COMMITTEE OF EUROPEAN SECURITIES REGULATORS

IASB

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LONDON EC4M 6XH
United Kingdom

Date: 3 December 2010
Ref.: CESR/10-1540

RE: the IASB's Exposure Draft *Insurance Contracts*

The Committee of European Securities Regulators (CESR), through its Standing Committee on Corporate Reporting (CESR-Fin), has considered the IASB's Exposure Draft *Insurance Contracts*. We thank you for this opportunity to comment on this Exposure Draft.

For our comments, we would like to refer to the appendix attached to this letter where we provide a copy of our comment letter to EFRAG on its draft response to the IASB on the Exposure Draft.

I would be happy to discuss all or any of these issues further with you.

Yours sincerely,

Fernando Restoy
Chairman of CESR's Corporate Reporting Standing Committee

EFRAG

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Date: 2 December 2010
Ref.: CESR/10-1494

RE: EFRAG's draft response to the IASB's ED *Insurance Contracts*

The Committee of European Securities Regulators (CESR), through its Standing Committee on Corporate Reporting (CESR-Fin), has considered EFRAG's draft comment letter on the IASB's Exposure Draft (ED) *Insurance Contracts*.

We thank you for this opportunity to comment on your draft letter and we are pleased to provide you with the following comments.

CESR welcomes this project as it is a major step to reducing diversity in the way insurance contracts are presented in the financial statements of issuers applying IFRS. As regards the main characteristics of this project, CESR agrees with the fulfilment approach proposed by the IASB which reflects the way insurance activities are managed more appropriately than fair value. We also support the identification of a risk margin rather than the use of a composite margin as proposed by the FASB. In terms of scope of the project, CESR agrees with the IASB that contracts with discretionary participating features should be within the scope of the new standard rather than dealt with under other standards. As regards requirements for disclosures, we broadly agree with the proposals and believe they will significantly improve information provided to users.

We have however a certain number of concerns and questions which are detailed in the appendix to this letter. Amongst the things for which we would encourage the IASB to clarify in respect of this project are the following:

- the discount rate used in the assessment of insurance liabilities, and how this discount rate should be assessed;
- the notion of incremental acquisition costs which, we feel might be interpreted diversely if not clarified;
- the criteria for defining a contract's boundaries, where we believe additional guidance would be very helpful; and
- the transitional provisions.

As set out in our detailed responses in the appendix, CESR is of the view that assessing the IASB's proposals highlights the paramount importance of having a proper debate on fundamental issues related to performance reporting such as (i) the notion of performance and its relationship with business models, (ii) the content of performance statement(s), including the principles that underpin comprehensive income, and (iii) recycling. As part of this debate, thorough research should be carried out to determine what information is most important as a basis for meaningful communication to users and what information is needed for an analysis of an entity's performance. We believe that the IASB should start this debate without undue delay.

Yours sincerely,

Fernando Restoy
Chairman of CESR's Corporate Reporting Standing Committee

APPENDIX – CESR's detailed answers to the questions in the Exposure Draft 'Insurance Contracts' (the ED)

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?

CESR agrees that the proposed measurement model will produce relevant and useful information for users of financial statements. This is because CESR believes that the present value of the fulfilment cash flows [as described in paragraph 22 of the ED] reflects the way that the insurer expects to extinguish the liability. As such, CESR is of the opinion that it is of paramount importance for the relevance and usefulness of the financial statements that this information is provided in the financial statements.

Question 2 – Fulfilment cash flows

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

CESR agrees that the measurement of an insurance contract should be based on the expected cash outflows and inflows arising as the insurer fulfils the contract (i.e. a fulfilment approach).

