Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board – NASB)

Question 1 – Scope

(a) The Exposure Draft proposes that the IFRS would apply to insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds, except for specified contracts covered by other IFRSs. The IFRS would not apply to accounting by policyholders (paragraphs 2-4 of the draft IFRS and paragraphs BC40-BC51 of the Basis for Conclusions).

The Exposure Draft proposes that the IFRS would not apply to other assets and liabilities of an entity that issues insurance contracts. In particular, it would not apply to:

(i) assets held to back insurance contracts (paragraphs BC9 and BC109-BC114). These assets are covered by existing IFRSs, for example, IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 40 *Investment Property*.

(ii) financial instruments that are not insurance contracts but are issued by an entity that also issues insurance contracts (paragraphs BC115-BC117).

Is this scope appropriate? If not, what changes would you suggest, and why?

(b) The Exposure Draft proposes that weather derivatives should be brought within the scope of IAS 39 unless they meet the proposed definition of an insurance contract (paragraph C3 of Appendix C of the draft IFRS). Would this be appropriate? If not, why not?

NASB response

(a) We support the proposal in ED5 that the IFRS on insurance contracts should apply to insurance contracts, rather than entities. This leads to consistent accounting regardless of the type of entity issuing the contract. We also agree that all other IFRSs, including IAS 39, should apply to insurance companies as they apply to all other entities.

We agree with the proposal that the IFRS on insurance contracts should not apply to other assets and liabilities of an entity that issues insurance contracts. No separate category should be introduced for financial assets held to back insurance liabilities, nor should any further exemptions be provided to the held-to maturity category in IAS 39. The latter means that uncertainty about the maturity of liabilities because of uncertainties about the timing of insured events, possible prepayments, surrenders and lapses of insurance policies, are not valid reasons to escape the tainting rules for the held-to maturity category under IAS 39.

Applying the fair value measurement rules under IAS 39 to financial assets when an insurer either cannot or chooses not to measure its insurance liabilities at fair value, will lead to volatility, either in income or in equity. In Norway, the non-life insurance companies are already required to measure financial assets classified as current assets at fair value, whereas the insurance liabilities are not measured at fair value. We also note that this is the case for insurers issuing US Gaap figures measuring financial assets at fair value in accordance with FAS 115.

The insurer has the opportunity to accommodate the mismatch problem by discounting their insurance liabilities as such an improvement of accounting principle is allowed under ED 5. However, most non-life companies don't discount under present local Gaap and life-insurance companies don`t use the current interest rate in their discounting of liabilities. Consequently, discounting the insurance liabilities would present practical difficulties and implementation costs and may not reflect the approach that the Board decides upon in phase II. We agree that this subject should be further developed in phase II and not a requirement under phase I.

As for insurance contracts containing a discretionary participation feature, typically found within life-insurance, the mismatch issue may be accommodated by the IFRS to some extent by allowing insurers to account for future appropriations to policyholders as liabilities or to be split between equity and liabilites. We comment further on this in our response to Question 9.

We agree with the scoping out of investment contracts from ED 5 as they should be accounted for under IAS 39.

(b) We agree that weather derivatives should be included in the scope of IAS 39 unless such contracts meet the definition of an insurance contract.

<u>Question 2 – Definition of an Insurance Contract</u>

The draft IFRS defines an insurance contract as a 'contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary' (Appendices A and B of the draft IFRS, paragraphs BC10-BC39 of the Basis for Conclusions and IG Example 1 in the draft Implementation Guidance).

Is this definition, with the related guidance in Appendix B of the draft IFRS and IG Example 1, appropriate? If not, what changes would you suggest, and why?

<u>NASB response</u>

Generally we find that the definition of an insurance as set out in ED 5 with related guidance in appendix A and B is acceptable. However, we are concerned that some of the guidance in appendix B apply the definition to broadly. The combined effect of an event needing to be merely "plausible" and a resulting loss being "more than trivial" may result in many contracts with insurance risk qualifying as an insurance contract and falling under the IFRS. There is a risk that the current definition might lead to construction of contracts with little insurance risk meeting the definition.

