Dear Sir,

File Reference No. 1870-100

Discussion Paper “Preliminary Views on Insurance contracts”

The Fédération Française des Sociétés d’Assurances (FFSA) welcomes the FASB’s invitation for comments on the Discussion Paper “Preliminary Views on Insurance Contracts”. The FFSA represents all types of insurance and reinsurance undertakings, accounting for 90% of the total French market.

We recently submitted a detailed comment letter to the IASB’s Exposure Draft “Insurance Contracts” and wish to highlight our main comments with regards to the FASB’s project. You will find a copy of this comment letter in the appendix, providing our detailed answer to the questions asked in the ED.

The DP meets several objectives of improvements to current US GAAP...

In the DP, the FASB mentions several objectives mentioned by stakeholders with regards to improving current US GAAP. The FFSA acknowledges that the DP and ED proposals meet several of these objectives with relevant proposals:

- Activity based rather than sector based standard

We approve the Boards’ decision to develop a separate standard applying to insurance contracts.

We are deeply convinced that other standards – revenue recognition, liabilities or financial instruments, are undoubtedly inadequate to reflect the specificities of the insurance business.

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- Uniform definition of an insurance contract based on the notion of compensation

We agree with the definition of insurance contracts included in appendix A. However, we are concerned with changes made to the application guidance, partially inspired by US GAAP, that may result in unintended consequences and excessive cost if all contracts currently meeting the definition of an insurance contract in IFRS 4 should be analyzed again with respect to this modified definition. We understood from the discussions with Board and staff members during outreach meetings and webcasts that the Boards’ intention was to keep the existing definition and classification of existing contracts under IFRS 4. The FFSA recommends the Board adopts the current application guidance in IFRS 4.

- Treatment of acquisition costs

We agree with including acquisition costs as cash outflows in the initial measurement of insurance contracts as acquisition costs are an integral part of the pricing of the contract.

We believe that expensing acquisition costs upon initial recognition would not provide useful information to users of the financial statements when the underlying contracts are expected to be eventually profitable. As the premium is the basis of the calculation of the residual margin, representing the deferred profit on the contract, it is appropriate that acquisition costs be included in the assessment of this margin.

Nevertheless, we recommend that acquisition costs be included as cash outflows in the initial measurement of insurance contracts if incremental at portfolio level, which is the relevant unit of account for insurance contracts.

- Reevaluation of some assumptions at each reporting period for long duration contracts

We agree that updating some or all assumptions at each reporting period provides useful information.

We refer to our proposals of alternative measurement models below for further details on how the impact of changes in these assumptions could be reported in the financial statements consistently with the business model.

- Discount rate for traditional long duration contracts

We support the Board’s proposal that the discount rate reflects the characteristics of liabilities for non participating insurance contracts, including liquidity, rather than the expected investment yield.

With regards to discounting of participating contracts, we understand from discussions with the IASB staff that the overall objective of the Boards was to achieve a "market consistent" approach. We support this approach.

- Discounting of short duration contracts

We concur with the Boards views that the measurement approach should take into account the time value of money, for future cash flows, when this effect is material.

We refer to our proposals of alternative measurement models below for further details on how the impact of changes in discount rates could be reported in the financial statements consistently with the business model.

... but still fails in faithfully representing the insurance business model and needs significant overhaul
The proposed model introduces undue volatility and does not portray adequately the asset liability matching inherent in the insurance business model.

We believe that the DP still fails to faithfully represent the insurance business in terms of measurement and presentation. The measurement approach in the DP does not adequately address the medium to long term nature and the asset-liability management inherent to the insurance business model. Presentation of the statement of net income misses volume information and hinder performance reporting deriving from the business model behind short term volatility.

Considered together with the FASB and IASB proposals on accounting for financial instruments, the current value approach proposed in the DP may indeed lead to large short-term fluctuations in the performance reported. This volatility contradicts the medium to long-term business model of an insurer and does not provide useful information for the users of financial statements as it means that reported results do not help in predicting long-term performance.

Many technical aspects of the DP need improvements in terms of content and clarity, notably unbundling requirements.

As detailed in our detailed answer to the questions asked in the IASB’s exposure draft below, we identified several areas where the Boards’ proposals require further work and/or rephrasing.

In particular, the FFSA is concerned with the lack of clarity and, to some extent, relevance that remains around this area of the DP. We suggest that the unbundling criteria be based on the way an insurer manages and reports the components of a contract. Components that are managed together would be presented as one contract, providing insight to users on the entity’s business model, whereas components that are managed separately would be unbundled.

Diverging views in the DP compared to the IASB’s ED should not be maintained.

The FFSA notes that the Boards were not yet able to converge in issuing a common proposal in spite of their continuing efforts. We believe the FASB should not maintain the following differences with the IASB’s proposals:

Scope of the insurance standard – financial instruments with discretionary participation feature.

We strongly support the inclusion of financial instruments with discretionary participation features (DPF) within the scope of the insurance standard.

It ensures consistent measurement with similar participating features in insurance contracts. We believe that this consistency outweighs the lack of insurance risk in these contracts.

We note that measurement principles and comprehensive guidance have been elaborated within the insurance standard, whereas no such principle exists in the financial instrument standard. For instance, the contract boundary principle developed for these contracts in the IASB’s ED is appropriate and clarifies an issue that should be addressed anyhow in the standard on financial instruments.

We thus exhort the FASB not to proceed with measuring these contracts at fair value through profit and loss under the financial instrument standard.

Residual / composite margin.

The FFSA supports the IASB’s proposal to use an explicit risk margin and a separate residual margin.
Indeed, managing risk is essential to the insurance’s business and is a key element to an insurer’s performance. In most cases, this key component is not as well evidenced in the FASB’s single composite margin model as in the IASB’s approach.

Further, in our view, a separate risk margin explicitly identifies the risk and uncertainty in the probability weighted cash flows included in the liability measurement and needs being updated at each subsequent reporting period. The risk margin reflects the variability in future possible scenarios that is not reflected in the best estimate / expected value of future cash flows. Indeed, the best estimate, or expected value of future outflows only reflects the weighted average of possible scenarios but provides no information as to how wide the range of scenarios is. Greater transparency is achieved with a separate risk margin, providing valuable information to the users of the financial statements on the insurer’s position.

The FFSA wishes to underline that an explicit calculation of a risk margin was deemed useful to assess the uncertainty surrounding the estimate of future cash flows by several insurance companies for internal reporting as well as external purposes (e.g. Market Consistent Embedded Value principles defined by the CFO Forum) and by regulators for prudential reporting.

On the FASB’s proposal of a composite margin, the FFSA identified the following issues that should preclude requiring such an approach:

- The information-usefulness and transparency of the composite margin is significantly lower than with an explicit risk margin. For instance, the changes in risk occurring over a contract’s life would not be reflected as the composite margin would not be remeasured subsequently to initial recognition;
- In the modified approach, the liability adequacy test performed at each reporting period under such an approach would not adequately include the effect of the risks attached to future cash flows. Further, in the post-claim period, the measurement of an insurance contract would only include the best estimate without any consideration for the level of risks characterizing the contract.
- Greater strain is put on the period over which a composite margin is to be released and on the recognition driver, that would directly impact the way an insurer’s performance is reported.
- The proposed formula to release the composite margin assumes that premium receipts and claims payments follow a pattern that is close to performance under the contract. Staff paper 2C - discussed in May 2010, lists cases where this assumption is not true in practice. We wish to underline that the above cases are commonly met in practice. For these contracts, the proposed formula for the release of the composite margin would be utterly inappropriate. We urge the Board to elaborate another principle, should the composite margin be brought forward to the final standard.

However, the FFSA noted some Board members’ concern about consistency in the calculation of such a risk margin. Past practice in some countries requiring the assessment of a separate risk margin shows that consistency developed through market practice and was reinforced by appropriate disclosure requirements on the methodology and assumptions used.

- Reinsurance
To us, symmetrical principles should apply to the measurement of direct / assumed business and the portion ceded to reinsurers.
Overall, gross liabilities combined with reinsurance assets should reflect the net risk remaining with the cedant. Financial statements should depict the risk exposure net of the relief provided by reinsurance, thus providing users with insight on the entities’ activities and perspectives. We advise the Board to elaborate a standard that meets this objective.

**Modified approach**

We note that the FASB is still undecided on whether to elaborate an alternative measurement model. The FASB discusses the IASB’s modified approach as an example of such an alternative model.

