ASC
ACCOUNTING STANDARDS COUNCIL

Institute of
Certified Public Accountants
of Singapore

XX November 2010

International Accounting Standards Board
1st Floor 30 Cannon Street
London EC4M 6XH
United Kingdom

(By online submission)

Dear Sir

RESPONSE TO EXPOSURE DRAFT ON INSURANCE CONTRACTS

The Accounting Standards Council (ASC), in conjunction with the Institute of Certified Public Accountants of Singapore (ICPAS), appreciate the opportunity to comment on the Exposure Draft on Insurance Contracts (the ED) issued by the International Accounting Standards Board (the IASB or the Board) in July 2010.

General

Overall, we agree that conceptually, the proposed measurement model and the corresponding presentation and disclosure requirements would eliminate accounting inconsistencies present in existing varied practices, and therefore, provide more comparability across entities, jurisdictions and capital markets. This is a significant improvement to the accounting for insurance contracts. Nevertheless, we wish to highlight to the Board the application challenges in some areas, notably, the aggregation of insurance contracts, and the measurement of reinsurance and certain short duration contracts. In addition, we are of the view that some principle-based requirements may warrant additional application guidance to achieve the Board's objective of enhanced comparability.

On the proposed presentation model, we recognize that there may be initial limitations to the Board's understandability objective as the ultimate users of the information adjust toward a margin-based presentation.

Therefore, we recommend that the Board considers all aspects of the proposals – including the application guidance – to arrive at a standard that best balances the objective of principle-based and comparability.

Our comments and suggestions are provided in the responses to the ED proposals below. However, we wish to draw the Board's attention to our disagreements on the following areas:

I. *Accretion of interest on the residual margin using a locked-in discount rate as determined at initial recognition:* Given that interest rates change subsequent to initial recognition, we believe that utilizing the historical locked-in rate is not relevant – refer to our response to question 6 (f)
II. *The proposed criteria for the modified measurement approach:* We believe that the prescriptive 12 months criteria [to determine short duration contracts] may cause unnecessary challenges in practice – refer to our response to question 8 (b)
III. *The scoping of financial guarantee contracts:* We are of the view that this requirement may add presentation and disclosure complexity [under the insurance contracts standard] to non-insurers – refer to our response to question 11 (c)
IV. *The measurement of reinsurance contracts:* There are considerable challenges in relation to the measurement of reinsurance contracts purchased, which we think the Board would benefit to consider – refer to our response to question 16 (b)
V. *The transition requirements:* We are of the view that an estimate of the residual margins [in relation to in-force contracts] at transition date should be determined to ensure measurement consistency between in-force and future contracts – refer to our response to question 17 (a)

Question 1
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?

Subject to the Board's consideration of our comments to the following questions, **we generally think that the proposed measurement model will produce relevant information** that will help users of an insurer's financial statements to make economic decisions.

Our comment(s):
Understandability: We note that the proposed measurement and presentation model will significantly change the way users of an insurer's financial statements obtain insight to an insurer's financial position and performance. Some of the fundamental changes include the accounting of product margins, acquisition costs and the proposed summarized margin presentation. With this, we would expect a period of adaptation before users could fully benefit from the new information content. This is not unusual with new concepts.

Question 2

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

We agree with the concept that the measurement of an insurance contract should include the expected present value of the future cash outflows less future cash inflows that will arise as the insurer fulfils the insurance contract. This is in line with the fact that insurers generally fulfill their contracts directly over time by paying benefits and claims to policyholders.

Practical consideration(s):
Aggregation of insurance contracts: We would like to draw the Board's attention to some practical concerns highlighted in our responses to questions 5(d) and 6(c) on the aggregation of insurance contracts into portfolios to accommodate the determination of risk adjustment and residual margin.

(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?

Given the principle-based intention of the Board, the draft application guidance in Appendix B on estimates of future cash flows appears to be at the right level of detail.