As to the definition of uncertain future event in appendix B, we do not agree that uncertainty in the form of how much an insurer will need to pay if an insured event occur, on its own, is an uncertain future event as that term is used in the definition of an insurance contract

Question 3 – Embedded derivatives

(a) IAS 39 *Financial Instruments: Recognition and Measurement* requires an entity to separate some embedded derivatives from their host contract, measure them at fair value and include changes in their fair value in profit or loss. This requirement would continue to apply to a derivative embedded in an insurance contract, unless the embedded derivative:

(i) meets the definition of an insurance contract within the scope of the draft IFRS; or

(ii) is an option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate).

However, an insurer would still be required to separate, and measure at fair value:

(i) a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in an equity or commodity price or index; and

(ii) an option to surrender a financial instrument that is not an insurance contract.

(paragraphs 5 and 6 of the draft IFRS, paragraphs BC37 and BC118-BC123 of the Basis for Conclusions and IG Example 2 in the draft Implementation Guidance)

Are the proposed exemptions from the requirements in IAS 39 for some embedded derivatives appropriate? If not, what changes should be made, and why?

(b) Among the embedded derivatives excluded by this approach from the scope of IAS 39 are items that transfer significant insurance risk but that many regard as predominantly financial (such as the guaranteed life-contingent annuity options and guaranteed minimum death benefits described in paragraph BC123 of the Basis for Conclusions). Is it appropriate to exempt these embedded derivatives from fair value measurement in phase I of this project? If not, why not? How would you define the embedded derivatives that should be subject to fair value measurement in phase I?

(c) The draft IFRS proposes specific disclosures about the embedded derivatives described in question 3(b) (paragraph 29(e) of the draft IFRS and paragraphs IG54-IG58 of the draft Implementation Guidance). Are these proposed disclosures adequate? If not, what changes would you suggest, and why?

(d) Should any other embedded derivatives be exempted from the requirements in IAS 39? If so, which ones and why?

<u>NASB response</u>

a) In general we support the view that embedded derivatives should be separated from host insurance contracts in the same way as is required under IAS 39 for other types of host contact. Derivatives that are closely linked to the host contract or that meet the definition of insurance contract need not be separated.

As for insurance derivatives embedded in a host investment contract that is not closely related to the host contract, we believe that either separation should be required or the loss recognition test should be strengthened to ensure that the amount of the liability includes both the amount of the liability that would otherwise be recognised under IAS 39 for the investment contract and an appropriate amount to cover the liability for the insurance component of the contract.

Also we recommend ED 5 to clarify that separation of a policyholder's option to surrender an insurance contract for a fixed amount also is not required where the surrender value is determined by the retrospective value of the insurance contract, i.e. as the premium with the addition of interest, deduction of cost, risk premiums and surrender charges.

b) See above

c) We agree with the proposals for the disclosure requirement

d) We see no other embedded derivatives that should be exempted from the requirements in IAS 39

<u>Question 4 – Temporary exclusion from criteria in IAS 8</u>

(a) Paragraphs 5 and 6 of [the May 2002 Exposure Draft of improvements to] IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* specify criteria for an entity to use in developing an accounting policy for an item if no IFRS applies specifically to that item. However, for accounting periods beginning before 1 January 2007, the proposals in the draft IFRS on insurance contracts would exempt an insurer from applying those criteria to most aspects of its existing accounting policies for:

(i) insurance contracts (including reinsurance contracts) that it issues; and

(ii) reinsurance contracts that it holds.

(paragraph 9 of the draft IFRS and paragraphs BC52-BC58 of the Basis for Conclusions).

Is it appropriate to grant this exemption from the criteria in paragraphs 5 and 6 of [draft] IAS 8? If not, what changes would you suggest and why?