EFRAG states in its draft comment letter (paragraph 19) that it agrees with paragraph 23 of the ED that cash flows should be estimated at the portfolio level. EFRAG also notes that estimates can be made more accurately at the portfolio level and that most insurers manage and measure their insurance contracts at that level. As stated in the ED (paragraphs B65-B66), the choice of measurement level, contract level or portfolio level does not affect the outcome. Hence the choice is taken more from a practical point of view as it is presumed to be easier to perform the estimation process at the portfolio level than at the level of the individual contract. CESR agrees with the IASB, as we do not see benefit in mandating that the portfolio level should be the compulsory level of measurement. On the contrary, it seems more consistent with what is in other standards (such as IAS 39 – *Financial Instruments: Recognition and Measurement* and IFRS 9 – *Financial Instruments*) to stick to the principle that what is measured is the individual contract and what is reflected in the financial statement are the contracts in aggregate. In the case of insurance contracts where estimates are usually based on statistics on past performance of the portfolio in question the estimates will inevitably be based on such portfolio data. However, this seems to be a matter that is relevant for application guidance rather than for the principles in the standard.[1]

EFRAG states that the cash flows should be estimated at the level of the portfolio. This principle implies that the cash flows will include direct costs and systematic allocations of costs that relate directly to the insurance contracts or contract activities.

CESR agrees with the principle that the costs should be allocated to the contracts to the extent the costs are related directly to the contracts in question. As stated above, CESR is not convinced that it is useful to establish as a principle that the portfolio is the level of measurement that should be applied. However, CESR agrees with EFRAG (paragraph 20) that if a level of measurement is

[1] Cf. IASB's ED on Financial Instruments: Amortised Cost and Impairment where it in the Application Guidance (B4-B6) is stated that the choice of the level of estimation (portfolio level or individual level) is a matter of determining which approach provides the best estimate under the circumstances and not a matter of principle.

determined it should be applied consistently throughout the standard. The standard should not, as is the case with the ED, prescribe different levels of measurement for different types of cash flows (cf. the comments to question 7).

EFRAG states in its draft comment letter (paragraphs 21-22) that the definition of a portfolio in the ED is too broad which could lead to inconsistencies between insurers' accounts. CESR is not of the view that the definition of a portfolio should be more narrow and rules-based but rather that application guidance should explain that estimates on cash flows expected to arise from an insurance contract should be derived from statistical data on the performance of portfolios of those contracts which (from a statistical point of view) are relevant to the measurement of the insurance contract.

(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?

CESR agrees that the guidance in Appendix B of the ED on the estimates of future cash flows is at an appropriate level of detail. As set out in our response to question 2(a) above, it may be helpful to include an explanation that estimates of cash flows expected to arise from an insurance contract should be derived from relevant statistical data.

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?

CESR agrees that the time value of money should be taken into account to represent faithfully future cash flows at the reporting date and that the rate used to discount expected cash flows should be a risk-free rate reflecting the characteristics of the insurance contract. CESR supports the view that the value of an insurance contract is independent of the value of the assets in which an insurer invests unless there is a contractually defined relationship that clearly links the cash flows of both (e.g. participating or unit-linked features).

Further, EFRAG's draft comment letter (paragraph 32) states that in EFRAG's understanding the difference between the discount rate on insurance liabilities and the yield on invested assets will create a mismatch, and that this mismatch reflects the economic difference between assets and insurance liabilities. Like EFRAG, CESR considers this to be useful information for users because it highlights the level of 'unmatched' risks in an entity's insurance activities.

Paragraph 32 of the ED provides that where the amount, timing and uncertainty of cash flows arising from an insurance contract 'depend wholly or partly on the performance of specific assets, the measurement of the insurance contract shall reflect that dependence'. CESR shares EFRAG's concern (set out in paragraph 35 of EFRAG's draft comment letter) that the phrase "depends wholly or partly on the performance of specific assets" is not sufficiently clear. Paragraph BC97 of the ED states that unit-linked contracts and some participating contracts are within the scope of this paragraph. Paragraph B47 of the ED also indicates that the requirement may also apply to cash flows replicating the performance of a put option on a basket of traded assets. CESR supports EFRAG's concern that it is uncertain whether the insurer (or a third party) must actually hold those specified assets and encourages the Board to clarify this issue further.

Finally, CESR agrees with EFRAG that the replicating portfolio technique impacts all aspects of the present value of fulfilment cash flows (i.e. estimated cash flows, discount rate and the risk adjustment) and supports the idea that its current placement in the ED under the sub-heading 'Time value of money' is confusing.

(b) Do you agree with the proposal to consider the effect of liquidity and with the guidance on liquidity? Why or why not?

