Rådet för finansiell rapportering

The Swedish Financial Reporting Board

RFR-rs 2013:12

International Accounting Standards Board
30 Cannon Street
London EC4M 6 XH
United Kingdom

Dear Sirs,

Re: IASB Exposure Draft ED/2013/7 A revision of ED/2010/8 Insurance Contracts

The Swedish Financial Reporting Board is responding to your invitation to comment on the Exposure Draft ED/2013/7 A revision of ED/2010/8 Insurance Contracts.

We appreciate the efforts made to adjust the ED based on concerns raised. However, we do see a need for further adjustments. As the ED now stands, there will be significant accounting mismatches for entities involved in insurance business. The insurance industry is not a homogenous market wherefore flexibility needs to be introduced to make it possible for entities to faithfully portray their performance.

In summary, we have the following views:

- Locked in and unlocked service margin have both relevance, depending on the circumstances. Locked in margin should be used when each component in a insurance contract is priced separately, otherwise an unlocked margin should be used.
- We support the basic principles for unbundling. However the standard is overly complicated. We believe that unbundling should be made based on circumstances at initial recognition and should not be adjusted thereafter.
- We support the measurement exception as such when there is a link between payments to policyholder and the returns on those underlying items. However, we believe that the exception should be available regardless if that follows from contract, law or by regulation. We do, however, believe that the exception should normally not be allowed when the policies contains higher-of-options.
- We have the following main views with regards to presentation of revenue and expenses:
    - We support the intention of the IASB to present revenue as service is rendered.
    - We support the exclusion of deposit components from revenue.
    - We believe that current discount rates always should be used. To minimize accounting mismatches, the effects of changes in discount rates should be presented either in P&L or in OCI.
- We appreciate the intent to omit irrelevant information from the disclosure requirements. However, we believe that the IASB has failed in its intent since the

disclosure requirements indirectly requires a tabular disclosure format which makes it difficult to omit irrelevant information.

- Finally, we appreciate the adjusted transitional requirements. However, we do see merit in allowing a fresh start when the new IFRS 4 is implemented since there may have been previous classifications choices which will cause accounting mismatches due to the differences between present and new IFRS 4.

Below you find our detailed comments.

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Adjusting the contractual service margin

We supported the proposal in the previous ED issued in 2010 that the service margin should be locked in. Since then our thoughts have developed and reached the conclusion that both alternatives have its merits, but which should be applied depends on the circumstances.

We believe that a locked in service margin should be used when each component in an insurance contract is priced separately. Then our view is that the recognition of the initial margin best reflects the revenue recognition pattern of the insurance contract. However, when the pricing of the insurance contracts focus on the total premium received instead of its components, we believe that the service margin should be unlocked and adjusted for changes in expectations.

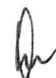
We notice that the proposed model with an unlocked service margin would defer the recognition in the income statement of actual changes in the value of the insurance contracts, making it difficult for the users to observe these changes without going into compensating disclosures. The effect of the proposal would be that all changes in revenue are deferred and amortized until the margin has been consumed in its entirety. This means that if losses are in excess of the contractual service margin, then the model would behave as the initial ED again. We conclude that the chosen methodology is in sharp contrast to the proposal for measuring impairments for expected losses that the IASB are presently redeliberating. In the latter proposal there is no deferral of expected losses even though the contract as such still is profitable. At the same time we notice that the proposal is consistent with the decisions made in the revenue recognition standard. There impairment is tested for the contract as a whole even though the focus in the standard is on separate performance obligations. Locking the service margin could lead to recognizing impairment losses for profitable contracts.

Unbundling criteria

We support the basic principles of when to unbundle investment and other service components, and when not to unbundle those components. However, in our view the interrelated criteria related to lapses and maturities should only be applicable in the case of the component to unbundle (i.e. not the insurance component).

For example, many unit-link contracts with immaterial insurance risk (thus not applicable for IFRS 4) are sometimes wrapped with a distinct insurance coverage (e.g. waiver of premium). The customer can choose to add the insurance coverage or cancel it. When a unit-link contract includes a waiver of premium coverage where the unit link component within the contract becomes a paid-up policy, the waiver of premium coverage will lapse automatically.