(b) Despite the temporary exemption from the criteria in [draft] IAS 8, the proposals in paragraphs 10-13 of the draft IFRS would:

(i) eliminate catastrophe and equalisation provisions.

(ii) require a loss recognition test if no such test exists under an insurer's existing accounting policies.

(iii) require an insurer to keep insurance liabilities in its balance sheet until they are discharged or cancelled, or expire, and to report insurance liabilities without offsetting them against related reinsurance assets (paragraphs 10-13 of the draft IFRS and paragraphs BC58-BC75 of the Basis for Conclusions).

Are these proposals appropriate? If not, what changes would you propose, and why?

NASB response

a) We recognize the need for exemption from criteria in IAS 8 given the current status of the development of a complete standard under phase II of the project on insurance contracts.

   We do not agree with the use of a sunset clause. In our opinion the exemptions in ED 5 should be valid throughout the whole of phase I rather than stating a specific date. However, we recognise the need for a complete high qualitative standard to be developed as soon as possible and encourage the Board to put the necessary effort and commitment into finalising phase II in time for implementation to take place 01.01.2007.

b) In general we agree with the proposals. However some clarifications should be made. As regards paragraph 10(a) we assume the permission to keep catastrophe reserves and equalisation provisions for existing contracts should not cover renewals of contracts and consequently we suggest that the last four words "under future insurance contracts" are deleted to avoid confusion.

   We believe that further clarification should be made both to requirements needed in order to be able to apply local loss recognition tests and on how to apply IAS 37. We believe the test should at least include the fair value of any embedded derivatives that are not separated in phase 1. A high-level analysis ensuring that intrinsic value and deposit features not separated are at least covered by the insurance liability is sufficient. More guidance should also include the use of discount rates as well as the use of book of contracts vs contract-by-contract.

Question 5 – Changes in accounting policies

The draft IFRS:

(a) **proposes requirements that an insurer must satisfy if it changes its accounting policies for insurance contracts (paragraphs 14-17 of the draft IFRS and paragraphs BC76-BC88 of the Basis for Conclusions).**

(b) **proposes that, when an insurer changes its accounting policies for insurance liabilities, it can reclassify some or all financial assets into the category of financial assets that are measured at fair value, with changes in fair value recognised in profit or loss (paragraph 35 of the draft IFRS).**

Are these proposals appropriate? If not, what changes would you propose and why?

NASB response

We agree with the proposals in a) and b). However, we do in principle not support the application of non-uniform accounting policies for insurance liabilities for the various subsidiaries within a group but acknowledge the need for such a solution in an interim period in order to avoid costly system changes that may no longer be needed in phase II.

Question 6 – Unbundling

The draft IFRS proposes that an insurer should unbundle (ie account separately for) deposit components of some insurance contracts, to avoid the omission of assets and liabilities from its balance sheet (paragraphs 7 and 8 of the draft IFRS, paragraphs BC30-BC37 of the Basis for Conclusions and paragraphs IG5 and IG6 of the proposed Implementation Guidance).

(a) Is unbundling appropriate and feasible in these cases? If not, what changes would you propose and why?

(b) Should unbundling be required in any other cases? If so, when and why?

(c) Is it clear when unbundling would be required? If not, what changes should be made to the description of the criteria?

NASB response

(a) We agree with the proposal for phase I but encourage further research into unbundling as part of the development of phase II. However, we suggest that the IFRS should further clarify to which contracts unbundling applies. We believe the criteria for unbundling should be changed from "the cash flows from the insurance component do not affect the cash flows from the deposit component" to "the cash flows of the insurance component and the investment component do not interact."

(b) We have not identified other cases where unbundling should be required.

(c) See comments under a) above.

Question 7 – Reinsurance

The proposals in the draft IFRS would limit reporting anomalies when an insurer buys reinsurance (paragraphs 18 and 19 of the draft IFRS and paragraphs BC89-BC92 of the Basis for Conclusions).