CESR questions EFRAG's view (as stated in paragraph 37 of its draft comment letter) that generally insurance contracts are illiquid. CESR notes that many life contracts have a surrender option and many non-life contracts can be put back to the insurer within a short time-limit with the policyholder entitled to the return of the unused part of the premium paid. Further, such arguments seem to confuse the long-term nature of the contracts with their illiquidity.

However, CESR, like EFRAG, does not support the proposed requirement in paragraph 34 of the ED to require the effects of liquidity to be taken into account in determining the discount rate when measuring an insurance liability. In CESR's view the effects of liquidity should not be included in determining the discount rate as a liquidity adjustment would be inconsistent with the measurement of a fulfilment value. CESR however agrees that the discount rate applied in the measurement of an insurance liability should be "consistent with observable current market prices for instruments with cash flows whose characteristics reflect those of the insurance liability" (paragraph 30(a) in the ED). We believe that there should be a clear statement that this is not intended to allow the use of an "asset backed" discount rate, which CESR does not support.

In addition, we believe that the IASB's has not clearly explained its rationale for including a premium for illiquidity in the discount rate and that the application guidance provided would not be sufficient to ensure consistent application, interpretation and enforcement.

If the idea of a premium for illiquidity were to be retained in the standard without a much clearer rationale and detailed guidance on implementation CESR is concerned that it will be a source of substantial divergence in practice and cause problems with comparability between insurers' financial statements and give rise to difficulties with enforcement. This is especially important since market techniques and practices for the valuation of insurance products are still developing.

Further, CESR suggests that the IASB reviews the appropriate discount rate for long-term liabilities on a cross-standard basis as several projects are affected by this issue (i.e. IFRS 9 – *Financial Instruments* and IAS 19 – *Employee Benefits*).

(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?

EFRAG is in line with IASB and considers that own credit risk is not a relevant characteristic of a liability as the fulfilment value of the insurance liability does not change because of changes in the credit status of the insurer.

CESR agrees with this.

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.

CESR agrees with EFRAG in supporting a risk adjustment and a residual margin and not the recognition of a single composite margin. CESR believes that it is important that the approach applied in an insurance accounting standard provides relevant information for users about the amount, timing and uncertainty of future cash flows. We believe that this is best served through an explicit risk adjustment. CESR believes that the composite margin would fail to meet the objective of providing users with relevant and useful information about the uncertainty of future cash flows. CESR is concerned that the composite margin, as proposed, could lead to an underestimation of insurance liabilities where contracts are onerous at initial recognition because of the risk adjustment. Given that the valuation of such contracts would be based only on the first two building blocks under the composite margin approach, this would lead to liabilities that are lower than the expected present value of the future cash flows adjusted for the effects of uncertainty. Further, CESR is concerned that the alternative approach applying composite margin will lock in the risk margin at inception and potentially provide structuring opportunities.

CESR agrees with EFRAG that the risk margin can be measured reliably and supports that the risk margin should be re-measured at the end of each reporting pe riod accompanied with disclosures including explanations of changes from one period to another contribute to establish relevance and reliability.

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?

Like EFRAG, CESR agrees that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved from the risk that the ultimate fulfilment cash flows exceed those expected. CESR is supportive that the definition of risk adjustment that is consistent with a fulfilment notion.

(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?

The main rationale for limiting the choice of techniques appears to be based on improving comparability of financial reporting across insurers. CESR does not believe that limiting the choice of techniques will achieve that objective as long as insurers may use different techniques for business that are broadly similar. This restriction might in addition hinder the future development of more appropriate techniques.

As such, CESR agrees with EFRAG that a principles-based approach should be applied and that it is not appropriate to limit the measurement of estimates of risk adjustments to only the techniques specified in the ED.

EFRAG acknowledges that such principles should be accompanied by clear disclosure requirements about the technique used in determining the risk adjustment including why it meets the measurement objective. CESR agrees with this. Paragraph 68 states that risk adjustments should convey information to users of financial statements about the effects of uncertainty about the amount and timing of the cash flows arising from an insurance contract. Paragraph B72 of the ED sets out the characteristics that a risk adjustment should have to meet that objective. CESR believes that meeting the characteristics set out in this paragraph is the most important factor when choosing the appropriate technique. It is, however, important to ensure that the chosen technique is applied consistently over time. That is why CESR is of the view that any subsequent change in technique should be accompanied by disclosure of the rationale for the change (including why the new technique results in a more appropriate outcome than the previous technique) and its effect.