The investment component will still be valid and can be regarded as both distinct and not interrelated to the insurance component. However, according to the ED's criteria for unbundling, the interrelated perspective should be considered from the insurance component view as well, and as such, the investment component will always be interrelated since the insurance component will lapse whenever the investment component lapse or become a paid-up policy. We are not convinced about the benefits



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to measure and recognise the investment component as an insurance contract, including a waiver of premium, compared to an insurance contract excluding a waiver of premium, which would be measured and recognised in accordance with IAS 39/IFRS 9.

Furthermore, when applying the rules for modification and derecognition, some of the investment contracts will alter accounting measures and applicable accounting standards over time, although in reality, the value of the investment contract will not be changed. The administrative burden to monitor and account for such contracts will be overly complex without any identified benefits.

We believe that the IASB could find an easy and uncomplicated solution to this; i.e. to allow unbundling when the components in the insurance contract at initial recognition are distinct and priced separately. Following our proposed approach the contracts mentioned would not fall in or out of the insurance standard. We believe that such a solution would be superior in evaluating the performance of an entity and would also reduce the administrative burden for the preparers.

The measurement exception

We support the measurement exception that would apply for contracts that requires the entity to hold underlying items and where there is a link between payments to the policyholder and the returns on those underlying items, regardless if that follows from contract, law or regulation. We see no reason why assets and liabilities would not be measured using the same measurement principles in those cases in which the policyholder bears 100 % of the investment risk.

However, the measurement exception also applies for contracts which in part have guaranteed fixed payments. We question if a separation then could truly be made when the contracts are of "higher-of-option style" since the cash flows then are interrelated between sharing the return and the minimum guaranteed payments. According to BC60 IASB should prescribe a certain methodology for the separation that should be required to apply. Firstly, we have not been able to identify that methodology in the main text of the ED. We believe that the standard and appendixes is not helpful in understanding the required methodology. Secondly, we fail to believe that the methodology for separation is not arbitrary. We would envisage scenarios in which the allocation between cash flows for the floating and the fixed return could not be maintained due to underperformance of the returns on the assets. We believe that the alternative measurement exception should only apply when it is a required separation of cash flows by contract or by law, i.e. when there are no interrelations between the return on the portfolio and the value of the options and guarantees.

Presentation of insurance contracts revenue and expenses including the interest expense

We support the intention to present revenue as service is rendered and agree with the intention to exclude deposit components from revenue. We believe that the chosen methodology increases the possibility to compare revenue from insurance contracts with other forms of revenue.

However we do not agree that changes in the insurance liability based on discounting using the initial discount rate will provide useful information in other than rare circumstances. In our experience the duration of the liabilities significantly differ from the duration of the assets or the composition of the asset portfolio is not directly related to the insurance liability. Therefore, the original discount rate will fail to faithfully portray the net return of the insurance portfolios. The reason for this is that the return on the assets will reflect present interest rates and present returns on other forms of assets (e.g. equity instruments and real estate) while the discount rate is heavily dependent on the inflation rates when the insurance liability was initially recognized.

Therefore, we favor an approach in which changes in the liabilities due to changes in the discount rate are recognized immediately. Then, depending on fact and circumstances for each separate portfolio, the entity needs to make an accounting choice, if changes in the insurance liability due to changes in the discount rate should be presented in P&L or in OCI. The accounting choice should minimize accounting mismatch and be clearly motivated and documented. I.e., if changes in value of the assets backing insurance liabilities are mainly recognized in P&L the changes in the insurance liability due to changes in the discount rate should be recognized in P&L. However, if the changes in value of the assets backing insurance liabilities are mainly recognized in OCI, changes in the insurance liability due to changes in the discount rate should be recognized in OCI.

Such an approach would also facilitate asset and liability management which aims at managing both IFRS figures as well as regulatory capital requirements since the latter are focusing on current value of assets and liabilities.

Further; regardless of where the effects of discount rate changes are presented, we question the cost benefit analysis of using initial discount rates for P&L recognition. The complicated calculation of such interest expense at amortized cost would bring about fundamental changes in the need to store data, but not at least lead to significant adjustments of the IT-systems, without any obvious improvements of the information given. If the proposals for an interest expense at amortized cost would be introduced, it should be necessary to store numerous discount rate curves; the current discount rate and the discount rate at inception, for each and every insurance premium, contract or possibly a group of contracts. That would be extremely burdensome.

Whilst we support the Boards view, that segregating underwriting performance from the effects of the changes in the discount rates would provide relevant information that faithfully would represent the entity's financial performance, we believe that the costs widely would exceed any perceived benefits.