We firmly disagree with developing a standard that includes two different models and requires separate presentation in the financial statements.

We view the modified approach in the IASB’s ED as a proxy of the standard building block approach and believe it should not be required but permitted. This would enable entities to apply the standard measurement approach consistently to all their contracts without being compelled to use a proxy. It would also alleviate the potential constraints on the definition of contracts to be accounted for under this modified approach.

**Our proposals to better reflect the insurance business model**

The FFSA recommends the Board elaborates further on the following alternatives that, when combined, allow for a better presentation of the business model and underlying performance:

- **Recognition of the effect of changes in discount rates in the separate statement of Other Comprehensive Income (OCI)**

  Recognition of the impact of changes in discount rates in the separate statement of OCI reduces the undue volatility in the statement of net income. As per the DP, insurance liabilities are recorded at current value in the statement of financial position and the use of OCI does not hinder performance reporting deriving from the business model behind short term volatility in the statement of net income.

  This alternative is consistent with our repeated requests, expressed in our comment letters to IFRS 9 and to IAS 1. We support measurement of financial assets at fair value through OCI similar to the existing available for sale category under IAS 39 and to the FASB’s current proposal on financial instruments, that would match changes in insurance liabilities recorded in the separate statement of OCI. We also support the presentation of net income and other comprehensive income in two separate statements.

- **Locked-in discount rate**

  Another alternative could be the use of a locked-in discount rate to eliminate undue volatility due to short term fluctuations in discount rates. This approach is consistent with the fulfillment approach, inherent to the insurance business model.

  In our comment letter on the FASB’s ED related to financial instruments, we advocated for a mixed measurement model allowing for amortized cost. Liabilities discounted at a locked-in rate match assets carried at amortized cost. Under current IFRS 9, insurers expect that amortized cost is required for a large majority of their investment portfolio, comprising mostly fixed-income high quality bonds carried to maturity, as both the nature and business model criteria are met.
• Prospective remeasurement of the residual margin for changes in variables other than the discount rate

Prospective remeasurement of the residual margin for changes in variables other than the discount rate should be combined with the above alternatives.

The residual margin is, in our view, the deferred profit to be released over both the coverage and claim-handling period of the insurance contract. The allocation of changes in variables other than the discount rate to the residual margin, provided the margin does not become negative, would provide continuity in the treatment of the contract’s performance between initial and subsequent measurements.

The recognition of immediate gains or losses for each interim change in assumptions of variables other than the discount rate indeed conveys information that is inconsistent with the continuous release of the initial residual margin. For instance, reporting a loss in a given reporting period, whereas larger amounts of profit margin are still to be released in subsequent periods does not reflect faithfully the overall contract’s profitability. For similar contracts, diverging assumptions made at initial recognition would also lead to significant diversity in subsequent reporting periods.

• Presentation of the financial statements

With regards to presentation of the financial statements, we believe that information on premiums and claims incurred is crucial to the understanding of our activity. This information should appear on the face of the income statement with equal prominence compared to margin information.

Timing should not compromise quality

Given the significance of this standard for the insurance industry, we believe that the Boards should take sufficient time to ensure that the final standard is based on clear and sound principles and adequately reflects the insurance business model. The FASB and IASB should concentrate on developing a high quality standard that creates a level playing field, even if this comes at the expense of delay in the finalization and implementation of the proposals.

Comprehensive field testing and reexposure are needed before a final standard can be issued

We believe that the organization of comprehensive field testing is essential to ensure that the final standard provides decision-useful information for users of financial statements consistently with the insurance business model and that operational challenges of the proposed measurement model are adequately addressed.

We hope you find these comments useful and would be pleased to provide any further information you might require. Please contact Bertrand Labilloy at +33 1 42 47 93 58 if you wish to discuss any of the issues raised.

Yours sincerely,

Bernard Spitz
Dear Sir David,

Exposure Draft “ED/2010/8 Insurance contracts”

The Fédération Française des Sociétés d’Assurances (FFSA) welcomes the IASB’s invitation for comments on the Exposure Draft “Insurance Contracts”. The FFSA represents all types of insurance and reinsurance undertakings, accounting for 90% of the total French market.

The ED includes improvements compared to the IASB’s 2007 Discussion Paper but does not yet achieve a faithful representation of the insurance business

We acknowledge the Board’s commitment and efforts in elaborating this ED and believe the proposed measurement model includes improvements from the approach proposed in the IASB’s 2007 Discussion Paper “Preliminary Views on Insurance Contracts”. In particular, we welcome an accounting treatment based on a fulfillment value rather than a model based on an exit value, the deferral of day one gains to subsequent performance of obligations under the contract through the inclusion of a residual margin, the inclusion in the measurement of, at least, some acquisition costs as well as scoping investment contracts with discretionary participation features in the insurance contract standard.

However, besides these steps in the right direction, we believe that the ED still fails to faithfully represent the insurance business in terms of measurement and presentation. The measurement approach in the ED does not adequately address the medium to long term nature and the asset-liability management inherent to the insurance business model. Presentation of the statement of net income misses volume information and hinder performance reporting deriving from the business model behind short term volatility.

Considered together with the proposals on accounting for financial instruments, the current value approach proposed in the ED may indeed lead to large short-term fluctuations in the performance reported. This volatility contradicts the medium to long-term business model of an insurer and does not provide useful information for the users of financial statements as it means that reported results do not help in predicting long-term performance. It may also result in a distorted perception of insurance relative to other sectors where significant portions of both assets and liabilities may be reported using an amortised cost model, putting insurers at a competitive disadvantage on the capital markets.

Sir David Tweedie
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We also believe that many technical aspects of the ED need improvements in terms of content and clarity in several other areas, such as unbundling and contracts with discretionary participation features.

We urge the Board to take these issues into proper consideration in developing a high quality standard that would faithfully represent the insurance business and commit to assist them in this task.

Our proposals to better reflect the insurance business model

The FFSA recommends the Board elaborates further on the following alternatives that, when combined, allow for a better presentation of the business model and underlying performance:

- Recognition of the effect of changes in discount rates in the separate statement of Other Comprehensive Income (OCI)

Recognition of the impact of changes in discount rates in the separate statement of OCI reduces the undue volatility in the statement of net income. As per the ED, insurance liabilities are recorded at current value in the statement of financial position. However, the use of OCI does not hinder performance reporting deriving from the business model behind short term volatility in the statement of net income.

This alternative is consistent with our repeated requests, expressed in our comment letters to IFRS 9 and to IAS 1. We support measurement of financial assets at fair value through OCI similar to the existing available for sale category under IAS 39 that would match changes in insurance liabilities recorded in the separate statement of OCI. We also support the presentation of net income and other comprehensive income in two separate statements.

- Locked-in discount rate:

Another alternative could be the use of a locked-in discount rate to eliminate undue volatility due to short term fluctuations in discount rates. This approach is consistent with the fulfillment approach, inherent to the insurance business model.

Liabilities discounted at a locked-in rate match assets carried at amortized cost. Under current IFRS 9, insurers expect that amortized cost is required for a large majority of their investment portfolio, comprising mostly fixed-income high quality bonds carried to maturity, as both the nature and business model criteria are met.

- Prospective remeasurement of the residual margin for changes in variables other than the discount rate:

Prospective remeasurement of the residual margin for changes in variables other than the discount rate should be combined with the above alternatives.

The residual margin is, in our view, the deferred profit to be released over the coverage and claim-handling period of the insurance contract. The allocation of changes in variables other than the discount rate to the residual margin, provided the margin does not become negative, would provide continuity in the treatment of the contract’s performance between initial and subsequent measurements.

The recognition of immediate gains or losses for each interim change in assumptions of variables other than the discount rate indeed conveys information that is inconsistent with the continuous release of the initial residual margin. For instance, reporting a loss in a given reporting period, whereas larger amounts of profit margin are still to be released in subsequent periods does not reflect faithfully the overall contract’s profitability. For similar contracts, diverging assumptions made at initial recognition would also lead to significant diversity in subsequent reporting periods.
Presentation of the financial statements

With regards to presentation of the financial statements, we believe that information on premiums and claims incurred is crucial to the understanding of our activity. This information should appear on the face of the income statement with equal prominence compared to margin information.

The FFSA is deeply concerned with the Board’s proposal on unbundling.