(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?

CESR like EFRAG is concerned that requiring disclosure of confidence level information may bias the choice of the technique used for measuring the risk adjustment. From a user perspective disclosure of the confidence level may not be useful information. As the confidence level technique is the least appropriate technique for most insurance liabilities, cf. B76-B78 in the ED, CESR agrees with EFRAG and supports the alternative disclosure requirements.

(d) Do you agree that an insurer should measure the risk adjustment at a portfolio level of aggregation (i.e. 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?

According to paragraph 36 of the ED, an insurer shall estimate the risk adjustment at the level of a portfolio of insurance contracts. Therefore, the risk adjustment shall reflect the effects of diversification that arise within a portfolio of insurance contracts, but not the effects of diversification between that portfolio and other portfolios of insurance contracts.

A portfolio of insurance contracts is defined in the ED as 'insurance contracts subject to broadly similar risk and managed together as a single pool'. CESR's understanding of this is that a portfolio of insurance contracts does not necessarily mean insurance contracts that are subject to identical risk. CESR supports an insurer measuring the risk adjustment at a portfolio level of aggregation.

Referring to our response to question 2, however, CESR questions whether the level of measurement is a matter of principle that should be included in the body of the standard. The risk will in practice be calculated based on statistics on past performance of a portfolio of contracts covering similar risks.

CESR does not agree with EFRAG that diversification effects between portfolios of contracts covering different risk under certain conditions (e.g. how they are managed) should be taken into account when calculating the risk adjustment. Allowance for such cross portfolio diversification effects is not in line with the principles identified in other IFRSs. Furthermore it will impede comparability between the financial statements depending on how entities manage their business and which portfolios that are combined in the entity.

(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?

CESR agrees that the application guidance is at an appropriate level of detail. We would however suggest the Board clarify that the detailed application guidance provided on the three selected techniques does not exclude the use of other techniques. As set out in our response to question 5(b) we are not supportive of limiting the techniques for estimating risk adjustment.

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?

CESR agrees that no gain should be recognised at the inception of an insurance contract.

(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?

CESR agrees that it is appropriate to recognise a loss at inception if the premium is insufficient to cover the expected present value of the policyholder's benefits, claims, costs and compensation for bearing the risk (risk margin).

(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?

CESR does not agree that the level of measurement should be specified as a matter of principle in the body of the standard. What has to be measured is, in principle, the individual contract. Adherence to that principle in relation to the residual margin would make the determination of relevant sub-portfolios superfluous. As such, CESR does not agree that a provision such as paragraph 20 of the ED belongs in a principles-based standard, but should rather be moved to the application guidance.

(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)?

The ED proposes to lock-in the residual margin and release it over the coverage period in a systematic way. The residual margin will not be recalibrated due to changes in estimates (e.g. when the discount rate changes).

CESR agrees that the residual margin generally should be released in a systematic way that best reflects the exposure from providing insurance coverage.

As set out to out below in more detail, CESR is of the opinion that a proper debate is necessary on fundamental issues related to performance reporting. In the absence of such a debate we believe that there are two different approaches towards the treatment of the residual margin:

— *to consider the residual margin a remedy to avoid profit at the inception of the contract and to cover the services rendered*

  In such a case it is sensible to agree with the IASB proposal to lock-in the residual margin determined at initial recognition and release it over the coverage period with the possibility of adjusting the residual margin recognised in profit or loss for the portion of contracts that are no longer in force at the end of the reporting period. Unearned income would be used if losses occurred by using the residual margin.

— *to consider the residual margin as a margin that reports profitability of the contracts over their coverage period (or over the average and settlements period)*

  In this case it makes sense that the residual margin should be re-measured in order to have a current representation of the profitability as it comes from the re-estimate of future cash flows.

Whichever way the question is answered, CESR believes that the IASB should ensure that changes in the present value of the fulfilment cash flows are presented transparently.

(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?

EFRAG does supports the composite margin approach in its response to question 4. Consequently, and in line with its response to question 6, EFRAG does not support the method of accounting proposed for the release of the composite margin.