Practical consideration(s):
Life insurance riders: There may be instances, particularly in a life insurance setting, where a particular insurance contract is a combination of two contracts: (1) A long-term main contract; and (2) A short-term rider contract, which provides enhanced benefits to the policyholder. In the ED, an insurance contract is defined as "A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder." Without application guidance in relation to the accounting treatment of rider contracts (i.e., whether to aggregate the estimates of future cash flows arising from the main contract and the rider contract), the ED's definition of an insurance contract would produce accounting inconsistency in practice among life insurers. We think that additional application guidance would not undermine the objective of a principle-based standard.

Claims cash flows: We note that the guidance on claims' cash outflows is not sufficiently clear – while the guidance in Appendix B61 (b), (c), and (d) operate at a portfolio level, the guidance in B63 and B64 do not appear to operate directly at the portfolio level (i.e., based on an allocation of costs). Since the accounting principle of cash outflows (particularly indirect claims outflows) impacts the computation of the risk adjustment and residual margin, we believe clear and consistent guidance on claims cash outflows should be laid down.

Question 3

(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?**

We agree that the discount rates 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.

Our comment(s):

Unit-linked and participating contracts: The cash flows from assets affect the cash flows arising from the liability in unit-linked and some participating contracts. In those cases, the ED (Para. 32) advocates a replicating portfolio technique to measure insurance liabilities, but does not restrict the use of other techniques. However, Appendix B of the ED (Para. B46) states that "if a replicating asset exists and an insurer uses a different technique, the insurer shall satisfy itself that a replicating portfolio technique would be unlikely to lead to a materially different answer". We are of the view that this requirement would limit the benefit of choice of using different techniques other than the replicating portfolio technique.

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

We agree with the proposal to consider the effect of liquidity. This gives recognition to the fact that insurance contracts are generally illiquid, and ensures that insurance contract design and pricing are consistent with market pricing for investments of similar nature.

Our comment(s):

Industry practice under Solvency II: While we appreciate the principle-based objective of the standard in not prescribing specific techniques to determine the effect of liquidity, we are mindful that there are certain industry techniques emerging under the Solvency II regime. Indeed, insurers adopting the Solvency II capital adequacy and risk management standards are likely to adopt these techniques. For long duration contracts, the effect of the liquidity adjustment may have a significant impact on the insurance contract liability measurement. Potentially, it may have a more significant impact on measurement than the risk adjustment to which the Board prescribes limited methodologies. Given the potential significant impact on measurement, and the availability of widely-accepted industry techniques [under Solvency II], we recommend that the Board considers including application guidance to limit variations in practice among insurers.

(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 fulfillment cash flows should not reflect the risk of non-performance by the insurer?**

We are of the view that including an adjustment for the effects of liquidity addresses some of the concerns, which expressed that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts.

Further, **we agree** with the Board's conclusion that the present value of the fulfillment cash flows should not reflect the risk of non-performance by the insurer. The measurement of insurance contracts for financial reporting purposes should be conducted from the point of view of the insurer as a going concern, and on the basis that it will fulfill those contracts.

Question 4

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.

We support using a risk adjustment and a residual margin (as the IASB proposes). We think that a 'two- margin approach' [as the IASB proposes] would better depict the risk and uncertainty inherent in insurance contracts.

In a 'two-margin' approach, the risk adjustment directly measures the remaining risk in the contract, whereas the residual margin depicts the profitability of the contract over time. In contrast, a single composite margin reflects the insurer's pricing policy and may not correspond to the degree of risk present in the liability both at inception and throughout the contract term. As was seen during the global financial crisis, market risk appetite fluctuates rapidly and valuation of sub-prime backed investments approaches tail risk within a short period of time. Similarly, in relation to an insurer's portfolio of insurance contracts, the risk adjustment (and its subsequent re-measurements) would depict tail risk developments.
In addition, the opposition of the 'two-margin approach' does not explicitly disagree with the benefits of this approach. Their arguments mainly cite difficulty of techniques and high costs of implementation.