The FFSA is concerned with the lack of clarity and, to some extent, relevance that remains around this area of the ED. The FFSA suggests that the unbundling criteria be based on the way an insurer manages and reports the components of a contract. Components that are managed together would be presented as one contract, providing insight to users on the entity’s business model, whereas components that are managed separately would be unbundled.

The modified measurement approach as defined in the ED should not be required

The FFSA considers that the modified measurement approach as defined in the ED should not be required for any short-duration contract and recommends that the Board permits but not requires such a modified approach, as long as exercising this option does not entail any additional requirements.

The proposed transition requirements must be amended so that performance reporting is not distorted for reporting periods subsequent to transition

The proposal in the ED leads to recognizing unrealized profits on existing portfolios in equity. As a consequence, large amounts would never appear in profit or loss, which would distort users’ assessment of capital, dividend paying ability and of key ratios such as the return on equity. Indeed, immediately after transition, the statement of net income will encompass profits related to new contracts, without regards for prior portfolios that may still be in force. As long as prior portfolios account for a material portion of all contracts in force, the statement of net income will not reflect faithfully the entity’s performance.

The FFSA urges the Board to amend the proposed transition requirements so that performance reporting is not distorted for reporting periods subsequent to transition and proposes revised transition requirements.

Effective date requirements should take due consideration for the insurers’ concerns

The concurrent development of IFRS 9 and IFRS 4 Phase II raises significant issues for insurers. In this regard, we would like to reiterate the following:

- **Mandatory application of IFRS 4 Phase II and IFRS 9 must be concurrent**: the 2013 mandatory application date of IFRS 9 must be reconsidered to enable insurers to concurrently adopt both standards. We also believe that the transitional provisions should be reviewed in this regard, for example in relation to relief from providing comparatives.

- **Insurers must have the ability to change the designation of financial assets upon transition to IFRS 4 Phase II if early adoption of IFRS 9 was elected**: we note that this issue is addressed in paragraph 102. However, the Board has only considered allowing reclassification as assets as at fair value through profit or loss. We consider that reclassification should be allowed without precluding any specific category.

Moreover, we believe that the usual two year timeframe left for transition to new standards will not be sufficient to face the operational challenges of the implementation of such changes and to educate both internally and externally on these complex requirements.
Timing should not compromise quality

Given the significance of this standard for the insurance industry, we believe that the Board should take sufficient time to ensure that the final standard is based on clear and sound principles and adequately reflects the insurance business model. The IASB's primary consideration should be the quality of the final standard, even if this comes at the expense of delay in the finalisation and implementation of the proposals.

Comprehensive field testing and reexposure are needed before a final standard can be issued

We believe that the organization of comprehensive field testing is essential to ensure that the final standard provides decision-useful information for users of financial statements consistently with the insurance business model and that operational challenges of the proposed measurement model are adequately addressed.

The above comments are detailed within our answers to the Board's questions in the Appendix to this letter.

We hope you find these comments useful and would be pleased to provide any further information you might require. Please contact Bertrand Labilloy at +33 1 42 47 93 58 if you wish to discuss any of the issues raised.

Yours sincerely,

Bernard Spitz
Appendix 1

**Question 1 – Relevant information for users**

Do you think that the proposed measurement model will produce relevant information that will help users of an insurer’s financial statements to make economic decisions? Why or why not? If not, what changes do you recommend and why?

The FFSA strongly approves the Board’s decision to develop a separate standard on insurance contracts. We are deeply convinced that other standards – revenue recognition, IAS 37 or financial instruments, are undoubtedly inadequate to reflect the specificities of the insurance business.

However, we fear the proposed measurement model hinders users from understanding the activity, estimating future cash flows and risk exposure and thus from taking well-informed decisions because of:

- Considerable short-term volatility in performance reporting. This volatility belies the medium to long term nature of our activity.
- Insufficient consideration given to asset-liability matching activities. Both IFRS 4 Phase II and IFRS 9 were developed in isolation and do not allow for a meaningful representation of the crucial interactions between assets and liabilities in the insurance business model.
- Accounting mismatch with assets classified pursuant to our business model.
- Inappropriate consequences of transition requirements.
- Unfulfilled objectives regarding presentation of key information in the statement of net income.
- Lack of clarity of some requirements, such as unbundling.

The significance of the considered changes requires extensive field testing with users of financial statements to ensure that the proposed model meets their needs. We noticed that users reported mixed views on the information usefulness of the ED proposals during the November meeting of the Insurance Working Group.

We provide more details on these key issues as well as our proposals to the Board hereinafter.
Question 2 – Fulfilment cash flows

(a) Do you agree that the measurement of an insurance contract should include the expected present value of the future cash outflows less future cash inflows that will arise as the insurer fulfils the insurance contract? Why or why not? If not, what do you recommend and why?

(b) Is the draft application guidance in Appendix B on estimates of future cash flows at the right level of detail? Do you have any comments on the guidance?

Question 2 a:

The FFSA agrees with the proposal in the ED that the measurement of an insurance contract should reflect the fulfilment cash flows for that contract, including the present value of future cash outflows less future cash inflows.

The FFSA opposed the current exit value favored by the Board in its 2007 Discussion Paper “Preliminary Views on Insurance Contracts” and supports the Board’s decision to move to a fulfilment approach. The FFSA concurs with the Board’s analysis that insurers mostly fulfill the obligations resulting from the insurance contracts they issue rather than transfer their obligation to third parties on a deep and liquid market and believes that the measurement approach should follow the way such obligations are settled.

Further, the FFSA agrees with a measurement that aggregates all cash inflows and outflows relating to a contract as this measurement would best depict the underlying transaction with the customer under a single insurance contract.

The measurement approach should take into account the time value of money, for future cash flows, when this effect is material.

We warn the Board to state as a principle that no double counting should arise from this proposal. For instance, loans granted to policyholders are substitutes to partial surrenders and could be considered as financial instruments or insurance contract cash flows. These loans are based on and limited to the surrender value of the insurance contracts, and netting of the loan balance is allowed upon full surrender of the contract.

Question 2 b:

The FFSA agrees that the application guidance in Appendix B is overall at the right level of details for a principle based standard.

Nevertheless, the guidance on expenses in paragraphs B61 and B62 goes into too many details that may generate cross-cutting issues and should be summarized to brief principles.
Question 3 – Discount rate

(a) Do you agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability? Why or why not?

(b) Do you agree with the proposal to consider the effect of liquidity, and with the guidance on liquidity (see paragraphs 30(a), 31 and 34)? Why or why not?

(c) Some have expressed concerns that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts. Are those concerns valid? Why or why not? If they are valid, what approach do you suggest and why? For example, should the Board reconsider its conclusion that the present value of the fulfilment cash flows should not reflect the risk of non-performance by the insurer?

Question 3 a:

The FFSA supports the Board’s proposal that the discount rate reflects the characteristics of liabilities for non-participating insurance contracts, including liquidity.

The FFSA recommends the Board elaborates further on the following alternatives that, in our view, allow for a better presentation of the business model and underlying performance:

- Use of the separate statement of Other Comprehensive Income (OCI) for changes in discount rates: as noted in our answer to question 13 on presentation of the financial statements, we believe that changes in discount rates – due to changes in both risk-free rate and liquidity premium - should not impact income and expenses reported in the statement of net income.

- Locked-in discount rate:
  
  Another alternative could be the use of a locked-in discount rate to eliminate undue volatility due to short term fluctuations in discount rates. This approach is consistent with the fulfillment approach, inherent to the insurance business model.

  Liabilities discounted at a locked-in rate match assets carried at amortized cost. Under current IFRS 9, insurers expect that amortized cost is required for a large majority of their investment portfolio, comprising mostly fixed-income high quality bonds carried to maturity, as both the nature and business model criteria are met.

To us, these alternatives should encompass all components of a contract taken as a whole, including options and guarantees.

With regards to discounting of participating contracts, we refer to our answer to question 10 a. We understand from discussions with the IASB staff that the overall objective of the Board was to achieve a "market consistent" approach. We support this approach.