CESR supports EFRAG's views regarding the composite margin approach.

(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?

The IASB believes that the time value of money should also be considered in relation to the residual margin and should therefore in principle accrete interest. CESR agrees with this would maintain that, because, the liability at initial recognition is calculated on the basis of a discontinued best estimate matched against a present value of premiums under the contracts, the residual margin already reflects the time value of money at initial recognition.

Question 7 – Acquisition costs

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?

Like EFRAG, CESR agrees with the principle that part of the acquisition cost should be included in the cash flows that determine the fulfilment cash flows, thereby reducing the residual margin. Such an approach reflects the fact that a part of the premium covers acquisition costs which represent activities that are already carried out by the insurer at the time of the issuance of the insurance contract. If acquisition costs were not taken into account in the cash flows the value of the liability inherent in the contract would be overstated.

Incremental acquisition costs
However, CESR disagrees with EFRAG on whether the word "incremental" necessarily captures those acquisition costs that it is appropriate to include in the cash flows.

In CESR's understanding one of the potential problems with limiting recognition only to incremental acquisition costs is that the specific form of the insurer's sales organisation could make a difference to the measurement of the contracts. This would imply that insurers using sales agents or sales commissions would have to measure their contracts differently to insurers using direct sales by a sales force on fixed salaries (paragraphsB61(f) and BC139 of the ED). CESR believes that such differences would harm comparability without resulting in more decision–useful information. Such means of cost recognition may even introduce inappropriate inducement to certain sales structures. In CESR's view the form of certain expenses (e.g. whether they are defrayed internally or externally) should not make a difference on how they are measured.

CESR however does agree that acquisition costs included should be limited to directly related costs and should not, for instance, include general costs such as expenses for sales promotions and advertising. CESR therefore recommends that the word "incremental" is replaced by "directly related", "directly attributable", or similar wording.

Level of acquisition costs
The IASB argues in the ED (BC 139) that acquisition costs should be measured at the level of the individual contract arguing that this would narrow the acquisition costs that could be taken into account. CESR agrees with EFRAG that the level of measurement, contract level or portfolio level, should be the same when estimating both acquisition costs and other costs included in the cash flows. However, as stated in our response to question 2, CESR is of the view that the level of measurement is a question belonging to application guidance and not to the principles in the standard itself.

Question 8 – Premium allocation approach

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

Like EFRAG CESR agrees that there should be a modified measurement approach for short-duration contracts. CESR understands this approach is a simplified approach in comparison with the full building block approach that is applicable under restricted conditions. We think that the use of this measurement method should not be a requirement as insurers with life and non-life insurance contracts may want to use the same method for both.

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

The simplified approach can in CESR's view be justified in instances where the estimated fulfilment cash flows are not likely to change in the coverage period. It seems reasonable that this condition is fulfilled in short-duration contracts. Most non-life insurance contracts have a coverage period of 1 year and it is seldom that with short-period contracts exceed 1 year. Because such contracts are only few in number we believe that the benefit of allowing such contracts in the scope of the modified approach outweighs the potential disadvantage around the implementation uncertainty related to the 'approximately-1-year-or-less-criterion'. CESR, like EFRAG, therefore supports that the standard should set an explicit period of 1 year or less.

However, CESR recommends that the IASB considers including in the guidance that contracts exceeding 1 year can be accounted for by the modified approach in instances where they form only an insignificant part of a portfolio of contracts that would otherwise not meet the criteria for being subject to the this approach.

CESR believes that the time value of money should also be considered under the modified approach and that the pre-claim liability under the modified approach could, in principle, require the accretion of interest.

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 and why not? If not, what would you recommend in practice and why?

CESR supports the principles behind the criteria for setting the contract boundary as proposed in the ED.

In its draft comment letter EFRAG recommends that the principles are supplemented by extensive application guidance. Although CESR warmly welcomes the call for such guidance, we are line with

EFRAG's suggestion that the definition itself in the ED might need amendment. CESR understands that one of the implementation problems relates to the fact that insurers in some cases are able to set a new price that reflects the general risk covered but that such re-pricings are not allowed to take into account the specific risk represented by the individual policyholder. The definition in the ED seems clearly to stipulate that such a re-pricing possibility does not represent a contract boundary. CESR questions whether it is appropriate that the definition of the contract boundary extends the contract beyond the point where the insurer is allowed to re-price taking the changes in the risk in general or for a group into account but not the specific risk related to the particular policyholder. CESR therefore recommends that the IASB considered whether a rephrasing of the second part of the contract boundary definition (paragraph 27 (b)) would be appropriate for instance by removing the words "particular" and "fully" from the text.

