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

30 November 2010

Dear Sir

Exposure Draft: Insurance Contracts

We are pleased to respond to your Exposure Draft – Insurance Contracts. Following consultation with members of the PwC network of firms, this response summarises the views of the member firms that commented on this Exposure Draft. "PwC" refers to a network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We recognise the efforts the IASB has made towards developing a comprehensive model of accounting for insurance contracts. The development of a comprehensive standard for insurance contracts is essential because the transitional arrangements established in IFRS 4 do not provide the level of transparency and comparability necessary for the users of financial statements. Furthermore, the current accounting for insurance contracts lacks a consistent measurement approach which users of financial statements demand.

We believe the Board's proposal is a significant improvement that addresses these concerns. Overall, we support the proposed use of a measurement model for all insurance contracts that portrays a current assessment of the amount, timing and uncertainty of the future cash flows that the insurer expects its existing insurance contracts to generate. We welcome the move away from the current exit value notion. We support the fulfilment objective proposed in the exposure draft which reflects the economics of the insurer's business and uses management's estimates of cash flows based on an entity's own strategy and efficiency. We agree with the use of market observable variables when they are used to determine the expected future cash flows arising from the insurance contract. We believe that if our concerns noted below are addressed the proposed model will provide a reliable source of data and useful information for users of the financial statements.

Detailed measurement approach

Whilst we support the Board's proposal overall, we do have some concerns with respect to certain aspects of the proposed measurement model which are described further below. We support the use of a current value measurement that assumes performance according to the terms of the contract for measuring insurance liabilities. We believe that users of financial statements would generally prefer to look to a current value measurement to obtain information about the present value of future cash flows.

Discount rate

We agree the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability. We also agree that the discount rate should not

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reflect the own credit risk of the insurer. Furthermore, the exclusion from profit and loss of the changes in the measurement of a liability due to changes in an entity's own credit risk in circumstances where they are not expected to be realised by transfer to a third party is consistent with the conclusions reached by the IASB in the recent project on financial liabilities. However, while we support the use of the risk free rate with an adjustment for illiquidity for the subsequent measurement, we note that in some instances the exclusion of own credit risk from the discount rate may result in the recognition of a day one accounting loss. This could occur, for example, where the insurer priced the insurance contract with an expected rate of return to the policyholder that is greater than the risk free discount rate. We recommend that the Board assess the prevalence and significance of such apparently uneconomic outcomes in conjunction with its field testing to determine whether an exception to the overall model is warranted or whether some additional disclosure should be given in such circumstances.

We also believe that insurers should be allowed an option to apply a locked-in discount rate as established at the inception of the contract. Under IFRS 9, 'Financial Instruments' certain assets supporting the insurance contracts would be measured at amortised cost. The use of a current discount rate could introduce an accounting mismatch in the income statement if the insurer in applying IFRS 9 uses amortised cost for some assets backing the insurance liability. An option to use a locked in discount rate at the inception of the contract would be consistent with the fulfilment objective for measuring insurance contracts. An insurer typically has the intention to fulfil its legal obligation to pay contractual amounts in the event of a claim or the maturity of the contract. This option, applied at portfolio level, should be available if it eliminates or reduces an accounting mismatch and is consistent with the insurer's business model of fulfilling the contracts.

Risk adjustment

We conceptually support the inclusion of an explicit risk adjustment in the measurement of an insurance contract. However, we have concerns regarding whether the proposed model will produce comparable results among insurers. Furthermore, we are also concerned with whether the proposed amortisation methods for both the residual margin and the composite margin in the alternative model will recognise the income on a contract in an appropriate manner.

We recommend that the Board work closely with the insurance industry to understand the practical implications and operationality of both the explicit risk adjustment and the alternative composite margin model before finalising the proposed standard. We also believe the Board should work with users to ensure that the recognition of an explicit risk adjustment will provide sufficient decision-useful information to make this approach cost beneficial to adopt. A post implementation review of the proposed standard would also enable the Board to assess whether there is comparability between risk adjustments calculated by different companies on different bases.

If the risk adjustment is ultimately included in the measurement model, we do not believe it is appropriate in a principle-based standard to limit the risk adjustment calculation to three prescribed methods. Whilst we believe the guidance provided for the three risk adjustment techniques will be useful for the preparers of the financial statements, limiting the range of permitted risk adjustment techniques would not allow for the use of new improved risk adjustment techniques that may be developed over time. However, we would suggest requiring the use of a consistent methodology for calculating the risk adjustment for similar contracts within the group financial statements.

Residual margin

We also have concerns with the immediate recognition of all changes in estimates in the statement of comprehensive income whilst the residual margin is not remeasured. An approach that could be taken would be to recalibrate the residual margin at each reporting period using updated cash flow estimates