CL 121

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Board
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Comments on ED 5 Insurance Contracts

Dear Mr. Clark

We would like to take the opportunity to comment on the questionnaire on ED 5.

The developments under IFRS are highly relevant to Swiss Life, especially with regard to the insurance business. We therefore appreciate the initiative of the IASB to develop a standard for insurance contracts.

A major concern of the insurance industry is the mismatch between assets and liabilities under IFRS. Swiss Life has already adopted IFRS/IAS with US GAAP for the insurance part. However, we support the general concerns of the industry and would welcome some relaxation regarding the application of IAS 39 in order to improve the comparability of the valuation of assets and liabilities. We therefore support the proposals to achieve this aim set out in the comment letters of the Swiss Insurance Association (SIA) and the European Insurance CFO Forum.

As phase I of the IASB Insurance Project is an interim step towards a comprehensive standard, we believe that emphasis should be placed on transparency and practicability without requiring significant system changes which will be obsolete in phase II

Whilst the implementation guidance seems helpful, our concern is that there is considerable room for interpretation left with regard to the definition of insurance contracts and also with regard to the required disclosures. We acknowledge that IFRS is a principle-based framework. However, we would appreciate if further clarification was added in order to enhance transparency and consistency within the insurance industry. The aim to enhance transparency with the extensive disclosure requirements might not be achieved with this high level of detail required.

With regard to the fair disclosure of insurance assets and liabilities which is intended to be introduced in phase I. we are concerned that not enough time will be available to test and validate the fair values once a consistent concept for the valuation of insurance assets and liabilities is determined by the IASB.

We doubt if it is useful to introduce a ‘sunset clause’ concerning the exemption from the application of the IFRS hierarchy (IAS 8 paragraphs 5 and 6) as this creates unnecessary uncertainty with regard to the accounting treatment for dates after 1 January 2007. However, we interpret the ‘sunset clause’ as a strong commitment of the IASB to develop phase II which we strongly support since phase I is only acceptable as a short-term solution.

Yours sincerely
Swiss Life/Rentenanstalt

Bruno Pfister
Chief Financial Officer

Michael Koller
Chief Risk Officer

Attachment:

Comments

Response to ED 5 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 7)
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? 4/not, why not?

(a)
(i) We propose to introduce a new category "assets held to back insurance liabilities" in order to reduce the mismatch between assets and liabilities. This category would be measured at amortized cost without the "held-to-matruity"-restriction.

(ii) Is appropriate. Also with regard to comparability with bank products.

(b) Is appropriate.

Question 2 – Definition of an Insurance Contract

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?

Definition is appropriate. The examples in the implementation guidance are helpful. With regard to "pure endowments", these contracts do not seem to fulfill the definition of insurance contracts under ED 5 (lack of adverse event). However, there is insurance risk involved in terms of mortality risk.

It would be helpful if the term "significant" was specified in more detail (para. BC 24). The same applies to the term "net cash flows" (para. B21.)

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?

Is appropriate.

<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 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?

(a) The exemption rule of IAS 8 is appropriate. However, it seems odd that it only applies until 1.1.2007. Unnecessary uncertainty is created by this limit. It would be reasonable to have an exemption rule until Phase II is implemented.

(b) Is appropriate.

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?

Is appropriate.

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?

(a) Is appropriate.
(b) Feasibility should be paramount in Phase I as it is only an interim step to Phase II If “unbundling” is required for a lot of contracts, this could have significant system implications which are only relevant to Phase I but not to Phase II.
(c) The description of the criterion when to unbundle “if the cash flows from the insurance component do not affect the cash flows from the deposit component” seems odd. It would seem intuitive that the components do not affect each other instead of stipulating a one-sided dependency.

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?

The treatment of reinsurance is often based on the respective treatment of the direct insurer. It could lead to inconsistency to stipulate an accounting treatment for the reinsurer but not for the direct insurer.

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 - BC01 of the Basis for Conclusions).
Are these proposals appropriate? If not, what changes would you suggest and why?

Is appropriate.

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?

More clarification is needed with regard to the treatment of investment contracts with discretionary participation features whether they are generally exempt from IAS 39 and if deposit accounting should be applied.

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?

The determination of a fair value of an insurance contract is still subject to discussion. It is therefore not appropriate to stipulate disclosure of fair values of insurance contracts as long as significant issues have not been resolved. Transparency is not enhanced if each enterprise uses its own definition of fair values of insurance contracts. The same applies to comparability (one of the principles of the IASB Framework).
It would make sense to disclose embedded values or similar calculations (including information about assumptions and methods) during Phase I The disclosure could be within the financial statements or in the MD&A (or similar sections).

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?

Is appropriate. However, there is room for interpretation what is acceptable and what is not.

Question 12 - Financial Guarantees

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?

Is appropriate.

<u>Question 13 - Other comments</u>

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

None.