Referring to our response to question 2 that *cash flows expected to arise from an insurance contract should be derived from statistical data on the performance of portfolios of those contracts* we believe that contracts in which an individual policyholder steps but where a framework agreement is made between the individual's employer and the insurer, should be accounted for at 'group level' (i.e. meaning that the level at which the insurer assesses the risk profile and prices the contract is not at the level of the individual policyholder).

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?

CESR, like EFRAG, agrees that liabilities related to participating features should be included in the measurement of insurance contracts on an expected present value basis like other parts of the contracts. That said, CESR notes that there is considerable uncertainty in this respect of the ED's proposal will work, which creates potential difficulties in practice.

For example, the proposals require that the liability for contracts with participating features include the expected future distribution to policyholders. While such an estimate may be straight-forward for current year distribution, preparers will also have to consider the expected future distribution to policyholders in respect of the existing estate (e.g. unallocated divisible surplus), which could require considerable judgement.

Uncertainty would not only relate to the expected future distribution to policyholders but could also relate to the insurer's future cash inflows. Some entities might apply strict rules resulting in the assessment of the liability being based on limited future cash inflows from the policyholders (for instance when these policyholders have a significant incentive to make further investments in the contract based on guarantees granted by the insurer). Others may try to use much more optimistic assumptions as far as future cash inflows are concerned.

Therefore, whilst CESR is supportive of applying an approach here that is consistent with other insurance contracts (i.e. based on the expectation to make payments), further guidance on the treatment of participating features is needed.

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

CESR agrees that investment contracts with participating features should be within the scope of the insurance contracts standard. This would ensure consistent treatment of such features and whether they are embedded in insurance contracts or in contracts without an insurance component or an insignificant insurance component.

(c) Do you agree with the proposed definition of a discretionary participation feature, including the proposed new condition that the investment contract 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?

Like EFRAG, CESR does not agree with the proposed new condition in the definition of a discretionary participation feature that requires that a financial contract is included together with insurance contracts in the same pool of assets and P/L of the same company, fund or other entity. Introducing this condition in IFRS 4 – *Insurance Contracts* will not ensure similar treatment of similar contracts but will make the measurement dependent on the type of issuer or on how the issuer chooses to organise its activity. As such it would create an inappropriate departure from the general principle in IFRS that the accounting treatment is determined by the type of instrument and not the type of the issuer or how the entity chooses to organise its activities. We believe that this condition will create problems with comparability between insurers and other entities that issue investment contracts with discretionary participation features and also between other insurers as the accounting treatment will depend on how they organise their activities. This is not acceptable from the perspective of the users of the financial statements.

(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?

Like EFRAG, CESR considers that the conditions relating to investment contracts with discretionary participation features set out in paragraph 64 and 65 of the ED are suitable.

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?

Like EFRAG, CESR agrees with the definition of an insurance contract including the two changes.

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

EFRAG agrees with the scope exclusions but with respect to the exclusion of fixed fee contracts from the scope, CESR like EFRAG is concerned that the wording of the scope exclusion of fixed fee service contracts is not clear enough. CESR wonders whether these contracts should be listed among scope exclusions or whether it is more appropriate to mention them in the application guidance with the aim of inclusion based on whether they are judged to transfer significant insurance risk or not.

(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?

CESR agrees that financial guarantee contracts should be assessed on whether they include insurance risk or not. If so, they should fall with in the scope of IFRS 4. CESR would like to highlight that the inclusion of financial guarantees appears appropriate and provides a more consistent accounting practice across industries.

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?

CESR is not in position to assess whether or not the change in wording from cash flows which are interdependent (IFRS 4 phase I) to cash flows that are closely related will have significant impact on how many contracts are unbundled. In general, CESR supports EFRAG's view that unbundling the non-insurance components can increase transparency and could allow users of financial statements to get an insight into the non-insurance components of insurance contracts.