Question 3 b:

The FFSA strongly agrees with the Board’s proposal to consider the effect of liquidity in the assessment of the discount rate for insurance contracts.
Such a liquidity premium on liabilities eliminates the accounting mismatch between illiquid liabilities characterized by highly predictable cash flows that are matched through the asset-liability strategy with assets of corresponding maturities that may experience a liquidity premium. The appearance of an important liquidity premium implicitly contained in the valuation of these assets would create a shortfall in the balance sheet of the concerned companies, which the FFSA claims to be artificial insofar that in case of an efficient hedge against credit risk, the revenues of the assets, both regular and at maturity, were not at risk and were sufficient to match the cash outflows of the insurance contracts.

The guidance provided on liquidity is appropriate for insurers to derive an assessment of this illiquidity premium in practice. The FFSA is convinced that consistency will develop in this area through market practice, fostered by adequate disclosures on the methods and assumptions used.

Question 3 c:

The FFSA believes that non-performance risk should not be reflected in the present value of the fulfilment cash flows for insurance contracts.

We refer to our prior comment letters on the Discussion Paper “Credit Risk in Liability Measurement” and to the Exposure Draft “Fair Value Option for Financial Liabilities”, consistently opposing the inclusion of the effect of the insurer’s own credit risk in the subsequent measurement of liabilities.

The FFSA strongly opposes the recognition of changes in the assessment of a liability that are attributable to changes in the credit risk of the liability, whether in equity, in other comprehensive income (OCI) or in profit or loss, until these gains and losses are realised.

**Question 4 – Risk adjustment versus composite margin**

Do you support using a risk adjustment and a residual margin (as the IASB proposes), or do you prefer a single composite margin (as the FASB favours)? Please explain the reason(s) for your view.

The FFSA supports the IASB’s proposal to use an explicit risk margin and a separate residual margin. Indeed, managing risk is essential to the insurance’s business and is a key element to an insurer’s performance. In most cases, this key component is not as well evidenced in the FASB’s single composite margin model as in the IASB’s approach.

Further, in our view, a separate risk margin explicitly identifies the risk and uncertainty in the probability weighted cash flows included in the liability measurement and needs being updated at each subsequent reporting period. The risk margin reflects the variability in future possible scenarios that is not reflected in the best estimate / expected value of future cash flows. Indeed, the best estimate, or expected value of future outflows only reflects the weighted average of possible scenarios but provides no information as to how wide the range of scenarios is. Greater transparency is achieved with a separate risk margin, providing valuable information to the users of the financial statements on the insurer’s position.

The FFSA wishes to underline that an explicit calculation of a risk margin was deemed useful to assess the uncertainty surrounding the estimate of future cash flows by several insurance companies for internal reporting as well as external purposes (e.g. Market Consistent Embedded Value principles defined by the CFO Forum) and by regulators for prudential reporting.

On the FASB’s proposal of a composite margin, the FFSA identified the following issues that should preclude requiring such an approach:
• The information-usefulness and transparency of the composite margin is significantly lower than with an explicit risk margin. For instance, the changes in risk occurring over a contract’s life would not be reflected as the composite margin would not be remeasured subsequently to initial recognition;

• In the modified approach, the liability adequacy test performed at each reporting period under such an approach would not adequately include the effect of the risks attached to future cash flows. Further, in the post-claim period, the measurement of an insurance contract would only include the best estimate without any consideration for the level of risks characterizing the contract.

• Greater strain is put on the period over which a composite margin is to be released and on the recognition driver, that would directly impact the way an insurer’s performance is reported.

However, the FFSA understands some Board members’ concern about consistency in the calculation of such a risk margin. Past practice in some countries requiring the assessment of a separate risk margin shows that consistency developed through market practice and was reinforced by appropriate disclosure requirements on the methodology and assumptions used.

**Question 5 – Risk adjustment**

(a) Do you agree that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected? Why or why not? If not, what alternatives do you suggest and why?

(b) Paragraph B73 limits the choice of techniques for estimating risk adjustments to the confidence level, conditional tail expectation (CTE) and cost of capital techniques. Do you agree that these three techniques should be allowed, and no others? Why or why not? If not, what do you suggest and why?

(c) Do you agree that if either the CTE or the cost of capital method is used, the insurer should disclose the confidence level to which the risk adjustment corresponds (see paragraph 90(b)(i))? Why or why not?

(d) Do you agree that an insurer should measure the risk adjustment at a portfolio level of aggregation (ie a group of contracts that are subject to similar risks and managed together as a pool)? Why or why not? If not, what alternative do you recommend and why?

(e) Is the application guidance in Appendix B on risk adjustments at the right level of detail? Do you have any comments on the guidance?

**Question 5 a:**

The FFSA agrees with the proposed definition of the risk margin that should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected.

**Question 5 b:**

The FFSA strongly opposes the final standard’s restricting the number of techniques permitted for the calculation of the risk margin.

This limitation does not meet the Board’s intent to issue a principle based standard.

Further, actuarial techniques experience continuous developments improving the way in which risk is evaluated. Future improvements should not be excluded if they meet the Board’s objective and characteristics assigned to the risk margin calculation as described in the standard and in the
application guidance (paragraph B68-B72). A new technique should be allowed when it meets the
criteria listed in paragraph 72.

As a result, the FFSA suggests that the final standard should include a rebuttable presumption that the
three techniques identified by the Board should be used in the calculation of the risk margin, but
should permit other calculation techniques that both meet the measurement objective and better reflect
the characteristics of the underlying risk.

Question 5 c:
The FFSA disagrees that the insurer should disclose the confidence level to which the risk margin
 corresponds when the CTE or the cost of capital techniques are used to evaluate the risk margin.
The FFSA believes that the usefulness of this information is very limited and that this disclosure may
be misleading in certain circumstances. The FFSA concurs with the Board’s concerns about
comparability when different techniques or parameters are used to assess the risk margin. However:

- The required disclosure is not adequate to ensure comparability as insurers would each provide
different confidence levels to which their risk margin corresponds, the analysis of which may
prove difficult for users.
- As the Board noted when selecting three permitted techniques and documenting their choice in
the Basis for Conclusions, the confidence level method is inappropriate when the probability
distribution is skewed. Selecting the CTE or the cost of capital technique for measurement
purposes reflects the fact that these methods are more appropriate to reflect the underlying
risk, and more often than not, that the confidence level technique would not provide useful
information.

Further, the FFSA would like to underline the significance of costs and inconsistency implied by such
a disclosure. For instance, if an insurer determines that the CTE technique is the most appropriate
technique to measure the risk margin of particular contract, it would be required to provide a
confidence level assessment, on top of a cost of capital assessment for regulatory purpose, thus
multiplying calculation efforts and blur the financial statement users’ understanding of the underlying
risk.

The FFSA is confident that adequate disclosure on the methodologies and assumptions used will
provide sufficient useful information to the users of the financial statements. This information should
not be distorted by the proposed requirement on a confidence level equivalent.

Question 5 d:
The FFSA does not agree with the restriction of diversification effects at the portfolio level when
assessing the risk margin. Further allowance should be included in the calculation of the risk margin to
the diversification effects at the reporting entity level.

As noted by the Board during their meetings prior to the issuance of the ED, there are no conceptual
grounds to such a restriction at portfolio level. The staff paper 2D discussed in May 2010 on the level
of measurement identified that diversification effects can be observed at a single portfolio level, from
pooling similar risks together, but can also be evidenced as a result from diversification between
portfolios and negative correlations between portfolios. Examples of risk mitigation between
portfolios were provided, such as diversification of earthquake exposure and offsetting of risks
between portfolios. Only practicality and subjectivity arguments were put forward against a higher
level than portfolios.

We noted in the BCs that the Board considered fungibility as a rationale to preclude the calculation of
diversification effects at group level. We believe that this rationale is inappropriate as fungibility is a
capital management and regulatory issue that does not belong to financial reporting.
The FFSA thus recommends that diversification effects be taken into account at the reporting entity level. The FFSA knows that diversification effects can be assessed at higher levels of aggregation and suggests requiring adequate disclosure that will ultimately provide comparability through market discipline.

However, if the Board was to bring their current proposal forward to the final standard, the FFSA wishes to draw the attention of the Board to the interaction between the current definition of the portfolio and the entities composing a group. For instance, some groups sell identical contracts through different subsidiaries (e.g. a group selling a single motor insurance contract under different commercial names through various insurance subsidiaries, each located in a different region or State). These contracts are managed as a pool at group level. In this case, the FFSA understands that the ED would require including the effects of diversification at the portfolio level, notwithstanding the distribution through various legal entities.

