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30 October, 2003

Mr. Peter Clark
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International Accounting Standards Board
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E-mail: commentletters@iasb.org.uk

Dear Mr. Clark,

Re: **Proposed IFRS, ED 5 Insurance Contracts**

We respond to your invitation to comment on the questions raised, on behalf of the Institute of Certified Public Accountants in Israel.

Generally, we believe that the main principles underlying the proposed IFRS are appropriate.

Our comments to the specific questions set forth in the ED are attached herewith.

Sincerely yours,

Adir Inbar, CPA (Isr.)
Chair, Professional Council

Arnon Ratzkovsky, CPA (Isr.)
Chair, Accounting Principles &
Financial reporting Committee



ATTACHMENT

30 October, 2003

Comments on questions set forth in ED5

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 whether 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?

Comment

ED 5 does not address financial assets held by insurance companies to back insurance contracts. This is done by IAS 39 (Financial instruments – recognition and measurement). However, the basis for conclusions does refer to investments (par. BC110).



The IASB decided not to relax criteria in IAS 39 for classifying financial assets as held-to-maturity. The board noted that an insurance company may be able to classify some of its financial assets as held-to-maturity if, in addition to meeting the other conditions set out in IAS 39, it concludes that an unexpected increase in lapses or claims would not compel it to sell those assets (except in a disaster scenario). For example, after examining its circumstances carefully, an insurer might conclude that it would not be compelled to sell, say, specified assets representing 80 percent of the fixed-maturity assets backing a book of insurance liabilities.

The IASB also noted that the mismatch between assets valued at fair value and liabilities valued under another basis has existed for some years in US GAAP, which requires insurance companies to account for their financial assets in broadly the same way as IAS 39.

An example of this mismatch is bonds held by Israeli life assurance companies. Part of these bonds may have to be classified as available for sale (and therefore valued at fair value) in accordance with the strict criteria of IAS 39. The corresponding liabilities would, in Phase I, not be valued at fair value. We accept the current guidance but suggest this mismatch could be avoided if the criteria for classifying an asset as held to maturity were loosened until Phase II.

Question 2 – Definition of 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?

Comment

Acceptable. However some quantitative criteria prescribing how to measure significant insurance risk or some benchmarks may be helpful.

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:



- (a) meets the definition of an insurance contract within the scope of the draft IFRS; or
- (b) 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 no, 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?

Comment

Embedded derivatives are an inherent part of many insurance contracts. It is difficult to separate and identify all these embedded derivatives. We consider the IT solutions required to properly apply the terms of IAS 39 are not yet widely available. In any case, in Phase II, when liabilities will be included at fair value, there will be no added benefit to valuing the embedded derivatives because the total liabilities (including the derivatives) will be presented at fair value.



Question 4 - Temporary exclusion from criteria in IAS 8

- (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 equalization 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?

Comment

We agree with the proposals.



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 recognized in profit or loss (paragraph 35 of the draft IFRS).

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

Comment

- 1) We suggest that the Exposure Draft clarifies “excessive prudence”. For example, is the use of the fund basis in a liability line of business considered to be “excessive prudence”?
- 2) We suggest the exposure draft clarifies paragraph 15: what is the meaning of “closer to meeting the criteria in [draft] IAS 8”?

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?

Comment

We concur but we suggest to provide disclosure of total life assurance premiums (including the savings element), whether on the face of the life assurance business statement (gross premium, less savings element = net premium) or in the notes to the financial statements.



Question 7 - Reinsurance

The proposal 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?

Comment

We have no comment.

Question 8 – Insurance contracts acquired in a business combination or portfolio transfer

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?

Comment

We agree with the proposals.



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?

Comment

We agree with the proposals.

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?

Comment

We believe it will be impractical to measure and disclose insurance liabilities according to fair value without sufficient practical guidance. We suggest to remove the requirement for this disclosure in Phase II or, alternatively, to include specific guidance.

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 BC 141 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?

Comment

We believe that the Management Discussion and Analysis, which forms part of the financial report, is a better place for disclosures of multi-year claims development.

Question 12 - Financial guarantees by the transferor of a non-financial asset or liability

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?

Comment

We have no comment.



Question 13 - Other comments

Do you have any other comments on the draft IFRS and draft Implementation Guidance?

Comment

We suggest the IFRS should include additional examples of disclosures, both of a numerical and of a wording nature.