Unbundling is appropriate when separate recognition and measurement of the components better reflects the substance of the instrument and thus provides more useful information. Where components are not closely related to the insurance coverage, measuring cash flows arising from the non-insurance component as if it was an insurance contract would not produce relevant information.

However, CESR is also of the opinion that unbundling should not be practiced if it produces none or only an insignificant difference in outcome compared with a recognition and measurement of the contract in its entirety. CESR is concerned that the proposal in the ED does not support this position and that the proposal will give rise to a lot of unbundling that will not lead to improved information. The basic measurement principle in the ED is current measurement comprising all cash flows arising from the contract. From this perspective it seems superfluous to unbundle elements that measured separately would also be measured at a current, i.e. fair value.

CESR is of the opinion that the proposal on unbundling should be reassessed from this perspective. That is to say that unbundling should only be mandatory in cases where it improves the information for the users of the financial statements.

Further, CESR believes that it is not appropriate to include examples, as is done in paragraph 8 (a) in the body of the standard. The standard should state principles while examples should be part of application guidance.

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?

CESR agrees with EFRAG that the proposed presentation of summarised margin is appropriate and consistent with the proposed presentation in the balance sheet where insurance contracts are shown as a net presentation of the rights and obligations arising from insurance contracts. CESR also agrees that the summarised margin is presented in the statement of comprehensive income as it provides decision-useful information.

The ED proposes that presentation in the income statement follows the measurement model, and does not permit the presentation of premium or claims information on the face of the income statement. However, EFRAG considers that both margin and volume information is key to understanding the performance of an insurer and should be presented on the face of the statement of comprehensive income for all insurance contracts alongside the underwriting margins. CESR supports the importance of volume information, but does not agree that it is necessary, or consistent, that this information is provided in the statement of comprehensive income. Such information can be provided in disclosures. CESR acknowledges that this represents a considerable change to existing practice, where such information often provides key performance measures for users. In our view, given the chosen measurement model, the IASB is right to require information derived from the building block model. However, the IASB should also consider how firms may best present premium and claims information so as to ease transition to the new model (e.g. by mandating clear and prescriptive note disclosures for premiums and claims etc).

(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?

Paragraph 76 of the ED provides that all income and expenses from insurance contracts should be recognised in profit or loss However, as changes in the fair value of equity securities can be reported in OCI in accordance with IFRS 9, EFRAG is concerned that an accounting mismatch could be created. This mismatch could be significantly mitigated by the insurer not electing to classify the equity security at fair value through OCI, but instead reporting it at fair value through profit or loss. If it is appropriate to allow the use of OCI in IFRS 9, EFRAG believes that insurers should not be deprived from that election because it would create an accounting mismatch.

Presentation in Profit or Loss
As stated in our comment letter on the ED *Presentation of Other Comprehensive Income* we believe that a proper debate is necessary on fundamental issues related to performance reporting such as (i) the notion of performance and its relationship with business models, (ii) the content of performance statement(s), including the principles that underpin comprehensive income, and (iii) recycling. As part of this debate, thorough research should be carried out to determine what information is most important as a basis for meaningful communication to users and what information is needed for an analysis of an entity's performance. We believe that the IASB should start this debate without undue delay. CESR believes that the outcome of such debate could influence whether or not income and expenses arising from insurance contracts should be presented in Profit or Loss (P/L) or OCI.

EFRAG's concerns risk adjustment estimates
With respect to paragraph 72 of the ED, EFRAG is uncertain where a change in the estimate of the risk adjustment would be presented. EFRAG assumes it would be presented in accordance with paragraph 72(d) but considers that this interpretation is not clear. EFRAG therefore recommends that the scope of paragraph 72(d) is clarified with respect to changes in estimates of the risk adjustment.

CESR understands that the change in estimate of risk adjustment is included in paragraph 72(a)(i).

Question 14 – Disclosures
(a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?

CESR agrees with EFRAG and supports the proposed disclosure principle.

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

EFRAG broadly agrees with the disclosure requirements but has a few minor concerns. Further, EFRAG proposes additional risk disclosures regarding actual claims and maturity analysis. CESR supports these additional disclosure requirements.

(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.