**Question 5 e:**

The FFSA believes that guidance should be limited to general principles in the standard to meet the Board’s intent to issue a principle based standard. In this respect, the paragraphs B75 to B90, describing the characteristics of actuarial techniques are deemed not to be relevant in the application guidance of a financial reporting standard. These paragraphs should be transferred to the Basis for Conclusions.

**Question 6 - Residual/composite margin**

(a) Do you agree that an insurer should not recognise any gain at initial recognition of an insurance contract (such a gain arises when the expected present value of the future cash outflows plus the risk adjustment is less than the expected present value of the future cash inflows)? Why or why not?

(b) Do you agree that the residual margin should not be less than zero, so that a loss at initial recognition of an insurance contract would be recognised immediately in profit or loss (such a loss arises when the expected present value of the future cash outflows plus the risk adjustment is more than the expected present value of future cash inflows)? Why or why not?

(c) Do you agree that an insurer should estimate the residual or composite margin at a level that aggregates insurance contracts into a portfolio of insurance contracts and, within a portfolio, by similar date of inception of the contract and by similar coverage period? Why or why not? If not, what do you recommend and why?

(d) Do you agree with the proposed method(s) of releasing the residual margin? Why or why not? If not, what do you suggest and why (see paragraphs 50 and BC125–BC129)?

(e) Do you agree with the proposed method(s) of releasing the composite margin, if the Board were to adopt the approach that includes such a margin (see the Appendix to the Basis for Conclusions)? Why or why not?

(f) Do you agree that interest should be accreted on the residual margin (see paragraphs 51 and BC131–BC133)? Why or why not? Would you reach the same conclusion for the composite margin? Why or why not?

**Question 6 a:**

The FFSA agrees with the Board’s proposal in the ED and welcomes the Board’s new decision compared to the Discussion Paper “Preliminary Views on Insurance Contracts”. As mentioned in our
comment letter to the 2007 Discussion Paper, the FFSA considers that no gain should be recognized at initial recognition of an insurance contract.

Consistently with the revenue recognition project, this gain should be released over a period corresponding to the performance of the obligations under the insurance contract.

**Question 6 b:**
The FFSA agrees that losses at initial recognition of an insurance contract should be recognized immediately in profit or loss.

**Question 6 c:**
We disagree with restricting the assessment of the residual margin at “cohort” level as defined in the ED.

To us, the relevant unit of account for insurance contracts is the portfolio. It should be applied consistently throughout the final standard, in the assessment of the residual margin as well as of the risk margin or of acquisition costs to be included in the best estimate of the cash flows.

Further, as noted in our answer to question 13 b), we suggest that the initial measurement of the residual margin be prospectively remeasured in subsequent periods to enhance the representational faithfulness of reported income. This prospective remeasurement allows for a portfolio approach to be made operational and reflects adequately the pooling effect inherent in the insurance activity, with compensation of gains and losses between generations of contracts within a portfolio. Extensive field tests are needed on the aggregation level to be used in the calculation of the residual margin so as to ensure that the final requirements are operational.

**Question 6 d:**

- **Release period**

  We disagree with the ED’s proposal to release the residual margin over the insurance coverage period and recommend that the margin be released over both coverage and claim-handling periods.

  The ED’s proposal derives from an erroneous conception of the residual margin as a bulk of undetermined obligations that should be released over the shortest period possible.

  In our view, the residual margin reflects the expected profit of the contract. Performance under the contract includes both providing insurance coverage and handling claims during or after the coverage period. Profit should be allocated to both periods as they relate to core activities in the insurance business.

  Conceptually, we agree that the residual margin may also comprise other services or components, apart from deferred profit. The Board’s analysis of these other services and components shows that they are likely to be performed over both coverage and claim-handling periods, such as the non-performance risk.

    - **Prospective remeasurement of the residual margin for changes in variables other than discount rate:**

  We recommend that the residual margin be subsequently remeasured prospectively for changes in variables other than the discount rate.

  To us, the residual margin corresponds to the deferred profit to be released over the coverage and claim-handling period of the insurance contract. The allocation of changes in variables other than discount rate to the residual margin, provided the margin does not become negative, would provide continuity in the treatment of the contract’s performance between initial and subsequent measurement.
The recognition of immediate gains or losses for each interim change in assumptions of variables other than discount rate indeed conveys information that is inconsistent with the continuous release of the initial residual margin. For instance, reporting a loss in a given reporting period, whereas larger amounts of profit margin are still to be released in subsequent periods does not reflect faithfully the overall contract’s profitability. For similar contracts, diverging assumptions made at initial recognition would also lead to significant diversity in subsequent reporting periods.

Additionally, at this stage, the ED is unclear as to whether the expected timing of incurred claims to be used for the release of the residual margin is locked in upon initial recognition of the insurance contract or whether it should be updated at each subsequent reporting date. The FFSA understands from paragraph 53 that initial expectations on the release of residual margin should only be revised for contracts that are not in force anymore, but not for any other assumption. The FFSA would appreciate that the Board clarify this issue.

Question 6 e:
For the reasons detailed above, the FFSA prefers the explicit risk margin approach to the composite margin approach.

The proposed formula to release the composite margin assumes that premium receipts and claims payments follow a pattern that is close to performance under the contract. Staff paper 2C - discussed in May 2010, lists cases where this assumption is not true in practice, such as:

- Upfront single premium payment, leading to a large release of composite margin upon initial recognition (>50% as premiums are expected to exceed benefits for a composite margin to be recognized), whereas the insurer has not performed any obligation under the contract;
- Linear premium payments with a non-linear risk pattern;
- Significant claim handling period between the date when the insured event occurred and the actual payment.

The FFSA wishes to underline that the above cases are commonly met in practice. For these contracts, the proposed formula for the release of the composite margin would be utterly inappropriate and urges the Board to elaborate another principle, should the composite margin be brought forward to the final standard.

Question 6 f:
The FFSA agrees with the accretion of interest on the residual margin, provided the effect is material and complexity does not outweigh the benefits of this approach.

**Question 7 – Acquisition costs**

(a) Do you agree that incremental acquisition costs for contracts issued should be included in the initial measurement of the insurance contract as contract cash outflows and that all other acquisition costs should be recognised as expenses when incurred? Why or why not? If not, what do you recommend and why?

The FFSA agrees with including acquisition costs as cash outflows in the initial measurement of insurance contracts as acquisition costs are an integral part of the pricing of the contract.
The FFSA believes that expensing acquisition costs upon initial recognition would not provide useful information to users of the financial statements if the underlying contracts are expected to be eventually profitable. As the premium is the basis of the calculation of the residual margin, representing the deferred profit on the contract, it is appropriate that acquisition costs be included in the assessment of this margin.

However, the FFSA considers that the proposal restricting acquisition costs to be included in the contract cash flows to those that are incremental at contract level is irrelevant. Indeed, such a limitation would create undue differences between two insurance companies, as well as within a single entity, selling similar contracts through different distribution channels, thus reducing comparability in financial reporting. For instance, similar contracts with identical acquisition costs would generate an expense upon initial recognition if distributed by employees or would reduce margin revenue in future periods if distributed by agents or brokers receiving commissions, even though the overall profit and the pattern of performance obligations are expected to be similar.

Further, pooling is the essence of the insurance business model, which justifies a unit of account that differs from the one in IAS 39 and IFRS 9 where the unit of account is the individual financial instrument.

As a result, the FFSA recommends that acquisition costs (i.e. all direct and indirect costs of selling, underwriting and initiating an insurance contract, as defined in Appendix A) be included as cash outflows in the initial measurement of insurance contracts if incremental at portfolio level. This treatment is consistent with the assessment of other cash flows resulting from insurance contracts, incremental at portfolio level as prescribed in paragraph 23. This treatment would meet the overall definition of cash flows to be included in the measurement in B61, covering both “direct costs and systematic allocation of costs that relate directly to the insurance contract or contract activities” and match the treatment for claim handling costs.

**Question 8 – Premium allocation approach**

(a) Should the Board (i) require, (ii) permit but not require, or (iii) not introduce a modified measurement approach for the pre-claims liabilities of some short-duration insurance contracts? Why or why not?

(b) Do you agree with the proposed criteria for requiring that approach and with how to apply that approach? Why or why not? If not, what do you suggest and why?