Question 5

(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 fulfillment cash flows exceed those expected? Why or why not? If not, what alternatives do you suggest and why?

We conceptually agree that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected.

Given that the purpose of the risk adjustment is to measure the effect of uncertainty in the cash flows arising from the insurance contract, the risk adjustment shall reflect all risks associated with that contract – i.e., including the risk that the ultimate fulfillment cash flows exceed those expected.

(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?

We agree that the three techniques for estimating risk identified in paragraph B73 (confidence level, conditional tail expectation (CTE) and cost of capital) would facilitate the measurement of a risk adjustment in accordance with the principle in paragraph 35 of the ED. These techniques are widely understood, applied in practice to some extent, and capable of providing relevant information. In addition, each of the permitted techniques builds on the probability distribution of the underlying cash flows, which is consistent with the measurement model of 'expected' cash flows.

Our comment(s):
Developments in techniques: Techniques may evolve over time. Specifying particular techniques might prevent the use of new techniques that are more suitable.

Not principle-based: We are mindful of the Board's thinking that permitting a wide range of techniques to determine the risk adjustment could lead to diversity in practice, which might reduce the relevance of the resulting measurement, and make it difficult for users to compare risk adjustments made by different insurers. However, we are of the view that limiting the number of techniques would conflict with the Board's wish to set principle-based standards. In particular situations, some techniques may be more applicable, or may be easier to implement. It may not be practicable for an IFRS to specify in detail every situation in which particular techniques would be appropriate.

(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?

We agree that if either the CTE or cost of capital method is used the insurer should disclose the confidence level to which the risk adjustment corresponds. We believe that the additional disclosure would accommodate comparability because the use of confidence levels for estimating a risk adjustment has the benefits of being relatively easy to communicate to users and relatively simple to calculate [in comparison to the CTE and cost of capital method].

Practical consideration(s):
Definition of 'cost of capital': Given the variation in insurers' capital structure and regulatory requirements, we are of the view that a clear definition of 'cost of capital' would reduce accounting inconsistency in practice. To highlight the possible differences in interpretation, 'capital' may refer to debt, equity or regulatory and 'cost' may refer to cost of debt, cost of equity, or the weighted average cost of capital.

(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?

We generally 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). As the portfolio contains reasonably homogeneous contracts, it is the most natural level at which to estimate the probability distribution of the cash flows.

Practical consideration(s) and alternative proposal:
Definition of portfolio: The current definition of 'portfolio' may create contradictions in practice – for example, similar mortality risks may exist in different portfolios, which are managed separately.

Insufficient statistics: Many portfolios [within the definition of the ED] are generally too small to derive credible statistical results to justify the experience and the distribution for the risk. Hence, it is common to look at a specific risk across many different portfolios to derive the statistics of that risk.

Diversification: There are many different risks that are highly correlated (and negatively correlated) to one another. An insurer's ability to ultimately be relieved of such risks would be affected by such correlation, and hence these should ideally be factored into the risk adjustment calculations. In addition, the disallowance to take credit for diversification across portfolios may be in contradiction with management's intention in managing the portfolios of insurance contracts – for example, the management of a life portfolio and an annuity portfolio often intends to derive diversification benefits.

For reasons stated above, we would recommend that the Board considers allowing risk adjustments to be determined across portfolios with similar and highly correlated risks, although managed separately.

(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?

Based on the principle-based approach preferred by the IASB, the level of guidance appears appropriate, subject to our comments on risk adjustments (above).

Question 6

(a) Do you agree that an insurer should not recognize 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?

We conceptually agree that an insurer should not recognize any gain at initial recognition of an insurance contract. To recognize a 'day 1 gain' would be inconsistent with the proposals in the exposure draft *Revenue from Contracts with Customers* – at inception, the insurer has not satisfied any of its performance obligations. In addition, there may be a risk that the amount identified as a day 1 gain has been identified incorrectly, and has arisen from an error in measuring the insurance contract liability.