EFRAG considers that the disaggregation options in paragraph 72 of the ED should be required as disclosures in the notes and not on an optional basis in comprehensive income. As we believe it would enhance comparability we believe that it would enhance comparability.

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?

Like EFRAG, CESR supports the idea that assets and liabilities related to unit-linked contracts should be presented on single line items in the balance sheet and is also supportive of separate line presentations in profit or loss of gains and losses from unit-linked contracts and related assets.

The ED proposes that some exceptions to other standards are introduced with the aim of overcoming accounting mismatches related to unit-linked contracts.

One of the exceptions is to allow for the recognition of own shares when they belong to a pool of assets related to unit-linked contracts. CESR is not convinced that the recognition of own shares should be allowed even under these restricted conditions but if the proposal is retained in the standard CESR considers that a similar exception would be relevant also for own bonds, i.e. bonds issued by the entity but repurchased and included in a pool of unit-linked assets.

CESR agrees with the proposal to allow a fair value option for property occupied by the insurer when the property belongs to unit-linked assets. However, mismatch problems arising when adjustments to the contract value are presented in profit or loss and adjustments on the assets are presented outside profit or loss arises not only in relation to owner-occupied property in pools of assets related to unit-linked contracts. The problem is wider and relates to all types of assets and liabilities the return on which is part of the profit or loss shared with policyholders according to either contracts with discretionary participation features or unit-linked contracts. CESR would therefore recommend inserting a general principle that states that a fair value option can be applied to assets or liabilities when value adjustments on those assets or liabilities resulting from participation or unit-linked features in the contracts are shared with the policyholders. Such a provision seems necessary to avoid the accounting mismatches that are currently avoided by the so-called “shadow accounting” in IFRS 4.

Question 16 – Reinsurance

Do you support an expected loss model for reinsurance assets? Why and why not? If not, what do you recommend and why?

CESR supports that ceded reinsurance contracts are measured by applying the same principles as for direct insurance contracts except that the risk of non-performance, which is not taken into account in the case of direct insurance, shall be taken into account when the reinsurance is ceded.

A special relationship exists between direct insurance liabilities and their related reinsurance assets which stems from the fact that a reinsurance asset is only valid if the related liability materialises. It is therefore important that the measurement of direct insurance contracts and the related reinsurance contracts is based on the same assumptions and estimates in order not to create artificial net assets or liabilities. It would be preferable if this relationship between direct contract liabilities and their related reinsurance assets and its consequences for measurement could be clarified in the application guidance.

For instance, in many cases ceded reinsurance will reduce the size of the relevant risk adjustment on direct insurance contracts when a direct contract and a reinsurance contract are looked at as a whole. This stems from the fact that ceded reinsurance might reduce not only the estimated net cash outflows but also the uncertainty related to those outflows. It would be appropriate to clarifying in the application guidance whether and, if so, how such effects relating to the interrelationship between direct contracts and the reinsurance contracts could be taken into account in the estimation of the risk adjustments.

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?

Like EFRAG, CESR disagrees with the proposal to set the residual margin on existing contracts equal to zero. Unrecognised profits on existing insurance contracts at the date of transition should not be taken directly to retained earnings without being recognised in the income statement. In addition, the proposal will introduce inappropriate incomparability between financial statements from insurers that primarily issues short-duration contracts and insurers that primarily issue long-duration contracts for many years after the transition date. Hence, CESR is of the opinion that the in line with the IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors* retrospective application of new accounting practices should be applied for the proposed amendments.

(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 Conclusion)?

CESR does not support the FASB approach.

(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?

CESR considers that it is crucial that IFRS 9 and the proposed amendments to IFRS 4 are applied from the same date especially as IFRS 9 removes the available for sale category which is not compatible with the new measurement approach on insurance contracts.

CESR supports the idea that insurers should be allowed to re-designate at implementation date assets and liabilities other than the ones resulting from the insurances contracts in order to prevent accounting mismatches that might otherwise arise.

(d) Please provide an estimate of how long insurers would require to adopt the proposed requirements.

As enforcers of IFRS and securities regulators we do not feel ourselves in a position to provide comments on this question.

Question 18 – Other comments

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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 enforcers of IFRS and securities regulators we do not feel ourselves in a position to provide comments on this question.