**Question 8 a:**

The FFSA considers that the modified measurement approach as defined in the ED should not be required for any short-duration contract. Indeed, companies willing to apply the full measurement approach to all their contracts, for instance to avoid duplicating measurement and / or presentation methods if the company sells both short term and long term contracts, should not be compelled to use a modified approach that approximates the full measurement approach. Further, the test of onerous contracts required in the ED may require the measurement of the best estimate and of the risk margin as defined in the general measurement approach, which is by no means a simplification.

The FFSA recommends that the Board permit but not require such a modified measurement approach, as long as exercising this option does not entail any additional requirements (e.g. disclosing the effect of not applying the option if any...). This option would allow issuers of financial statements to choose the measurement approach and the presentation that best depicts their business model.

Should the Board decide to impose constraints on the use of the option suggested above, the FFSA would prefer the Board not to introduce a modified measurement approach as it may generate an additional burden on issuers not willing to use the option.
Question 8 b:
The FFSA believes that the criteria for identifying the insurance contracts entering into the scope of the modified measurement approach are bright lines blurred so as to look like more principle based than rule based. The FFSA is concerned by potential unintended applications of the modified approach, inappropriately including or excluding certain contracts of the scope of this approach.

Question 9 – Contract boundary principle
Do you agree with the proposed boundary principle and do you think insurers would be able to apply it consistently in practice? Why or why not? If not, what would you recommend and why?

The FFSA agrees with the principle proposed in paragraph 27 of the ED on insurance contract boundaries.

Further, the FFSA did not identify any case where criteria a and b set in paragraph 27 might diverge. Should such cases arise in practice, we believe that it would be more relevant to require that both criteria be met rather than any one of the two. We recommend that the “or” in paragraph 27 a be replaced by “and”.

Question 10 – Participating features
(a) Do you agree that the measurement of insurance contracts should include participating benefits on an expected present value basis? Why or why not? If not, what do you recommend and why?

(b) Should financial instruments with discretionary participation features be within the scope of the IFRS on insurance contracts, or within the scope of the IASB’s financial instruments standards? Why?

c) Do you agree with the proposed definition of a discretionary participation feature, including the proposed new condition that the investment contracts must participate with insurance contracts in the same pool of assets, company, fund or other entity? Why or why not? If not, what do you recommend and why?

(d) Paragraphs 64 and 65 modify some measurement proposals to make them suitable for financial instruments with discretionary participation features. Do you agree with those modifications? Why or why not? If not, what would you propose and why? Are any other modifications needed for these contracts?

Question 10 a:
The FFSA strongly supports including all cash outflows resulting from participating features on an expected value basis in the measurement of insurance contracts or financial instruments, without limiting the cash flows to those for which a legal or constructive obligation exists. This ensures consistency in the measurement approach, based on expected fulfilment cash flows, between participating and non participating contracts. It also provides more decision-useful information on future cash flows than enforceable cash flows.
With regards to discounting of participating contracts, we understand from discussions with the IASB staff that the overall objective of the Board was to achieve a "market consistent" approach. Market consistent approaches allow for the effects of interactions between assets and liabilities that are the cornerstone of participating contracts. We support this approach.

As noted in our answer to question 15, we ask the Board to address the mismatch resulting from own shares and own debt held in the pool of assets underlying participating contracts, consistently with the proposed treatment for own shares held in the pool of assets underlying unit-linked contracts.

**Question 10 b:**

We agree with the inclusion of financial instruments with discretionary participation features (DPF) within the scope of IFRS 4 Phase II.

It ensures consistent measurement with similar participating features in insurance contracts.

We note that measurement principles and comprehensive guidance have been elaborated within the insurance standard, whereas no such principle exists in the financial instrument standard.

However, as described in our answer to question 12, unbundling requirements lack clarity. We find the contradictory requirements in the ED as well as recent outreach and Insurance Working Group meetings utterly confusing. Indeed, components to be unbundled are those that are not closely related to the insurance component, missing in a financial instrument with DPF. However, the paragraphs addressing the specificities of financial instruments with DPF in the ED do not mention that unbundling requirements are modified compared to those applicable to insurance contracts. The FFSA agrees with the interpretation presented to the Insurance Working Group that unbundling requirements do not apply to financial instruments with discretionary participation features.

**Question 10 c:**

The FFSA did not find any improvement brought by the change to the current definition of discretionary participation features. The FFSA recommends the current definition of DPFs be maintained in the final standard.

**Question 10 d:**

We find the definition of the contract boundary for financial instruments with DPF in paragraph 64 appropriate.

Reference to insurance coverage is irrelevant to these contracts. Basing the contract boundary on the right to receive participation benefits appears reasonable as the criterion supporting the inclusion of financial instruments with DPF in the scope of the insurance standard is the existence of participation features. As a consequence, all foreseeable future premiums are within the boundary of the contract.

Besides, we agree that the residual margin on financial instruments with DPF cannot be released based on the exposure from providing insurance coverage. However, the definition of the driver in paragraph 65 assumes that all assets managed backing such contracts are measured at fair value. This driver may contradict the measurement of a large majority of an insurer’s assets at amortized cost, mandated by the business model under current IFRS 9.

We are confident that the most relevant driver can be identified during field tests on this issue.
Question 11 – Definition and scope

(a) Do you agree with the definition of an insurance contract and related guidance, including the two changes summarised in paragraph BC191? If not, why not?

(b) Do you agree with the scope exclusions in paragraph 4? Why or why not? If not, what do you propose and why?

(c) Do you agree that the contracts currently defined in IFRSs as financial guarantee contracts should be brought within the scope of the IFRS on insurance contracts? Why or why not?

Question 11 a:

The FFSA agrees with the definition of insurance contracts included in appendix A but is concerned with changes made to the application guidance, inspired by US GAAP, that may result in unintended consequences and excessive cost if all contracts currently meeting the definition of an insurance contract in IFRS 4 should be analysed again with respect to this modified definition.

The FFSA understood from the discussions with Board and staff members during outreach meetings and webcasts that the Board’s intention was to keep the existing definition and classification of existing contracts under IFRS 4. The FFSA recommends the Board maintain the application guidance in IFRS 4 unchanged.

Question 11 b:

We agree with the scope exclusions in paragraph 4. We understand that fixed fee contracts that meet the definition of insurance contracts will be scoped in the insurance standard if they correspond to the insurance business, where provision of service is a mere modality of claim payment to compensate for insured events and not the primary purpose of the contract.

Question 11 c:

We acknowledge the Board’s effort to elaborate a principle that applies consistently to all financial guarantee contracts and agree that financial guarantee contracts meeting the definition of insurance contracts are in the scope of IFRS 4 Phase II, such as trade credit insurance.

However, we understand that applying IFRS 4 Phase II may not fit some guarantees issued in relation to other business models. We therefore support an option to elect accounting for financial guarantees under the financial instrument standard.

Question 12 – Unbundling

Do you think it is appropriate to unbundle some components of an insurance contract? Do you agree with the proposed criteria for when this is required? Why or why not? If not, what alternative do you recommend and why?

The FFSA believes that unbundling should not be required, except for the case mentioned in paragraph 8 c of the ED when components are put together without commercial substance. Indeed, unbundling will induce unnecessary costs and complexity for issuers of the financial statements, going through all their contracts and adapting their systems upon transition and producing data for unbundled components at each reporting date, for instance to split acquisition costs. Further, unbundling does not provide users of the financial statements with a clear understanding of the bundle of rights and
obligations created by the contract and is not consistent with a measurement objective of the insurance contract that includes all cash inflows and outflows (refer to our answer to question 2 above). As stated in BC 215, "... the Board’s intention is not to require an exhaustive search for components in every insurance contract. Rather, the point of unbundling those components is to assist users in understanding the different facets of a hybrid contract...". This intention should be reflected in the wording of the ED and result in a limitation of unbundling requirements to the case described in paragraph 8 c of the ED.

As a result, the FFSA is deeply concerned with the Board’s proposal on unbundling.

The FFSA noted the difficulties experienced by the Board in elaborating the unbundling principle prior to the issuance in the ED and believes that further work is needed to clarify the Board’s intention mentioned in BC 215 in a clear and operational wording within the ED. The FFSA heard various interpretations during the outreach meetings and webcasts, proving the need for clarification and examples on this crucial issue. We understand that the Board’s intention was to avoid introducing undue complexity.

The FFSA suggests that the unbundling criteria be based on the way an insurer manages and reports the components of a contract. Components that are managed together would be presented as one contract, providing insight to users on the entity’s business model, whereas components that are managed separately would be unbundled.