(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 (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?

We conceptually agree that the residual margin should not be less than zero, so that a loss at initial recognition of an insurance contract would be recognized immediately in profit or loss.

It is appropriate to recognize a loss at initial recognition immediately in profit or loss if the amount paid by the policyholder is insufficient to cover the expected present value of the policyholder benefits and claims and also to compensate the insurer adequately for bearing the risk that the policyholder benefits ultimately exceed the expected premiums paid by the policyholder. Further, the residual margin is an allocation of part of the premium provided by the policyholder. Because it is an allocation, it cannot be negative, either at inception or subsequently.

(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?

A portfolio is defined in the ED as insurance contracts that are subject to broadly similar risks and managed together as a pool. **We agree** with the level of aggregation for the residual margin because the above definition of 'portfolio' permits a certain level of flexibility to an insurer in defining a portfolio that is in line with how it identifies and manages its insurance risks together as a pool.

Practical consideration(s):
Application guidance on the aggregation of contracts within a portfolio: We anticipate that the broad, principle-based aggregation requirement [to determine residual margin] may produce accounting inconsistency in practice among insurers, depending on the granularity at which an insurer aggregates its collection of insurance contracts within a portfolio – i.e., by day/month/year. Additional application guidance in several common circumstances would not undermine the objective of a principle-based standard.

(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)?

We agree with the proposed method of releasing the residual margin.

Residual margin could be viewed as an aggregation of several factors (as presented in the ED's basis for conclusions Para. BC125). We recognize that because those margins are a blend of various factors not separately identifiable, any such release pattern inevitably will be arbitrary to some extent.

Since insurance risk is present in every insurance contract and the insurance coverage from this type of risk represents a predominant factor for the performance under the insurance contract, the insurance coverage can be used as the basis for release across most types of contracts. Further, factors implicitly included in the margin would no longer be relevant after the end of the coverage period.

Our comment(s):
Re-measurement of residual margin: Although we do not disagree with the Board's approach, we are of the view that an alternative approach, which recalibrates the residual margin over the contract period, may be more in line with the Board's 'building blocks' approach. The principles of the current expected fulfillment cash flows approach may be better represented if the residual margin identified at initial recognition is earned using a method that is interdependent with the 'building blocks' approach, i.e., through ongoing re-measurement (recalibration).

(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?

We do not agree with the composite margin approach. We have no comments on the release of composite margin.

(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?

We agree that interest should be accreted on the residual margin.

Our disagreement(s) and alternative proposal:
Use of a locked-in discount rate: **We do not agree** with the Board's proposal **to use a locked-in discount rate** [as determined at initial recognition] as the reference rate for accretion. Such historical locked-in rate is not relevant given that interest rates change subsequent to initial recognition. We recommend that the Board reviews its current position

and considers using current interest rates as the reference rate for accretion if interest accretion is to be mandated.

Question 7
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 recognized as expenses when incurred? Why or why not? If not, what do you recommend and why?

We agree in principle 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 recognized as expenses when incurred.

We see it as an enhancement that focusing on incremental costs at a contractual level further aligns the treatment of acquisition costs for insurance contract with IAS 39, IFRS 9 and the IFRS standards in general. This would align an insurer's treatment of acquisition costs to other financial services sector, such as banking and asset management.

In essence, the insurer typically charges the policyholder a price that the insurer regards as sufficient to compensate it for two things: (a) undertaking the obligation to pay for insured losses and (b) the cost of originating the contracts. Thus, a faithful representation of the remaining obligation should not include the part of the premium that paid for the incremental acquisition costs – i.e. premiums should be net of incremental acquisition costs.

Only incremental costs should be included in the initial measurement of the insurance contract as contract cash outflows, because those costs can be clearly identified as relating specifically to the contract. Determining whether other costs are directly related to the contract can be more subjective.

