment management services and the service margin that market participants would require for those services. Chapter 3 discusses service margins. If the contractual in				Yes	- to be specified (lacks clarity)
Entity-specific cash flows? (E27 et E28)		Yes			refer to E2e

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APPENDIX F : draft guidance on risk margins	right level of detail ?	to be modified ?	to be deleted ?	to be extended ?	Commentary
F2 : The risk margin should be an explicit and unbiased estimate of the margin that market participants require for bearing risk.			Yes		- difficulty observing market prices => each company will probably have its own valuation of the appropriate market prices. Therefore, differences may arise from the parameters used (scope, portfolio, structures, standard prices) on the one hand, and valuation models on the other hand (unit of account, modelling). - on the transfer value point : refer to question 5
F3 a) Because insurance liabilities are measured at current exit value, the risk margin should be consistent with the margin that would be expected if the insurer were to transfer its contractual rights and obligations to another party.			Yes		- we believe the Board should change the term "another party" for it is not a usual context for valuing insurance liabilities and it could cause confusion; - the risk margin calculation is mode at portfolio level. The Board has not specified to what extent we should take into account the size effect / antiselection effect. Moreover, the latter are not taken into account at market level (if any); - more conceptually, contract portfolio prices normally include entity-specific cash-flows (management expenses, investment return) and this is explicitly excluded by the Discussion Paper.
F3 b) Risk margins should be explicit, not implicit. That is an important change from many existing practices that rely on estimates incorporating an implicit (and often unstated) degree of conservatism or prudence. Separating explicit estimates of future	Yes				OK provided the company discloses on the level of its risk margins, which would enable users to benchmark insurance companies (F3h)
F3 (c) The risk margin for an insurance liability should reflect all risks associated with the liability. (d) The risk margin for an insurance liability should not reflect risks that do not arise from the liability, such as investment risk (except when in			Yes		Risk margins only apply to risks related to liabilities. This point is not consistent with Solvency II for the Cost of Capital approach notably takes into account financial and operational risks (more particularly acquisition costs and servicing of contracts).
F3 e) The margin should be as consistent as possible with observable market prices (see paragraphs F5–F8).			Yes		no observable market prices
F3 f) and g)	Yes				OK
F3 i)	Yes				We favour the use of existing models as those developed for economic capital calculations, embedded value or for solvency II. Nevertheless, some IFRS4 principles will not enable direct re-use of these methods.
F3 j)	Yes				OK
F4 characteristics of the risk margin	Yes				OK
F5 to F7					OK
F8 : replicating asset				Yes	examples should be given to sustain this point
F9 Approaches to determining risk margins				Yes	If the Board's guidance on practical methods for calculating risk margins should be sustained, nevertheless it is difficult to see how this will give way to "general market information" if it is not homogeneous. We believe the Board should thus specify the quantitative and qualitative information to be disclosed so as to insure financial statement comparability.