Furthermore, we question the relevance of focusing on the interest rate at contract inception for the non-life business. We firmly believe that for all types of insurance contracts, other than savings products, it should be the interest rate when the claim is initially recognized that should be used.

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Finally, we support the decision of the IASB to maintain the presentation exception for short-term contracts, especially related to non-life business. However for the latter, we repeat our comment made to the previous ED that the IASB should allow such presentation for non-life business, also for long-term contracts.

Disclosure requirements

As a general remark we would like to emphasise that it is the quality of the single disclosures regarding single distinct items that has information value, not general reconciliations of single items. Therefore, we appreciate the explicit reference in p70 and p71 that irrelevant information should be omitted and that aggregation and disaggregation should be evaluated on a case-by-case basis. However, we fail to understand the logic of then requiring that the disclosure requirements should be fulfilled by presenting the disclosures with reconciliations of opening and closing balances. Such presentation requirements indirectly require a tabular format which we fail to believe is consistent with the initially expressed principles that should be followed.

In p88 the ED requires the disclosures of minimum capital requirements. Such disclosure requirements may be in conflict with prudent regulations that sometimes prohibit the disclosures of certain capital requirements. The requirement therefore creates an impossible situation for those entities. Similar requirements already exists in IAS 1 p135 (d) which only requires information regarding if an entity has complied with any externally imposed capital requirements or not. We therefore urge the IASB to rephrase the wording in line with IAS 1 or simply delete it since it already is covered by IAS 1.

Transition and effective date

We believe that the IASB has reached a reasonable proxy between being prudent and pragmatic when changing the transitional provisions from the initial ED. However, we would like to highlight the possibilities of a fresh start with regard to the classification of assets used to back insurance liabilities. It is natural to allow a fresh start for financial instruments, but it could be equally relevant to allow for other forms of assets. The most obvious example of other form of assets is real estate. The classification made could have been deeply dependent on the present IFRS 4. Being required to maintain those previous classifications of assets may not lead to a faithful reflection of the performance of the entity. E.g. investment property may better be measured at amortized cost than at fair value in the future, if the IASB chooses to keep the intention of measuring insurance liabilities at amortized cost using the discount rate at initial recognition in revenue.

Finally, we urge the IASB to consider the alignment of the effective dates of IFRS 9 and IFRS 4. A situation in which an entity firstly is required to implement IFRS 9, with all its costs involved for users and preparers to adopt, and thereafter being 'required' to review and possible adjust its previous classifications to minimize accounting mismatches when implementing IFRS 4, is suboptimal. It would not only cause significant costs, but also make it difficult for users to evaluate the performance of the

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entity due to the lack of continuity in the figures presented. We therefore favor a solution in which entities with significant insurance activities has the possibility to defer the implementation of IFRS 9 until IFRS 4 is implemented.

Other issues

The definition of financial guarantee contracts

In p7 (f) a definition is made regarding which guarantee contracts that should be within the standard and which should not be. We understand the intention of the IASB to maintain the old definitions from present IFRS 4. However, the definition is not workable in practice and need some rewording even though the intention is well understood based on the last sentence in the same paragraph which allows a classification on a contract-by-contract basis. Our concern is that the entity needs to have a past practice of classifying financial guarantee contracts as insurance contracts to be able to have such classification. A literal interpretation makes it impossible to apply the standard for financial guarantee contracts if the insurance company is started after the effective date of the standard since it refers to past practice.

Definition of "to deliver cash"

The standard consequently uses the expression "to deliver cash" and make explicit statements that other ways of settling an obligation is excluded from the standard. The expression is not defined anywhere in the standard.

There are other ways of settling insurance liabilities, e.g. by delivering an asset or perhaps rebuilding a house that has burnt down. We urge the Board to clarify the meaning of the expression to avoid any doubt of the intention of the wording.

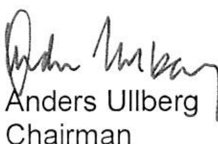
Future events

B61 explicitly states that an entity should not take into consideration future events like changes in legislation. We believe that this should be rephrased. Consideration ought to be taken to changes in legislation if those changes are already decided but not yet effective. Compare with IAS 12 p46 and p47, the latter explicitly requires an entity to use the tax rate that is "enacted or substantially enacted" at the end of the reporting period.

If you have any questions concerning our comments please address our Executive member Claes Janzon by e-mail to: claes.janzon@radetforfinansiellrapportering.se

Stockholm, 1 November 2013

Yours sincerely



Anders Ullberg
Chairman

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