Our comment(s):
Inconsistency arising from variation in distribution structure: The inclusion of incremental acquisition costs on a contractual level may result in different results reported for insurers with the same cost level but with different sales structures. Therefore, it may be prudent for the Board to consider permitting a choice to include incremental acquisition costs either on a contract level or on a portfolio level. The main criteria for driving this choice would be the nature and extent of the sales structures. Ideally, such choice should be supported by disclosures about the underlying rationale.

Question 8
(a) Should the Board (i) require, (ii) permit but not require, or (iii) not introduce a modified measurement approach for the pre-claims liabilities of some short-duration insurance contracts? Why or why not?

In line with the Board's principle-based objective, we believe that the Board should **permit but not require** (i.e., Option (ii)) the modified measurement approach for pre-claims liabilities to be used for all short-duration insurance contracts, which do not contain any significant embedded derivatives.

We agree with the Board's view that using the current unearned premium approach for the pre-claims liabilities of some short duration contracts is a reasonable approximation. Further, we laud the Board's understanding that the incremental benefits of switching fully to the new measurement model would not justify the significant cost of doing so.

Our comment(s):
Reinsurer context: Many reinsurers project their cash flows on an underwriting year basis, which is conceptually similar to the building blocks approach. We therefore re-emphasize that the modified measurement approach for reinsurance contracts should be optional and not mandatory.

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

We do not agree with the proposed criteria for requiring or permitting that approach and with how to apply that approach.

Our disagreement(s) and alternative proposal:
12 months duration is prescriptive: We find the 12 months duration in the proposed criteria to be prescriptive, and not in line with the Board's principle-based objective. Many insurers have contracts to insure or reinsure interests in infrastructure, engineering, or contract works, which have durations of more than 12 months to complete – i.e., up to 4 to 5 years from conceptual stage to completion. We believe that insurers should be allowed to apply the modified measurement model for all non-life insurance contracts, regardless of duration. Although measured under the modified measurement model, these contracts are still subject to the onerous assessment under Paragraph. 60 of the ED. This assessment requires an insurer to recognize an additional liability and a corresponding expense, measured as the difference between the carrying amount of the pre-claims obligation and the present value of the fulfillment cash flows. The onerous assessment essentially captures onerous contracts and aligns their measurement with the building blocks measurement model while allowing the non-onerous ones to continue under the modified measurement model.

Reinsurance contracts may exceed 12 months: In the context of a reinsurer, the reinsurer may not know what proportion of each treaty contract exceeds 12 months – i.e., the treaty could be for 12 months but be on a risk attaching, risk occurring, losses discovered, or claims made basis.

Question 9

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

We agree in concept with the proposed boundary principle. We think that most insurers would be able to apply it consistently in practice.

Our comment(s):

Application guidance on contract boundary: Additional application guidance in several common circumstances would not reduce the objective of a principle-based standard. For example, certain group medical contracts may allow the insurer to reassess the risk of a particular policyholder, and, as a result, can set a new price that fully reflects that risk, usually through an endorsement to the main contract. In another example, it is not clear whether a contract that allows the insurer to review premium rates on a portfolio basis, but not on an individual policyholder basis, would define a contract boundary. It can be argued that since the contract allows premium review on a portfolio basis, premium rates payable by each individual policyholder can be effectively revised.

Question 10

(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?

We agree that the measurement of insurance contracts should include participating benefits on an expected present value basis.

Payments arising from participating features are obligations of the insurer and an integral part of the contract. It is not practical to split this from the other parts of the contract, and as such, should be included in the measurement of insurance contracts.

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

We think that financial instruments with discretionary participation features **should be within the scope of the IFRS on insurance contracts**.

These contracts have more similar characteristics to insurance contracts than other investment contracts. Participating investment contracts and participating insurance contracts are sometimes linked to the same underlying pool of assets (and sometimes participating investment contracts even share in the performance of insurance contracts). Using the same approach for both types of contract will produce more relevant information for users and simplifies the accounting for those contracts.