Are these proposals appropriate? Should any changes be made to these proposals? If so, what changes and why?

NASB response

We do not believe that Phase I should introduce principles for recognising gains and losses on reinsurance as long as such principles are not established for direct insurance contracts. This would allow the accounting for reinsurance to develop consistently with the accounting for direct insurance. In our opinion phase I should only seek to eliminate practices of accounting for reinsurance that is clearly unacceptable. This may be the case for financial reinsurance when the transfer of insurance risk is not significant. We believe this to a large extent will be achieved by applying the definition of insurance contracts and the unbundling requirements.

Question 8 – Insurance contracts acquired in a business combination

IAS 22 *Business Combinations* requires an entity to measure at fair value assets acquired and liabilities assumed in a business combination and ED 3 *Business Combinations* proposes to continue that long-standing requirement. The proposals in this draft IFRS would not exclude insurance liabilities and insurance assets (and related reinsurance) from that requirement. However, they would permit, but not require, an expanded presentation that splits the fair value of acquired insurance contracts into two components:

(a) a liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues; and

(b) an intangible asset, representing the fair value of the contractual rights and obligations acquired, to the extent that the liability does not reflect that fair value. This intangible asset would be excluded from the scope of IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*. Its subsequent measurement would need to be consistent with the measurement of the related insurance liability. However, IAS 36 and IAS 38 would apply to customer lists and customer relationships reflecting the expectation of renewals and repeat business that are not part of the contractual rights and obligations acquired.

The expanded presentation would also be available for a block of insurance contracts acquired in a portfolio transfer (paragraphs 20-23 of the draft IFRS and paragraphs BC93-BC101 of the Basis for Conclusions).

Are these proposals appropriate? If not, what changes would you suggest and why?

NASB response

We support the proposal that require insurers to measure assets acquired and liabilities assumed in a business combination according to IAS 22 at fair value and the proposal to permit an insurer, during phase I, to use an expanded presentation as described. The IFRS should clarify that the carrying amount of the separated asset should not exceed the present value of the future profits that the entity expects to generate from contracts in force at the date of acquisition. It should not include the value of expected renewals or new business. The loss recognition test should be clarified to ensure that the separated amounts are deducted from the liabilities before applying the test.

Question 9 – Discretionary participation features

The proposals address limited aspects of discretionary participation features contained in insurance contracts or financial instruments (paragraphs 24 and 25 of the draft IFRS and paragraphs BC102-BC108 of the Basis for Conclusions). The Board intends to address these features in more depth in phase II of this project.

Are these proposals appropriate? If not, what changes would you suggest for phase I of this project and why?

NASB response

We acknowledge the challenges related to the accounting for discretionary participation features and support the proposal to address the accounting for such contracts in phase II. We agree that an intermediate category, neither liability nor equity, should not be permitted for the unallocated surpluses associated with discretionary participating features in insurance contracts. We encourage the Board to define the term "discretionary" and to clarify in the IFRS that such discretionary features should be regarded as constructive obligations if market participants make the payment of the benefits reasonably certain. Consequently, we believe that where unrealised gains and losses resulting from carrying assets at fair value relate to participating contracts with discretionary features, during phase I they should be regarded as constructive obligations and not as equity. The Board should consider referring in the standard to the requirements in IAS 32 to determine whether a feature is truly "discretionary". For countries where the policyholders are legally eligible to participate in the insurer's profit, IAS 32 would account for such a right as a liability. We do not believe it is appropriate that an amount that would be classified as a liability under IAS 32 should be classified as equity for phase I.

Paragraph 25 of ED 5 states that paragraph 24 applies also to a financial instrument that contains participation features. In our opinion ED 5 should not provide exemptions from the requirements in IAS 32 and 39 for financial instruments whose insurance risk is not significant.