Further, if implemented, the proposals in §9 of the ED may result in inconsistencies in the presentation of the financial statements due to the allocation of all charges and fees to the insurance component when unbundling a financial component. For instance, expected fee inflows on future premiums may exceed expected cash outflows related to insurance risk, which would lead to recognizing an asset for the best estimate of the insurance component and a liability for the financial component.

Question 13 – Presentation

(a) Will the proposed summarised margin presentation be useful to users of financial statements? Why or why not? If not, what would you recommend and why?

(b) Do agree that an insurer should present all income and expense arising from insurance contracts in profit or loss? Why or why not? If not, what do you recommend and why?

Question 13 a:

The FFSA disagrees with the Board’s proposal of a summarized margin presentation for the statement of net income. We concur with the Board’s considerations of the significance of volume information for users of financial statements. To us, premiums and claims incurred are crucial to the understanding of the insurance business. This key information cannot be relegated to the notes. Margin for contracts with a significant investment component and volume information for other contracts should be presented with equal prominence on the face of the statement of net income. We acknowledge the conceptual limits and implementation issues of the expanded margin approach once considered by the Board and believe that another alternative should be elaborated. We would be pleased to assist the Board in developing a robust and comprehensive presentation.

Further, the proposed presentation model represents a major change in the way issuers prepare their financial statements and users analyse the performance of an entity. The FFSA urges the Board to leave sufficient lead time before the transition to the new standard so that system changes can be properly designed and implemented and adequate training can be provided to both preparers and users.

Additionally, consistently with our answer to question 8, the FFSA disagrees with the proposed presentation requirements for insurance contracts measured under the premium allocation approach.
As this measurement method is only meant to be a simplification to approximate the results of the standard approach, it should not result in a separate presentation. Further, introducing a separate presentation for these contracts will impair comparability between the different lines of business of a single entity and between different issuers. This separate presentation would also not match the structure of the statement of financial position, which impairs the cohesiveness of the financial statements for users.

We agree with the separate disclosure, on the face of the income statement or in the notes to the financial statements, of experience adjustments and changes in estimates when the liability measurement is based on explicit assumptions (such as mortality/morbidity rates). We draw the Board’s attention to the fact that this distinction cannot be made when measurement is not based on such explicit assumptions. For instance, many actuarial techniques used in the measurement of future cash flows for non-life insurance do not rely on explicit assumptions.

Last, the FFSA would welcome clarifications on the presentation of portfolios in the statement of financial position: paragraph 69 of the ED states “An insurer shall present each portfolio of insurance contracts as a single item within insurance contract assets or insurance contract liabilities”. The FFSA understands that this does not entail a separate presentation of each portfolio on the face of the statement of financial position but a presentation of the net asset or liability position, determined at portfolio level, within one single line item for all insurance contracts in the assets and in the liabilities.

We believe that the Board should clarify the interactions of the proposals on presentation in the current ED and the on-going Financial Statement Presentation project. For instance, precedence of explicit requirements for specific line items in both projects should be defined. Cash flow statement specific issues should also be addressed in the insurance standard, rather than being dealt with under a generic standard.

**Question 13 b:**

The FFSA firmly opposes the immediate recognition of all income and expense arising from insurance contracts in profit or loss.

The proposed approach will not match the underlying business model of insurance contract, based on a medium or long term perspective. Changes in financial variables that do not affect the performance of assets backing the contracts should not result in gains or losses unless realized. The FFSA believes that predictability of cash flows for users of financial statements would be significantly impaired if the impact of all changes in financial variables is recorded in the P&L all through the life of insurance contracts, whereas this impact does not reflect the final result of the portfolio of insurance contracts. The FFSA recommends the Board elaborates further on an OCI alternative that, in our view, allow for a better presentation of the business model and underlying performance.

- Recognition of the impact of changes in discount rates in the separate statement of OCI reduces the undue volatility in the statement of net income. As per the ED, insurance liabilities are recorded at current value in the statement of financial position. However, the use of OCI does not hinder performance reporting deriving from the business model behind short term volatility in the statement of net income.

This alternative is consistent with our repeated requests, expressed in our comment letters to IFRS 9 and to IAS 1. We support the presentation of net income and other comprehensive income in two separate statements. We also support measurement of financial assets at fair market value.
value through OCI similar to the existing available for sale category under IAS 39 that would match changes in insurance liabilities recorded in the separate statement of OCI.

- Remeasurement of the residual margin for changes in variables other than the discount rate:

The residual margin is, in our view, the deferred profit to be released over the coverage and claim-handling period of the insurance contract. The allocation of changes in variables other than the discount rate to the residual margin, provided the margin does not become negative, provides continuity in the treatment of the contract’s performance between initial and subsequent measurement.

The recognition of immediate gains or losses for each interim change in assumptions of variables other than the discount rate conveys information that is inconsistent with the continuous release of the initial residual margin. For instance, reporting a loss in a given reporting period, whereas larger amounts of profit margin are still to be released in subsequent periods does not reflect faithfully the overall contract’s profitability. For similar contracts, diverging assumptions made at initial recognition would also lead to significant diversity in subsequent reporting periods.

To us, this alternative should encompass all components of a contract taken as a whole, including options and guarantees.

Further, the proposed approach may generate accounting mismatches. For instance, it would be the case if equity securities are measured at fair value through OCI under current IFRS 9, whereas changes in contracts liabilities in the scope of the ED are to be recorded through the statement of net income under the ED’s proposals. The FFSA noted the Board’s argument that an issuer can opt not to classify an equity security at fair value through OCI so as to reduce this accounting mismatch. However, in cases where using this option is appropriate to reflect the company’s business model under IFRS 9, insurers should not be deprived from that election because the interactions with another standard generate an accounting mismatch.

**Question 14 – Disclosures**

(a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?

(b) Do you think the proposed disclosure requirements will meet the proposed objective? Why or why not?

(c) Are there any disclosures that have not been proposed that would be useful (or some proposed that are not)? If so, please describe those disclosures and explain why they would or would not be useful.

**Question 14 a:**

The FFSA agrees with the proposed disclosure principle in paragraph 79 and wonders whether the detailed list of requirements in paragraphs 85 to 97 meets the Board’s intention that this principle “eliminates the need for detailed and prescriptive requirements to meet the specific information needs for the various types of insurance contracts” as expressed in BC 242.
Question 14 b:
The FFSA acknowledges that the proposed disclosure requirements may meet the proposed objective. However, the FFSA is concerned with the ever increasing list of disclosure requirements and would prefer that the final standard retains the overall objective discussed above, with a list of disclosure in the BC that was considered useful by the Board as long as they meet the information needs for the types of insurance contracts carried by the issuer.

In this respect, the FFSA notes the Board’s consideration in paragraph 81 on the level of aggregation and believes this should be extended to the principle underlying disclosures. Information would then be provided “as long as they do not obscure useful information by either the large amount of insignificant details or the aggregation of items that have different characteristics”.

Further, as mentioned in our answer to question 5c, the disclosure of the confidence level equivalent when CTE or cost of capital methods are used is not adequate to ensure comparability as insurers would each provide different confidence levels to which their risk margin corresponds and may prove difficult to analyze for users.

Question 14 c:
The FFSA believes that paragraph 80 provides for any disclosure that is not included in the Board’s list of requirements if additional information is needed to meet the objective of disclosure. This paragraph makes the list of disclosure requirements redundant and ensures that all relevant information is required.

Question 15 – Unit-linked contracts
Do you agree with the proposals on unit-linked contracts? Why or why not? If not what do you recommend and why?

We approve separate presentation of assets, liabilities as well as income and expenses related to unit-linked contracts in the financial statements. Disaggregation from other contracts under IFRS 4 Phase II provides users with useful information on this specific line of business.

We ask the Board to address the mismatch resulting from own debt held in the pool of assets underlying unit-linked as it did for own shares and that both be extended to pool of assets underlying participating contracts.

Question 16 – Reinsurance
(a) Do you support an expected loss model for reinsurance assets? Why or why not? If not, what do you recommend and why?
(b) Do you have any other comments on the reinsurance proposals?