Question 10 – Disclosure of the fair value of insurance assets and insurance liabilities

The proposals would require an insurer to disclose the fair value of its insurance assets and insurance liabilities from 31 December 2006 (paragraphs 30 and 33 of the draft IFRS, paragraphs BC138-BC140 of the Basis for Conclusions and paragraphs IG60 and IG61 of the draft Implementation Guidance).

Is it appropriate to require this disclosure? If so, when should it be required for the first time? If not, what changes would you suggest and why

NASB response

We believe that until the Board has decided how the fair value of insurance contracts should be calculated, it is not appropriate to require disclosure of fair value from 2006. At present there is a variety of views as to which methods and assumptions should be used to arrive at fair value. As long as the methods for calculating fair value has not been determined the requirement may only lead to unreliable information that is not comparable. Also, the insurers are at risk of having to make costly system changes that would have to change once the Board determines how fair value should be calculated. Instead of setting a deadline in phase I, once guidance on fair value has been developed, the standard should be amended to incorporate that guidance and to require fair value disclosure allowing for reasonable time to implement.

Question 11 –Other disclosures

(a) The Exposure Draft proposes requirements for disclosures about the amounts in the insurer's financial statements that arise from insurance contracts and the estimated amount, timing and uncertainty of future cash flows from insurance contracts (paragraphs 26-29 of the draft IFRS, paragraphs BC124-BC137 and BC141 of the Basis for Conclusions and paragraphs IG7-IG59 of the draft Implementation Guidance).

Should any of these proposals be amended or deleted? Should any further disclosures be required? Please give reasons for any changes you suggest.

To a large extent, the proposed disclosures are applications of existing requirements in IFRSs, or relatively straightforward analogies with existing IFRS requirements. If you propose changes to the disclosures proposed for insurance contracts, please explain what specific attributes of insurance contracts justify differences from similar disclosures that IFRSs already require for other items.

(b) The proposed disclosures are framed as high level requirements, supplemented by Implementation Guidance that explains how an insurer might satisfy the high level requirements.

Is this approach appropriate? If not, what changes would you suggest, and why?

(c) As a transitional relief, an insurer would not need to disclose information about claims development that occurred earlier than five years before the end of the first financial year in which it applies the proposed IFRS (paragraphs 34, BC134 and BC135).

Should any changes be made to this transitional relief? If so, what changes and why?

<u>NASB response</u>

a) b) In general we support the other disclosures proposed in ED 5. The wording of the paragraphs in the exposure draft itself is broad and will allow for some flexibility in how to satisfy the requirements. The Implementation Guidance gives more details into how the requirements can be satisfied. However, it is important that the guidance isn't interpreted in a way that requires a mass of detailed information. The degree of qualitative versus quantitative information as well as the level of aggregation of quantitative information must be suited to the circumstances. The Implementation Guidance should clarify that it displays only one possible disclosure format and that the entity should tailor the available information in a format suitable to the circumstances.

c) We agree with the suggested transitional relief.

<u>Question 12 – Financial Guarantees</u>

The Exposure Draft proposes that the transferor of a non-financial asset or liability should apply IAS 39 *Financial Instruments: Recognition and Measurement* to a financial guarantee that it gives to the transferee in connection with the transfer (paragraphs 4(e) of the draft IFRS, C5 of Appendix C of the draft IFRS and BC41-BC46 of the Basis for Conclusions). IAS 39 already applies to a financial guarantee given in connection with the transfer of financial assets or liabilities.

Is it appropriate that IAS 39 should apply to a financial guarantee given in connection with the transfer of non-financial assets or liabilities? If not, what changes should be made and why?

NASB response

We agree with the proposal that IAS 39 should apply to a financial guarantee given in connection with the transfer of non-financial assts and liabilities.

Question 13 – Other comments

Do you have any other Comments on the Exposure Draft and Implementation Guidance?

NASB response

We suggest that like IAS 39, restatement of comparable figures for 2004 should not be required when implementing IFRS from 2005. Rather a reconciliation between 31 December 2004 and 1 January 2005 should be sufficient.