Question 16 a:
The FFSA supports the proposal to apply an expected loss model for reinsurance assets.
Question 16 b:
To us, consistent principles should apply to the measurement of direct / assumed business and the portion ceded to reinsurers. Overall, gross liabilities combined with reinsurance assets should reflect the net risk remaining with the cedant. Financial statements should depict the risk exposure net of the relief provided by reinsurance, thus providing users with insight on the entities’ activities and perspectives.

We advise the Board to review the ED’s proposals to ensure they meet this objective.

Question 17 – Transition and effective date

(a) Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?
(b) If the Board were to adopt the composite margin approach favoured by the FASB, would you agree with the FASB’s tentative decision on transition (see the appendix to the Basis for Conclusions)?
(c) Is it necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9? Why or why not?
(d) Please provide an estimate of how long insurers would require to adopt the proposed requirements.

Question 17 a:
The FFSA strongly disagrees with the proposed transition requirements and urges the Board to opt for the staff’s proposal complemented with appropriate disclosures.

The FFSA noted several critical issues that should prevent the Board from bringing the proposed transition methodology forward to the final standard:

- Inconsistency with an approach where revenue is recognized when the entity performs its obligations under the contract, as insurance coverage would still be provided after transition on a significant number of contracts starting prior to this date. The following examples evidence this inconsistency:
  - a contract entered into one day before transition would not generate any revenue or gain in profit or loss, whereas a similar contract entered into on the day following transition would generate such revenues;
  - an entity starting to run-off shortly before transition date would not recognize any revenue whereas it may still perform under the existing contracts after transition.

- Impaired usefulness of the information provided to the users of the financial statements as long as contracts entered into prior to transition represent a significant portion of the portfolio:
  - profit and loss would not faithfully represent the performance of the entity as large amounts of gains on contracts existing at transition date are never to be reported in the P&L;
  - artificial distortion of key ratios such as return on equity that would impose a competitive disadvantage on insurers on capital markets, through reduced earnings per share that would impair comparability between insurers and other sectors and between insurance companies, depending on the mix of short and long term contracts.
The FFSA agrees with the Board's analysis of the practical difficulties and risk of hindsight of a full retrospective application of the insurance contract standard, pursuant to IAS 8, although retrospective application is conceptually stronger.

Because the current project on insurance contracts brings deep changes to the way insurance contracts are reported, the FFSA is convinced that transition requirements deserve thoughtful treatment and may need dispensatory rules. In this respect, the FFSA reminds that such dispensatory rules were adopted in IFRS 1 for goodwills. The amortized cost recognized prior to transition was frozen, whereas this amount did not carry any economic substance.

Accordingly, the FFSA supports revised transition requirements that would allow for a retrospective application where practicable at a reasonable cost - acknowledging that it would probably imply the use of hindsight, and provide an alternative treatment where retrospective application is not practicable.

This alternative treatment could be elaborated on the basis of the proposal put forward by the staff, where the residual margin is assessed as the difference between the value of insurance contracts recorded prior to transition (reserves net of any deferred acquisition costs and related intangible assets) and the current value of fulfillment cash flows evaluated upon transition. This residual margin would be clearly identified as a "transition margin" and reported separately from the residual margin calculated on new business. Appropriate disclosures can be developed to highlight the changes of this transition margin and provide clear and useful information to users of the financial statements, therefore remediating to comparability issues raised by the Board.

The FFSA is ready to assist the Board in considering other alternatives. Comprehensive field testing would then be needed to ensure that the final transition requirements can be implemented by insurers at a reasonable cost while providing adequate information for users of financial statements.

**Question 17 b:**

No comments on this issue

**Question 17 c:**

Consistently with our answer to the exposure draft "Financial Instruments: Classification and Measurement", the FFSA wishes to highlight that aligning the effective date of the future standard for insurance contracts and of IFRS 9 is of the outmost importance. In this respect, the FFSA supports the Board's intention to mandate concomitant transition to the two standards, and potentially delay transition to IFRS 9 later than 1 January 2013 if the new standard on insurance contracts has a mandatory effective date at a later stage.

Asset-liability management is essential to the business model of insurance activities. The FFSA advocates for measurement approaches developed for financial instruments as well as for insurance contract that take into account this intimate relationship.

Further, transition in stages to these standards would be confusing to users of financial statements, in particular if an insurer reclassifies financial instruments, and burdensome for preparers of the financial statements.

However, if the effective dates or early application of IFRS 9 and IFRS 4 Phase II were to diverge, insurers should not be bound by prior classification of financial assets under IFRS 9. Reclassification to all categories – amortized cost, fair value through P&L and fair value through OCI, should be allowed upon transition to IFRS 4 Phase II. We also believe that the transitional provisions should be reviewed in this regard, for example in relation to relief from providing comparatives.
Question 17 d:
We are not currently in a position to provide an assessment of the time needed to adopt the proposed requirements. In our view, these requirements need significant changes before the final standard is issued. Extensive field testing is also needed to analyse the impact of the future standard in practice. Our assessment will be refined based on the time needed to make changes to the ED and on field test results.

The usual two year timeframe left for transition to new standards will not be sufficient to face the operational challenges of the implementation of such changes and to educate both internally and externally on these complex requirements.

Question 18 – Other comments
Do you have any other comments on the proposals in the exposure draft?

Our general comments are presented in the cover letter and in our answer to question 1. Detailed answers to the questions in the ED are presented in questions 2 and following.

We would also like to draw the Board’s attention to the following issues:

ACCOUNTING MISMATCH WITH ASSETS CLASSIFIED PURSUANT TO OUR BUSINESS MODEL:
FFSA members are deeply concerned regarding the interaction of the proposals in the ED and IFRS 9 Financial Instruments. Short term volatility does not portray our medium to long term business model. Our business model mandates classification of significant portion of our portfolio at amortized cost or fair value through OCI under current IFRS 9.

In particular, concerns exist regarding potential accounting mismatches that insurers may encounter due to the different measurement models for financial assets (IFRS 9) and insurance liabilities. We notably identified the following cases of mismatches:

- Financial assets carried at amortized cost under IFRS 9 pursuant to our business model, since the fair value option that could eliminate this mismatch is inconsistent with our business model.

- Equity securities carried at fair value through OCI, under the OCI option in IFRS 9. The use of this option should not be precluded for insurers because of these mismatches:
  - changes in the fair value of these securities would be recorded through OCI, whereas changes in insurance liabilities are to be recorded through the statement of net income under the ED’s proposal.
  - a similar mismatch could arise when equity securities at fair value through OCI are part of a portfolio subject to participation features. In that case, remeasurement on financial assets would be recognised in other comprehensive income and the impact on the liability related to the participation feature would be recognised in profit or loss.

The ED proposes requirements for the measurement of insurance contracts in isolation: it does not consider the inter-relationship of financial assets and insurance liabilities that forms a key component of many insurers’ business models.
COMPREHENSIVE FIELD TESTING:
The FFSA believes that the organization of comprehensive field testing is essential to ensure that the final standard provides decision-useful information for users of financial statements consistently with the insurance business model and to make sure that operational challenges of the proposed measurement model are adequately addressed.

Field tests should especially address the following issues:

- Alternative measurement models.
- Level of aggregation to be used in the calculation of the residual margin.
- Driver to release the residual margin on financial instruments with discretionary participation features.
- Contract boundaries.
- Unbundling.
- Interactions of all components in the presentation of the financial statements over time.
- Usefulness of the measurement and presentation requirements for users of financial statements.
- Transition approach and assessment of time needed to implement the future standard.

RECOGNITION DATE:
We agree that an insurance contract liability or asset should be recognized when the insurer becomes a party to the contract as proposed in paragraphs 13 and 14. We understand that this occurs when both parties reach a common agreement on the contract terms.

Further, all changes in estimates between the initial date of recognition and the start of the coverage period should be recognized as an adjustment to the residual margin rather than in net income.

Question 19 – Benefits and costs
Do you agree with the Board’s assessment of the benefits and costs of the proposed accounting for insurance contracts? Why or why not? If feasible, please estimate the benefits and costs associated with the proposals.

As mentioned in our answers to various questions above, the ED is likely to bring major changes in the way insurers prepare and present their financial statements and improves current reporting. Users will also have to follow adequate training to these new requirements. We expect that these changes will induce significant costs for the industry. In spite of improvements brought to the 2007 DP, we are not persuaded at this stage that this new model outweigh these costs.

We advise the Board to elaborate further on the alternatives described above and reshape the considered standard so that benefits compensate for costs on all aspects of the proposal.