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

We agree with the proposed definition of a discretionary participation feature, including the proposed new condition that the investment contracts must participate with insurance contracts in the same pool of assets, company, fund or other entity.

The reasons are discussed in our response to question 10 (b) above.

(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?**

We agree with those modifications.

Question 11

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

We agree with the definition of an insurance contract and related guidance, including the two changes summarized in paragraph BC191.

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

We agree with the scope exclusions in paragraph 4.

(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?**

We disagree with the Board's proposal to expressly include financial guarantee contracts within the scope of the IFRS on insurance contracts.

Our disagreement(s) and alternative proposal:
Option to non-insurers: We are of the view that non-insurers should be given the option to account for financial guarantees as financial instruments or as insurance contracts. The ED *Amortised Cost and Impairment of Financial Instruments* issued in November 2009 proposed that financial liabilities accounted for at amortised cost should continuously be measured and estimated based on the expected future cash outflows at each measurement date. If the proposal is accepted eventually,, the measurement of financial guarantee liabilities should

theoretically be similar under both the financial instruments standard and the new insurance contracts standard.

Allowing financial guarantee contracts to be accounted for as financial instruments may be more reflective of their economic substance since they transfer credit risk. Further, scoping non-insurers into the insurance contracts standard may burden non-insurers with the proposed presentation and disclosure requirements, which are more suitably applied to insurers.

We would also recommend the Board to clarify the accounting treatment for bid bonds, performance bonds, advance payment bonds and standby letters of credit since both banks and insurers issue such contracts.

Question 12

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?

We agree with the principle of the requirement to unbundle certain components of insurance contracts, which are <u>not</u> closely related to the insurance coverage specified in the insurance contract.

Question 13

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

We agree with the proposed presentation principal that links clearly with the measurement approach for the insurance liability in the statement of financial position.

The margin approach views all cash inflows associated with an insurance contract as deposits received from the community of policyholders and all the cash outflows as repayments to the community of policyholders. It makes it unnecessary to unbundle deposit receipts from the premiums because it treats premiums in the same way as deposits. Many longer-term life insurance contracts contain deposit components. Drawing a line between the deposits and the premiums may be somewhat arbitrary for some contracts.

We appreciate that the revised format will provide a more relevant and useful information because the sources of profit for an insurance company is clearly presented on the face of the financial statements, e.g., profit arising due to changes in risk adjustments, which reflects increases/decreases associated with the in-force portfolio); experience adjustments, which measures profit arising due to differences between best estimate assumptions and actual experience); changes in estimates measures the impact on profit due to changes in circumstances that leads to assumption changes. Previously, such information was not available to the users as it is co-mingled within insurance contract liabilities. Although similar information may be available to some life insurers under the embedded value reporting, this is not common for non-life insurers.

We also note that the draft IFRS proposes enhanced disclosure to provide users with information on premiums, claims and expenses. This adds context to the information presented under the summarized margin approach.

Our comment(s):
Presentation of financial statements of diversified groups: We believe that further consideration should be given to the presentation for entities that issue insurance contracts whilst undertaking significant non-insurance activities.

Clarity of proposed presentation items: We would also wish to gain more clarity, whether through application guidance or amendment to the wording in the final standard – in particular, to clarify the difference between 'changes in discount rates' in Para. 72(d) (ii) and 'changes in estimates of discount rates' in Para. 73.

(b) Do you 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?

We agree that an insurer should present all income and expense arising from insurance contracts in profit or loss.

We are of the view that the principal activity of an insurance company is the assumption and management of insurance risks. We believe that underwriting margin, experience adjustments, interest on insurance liability all relate to the core operations of an insurance company, and therefore, should flow through profit or loss, and not through other comprehensive income.

In addition, gains and losses on insurance contracts – e.g., underwriting margin, experience adjustments, interest on insurance liability, etc. – are a core part of an insurer's performance in both the short term and long term. Therefore, presentation of those gains and losses in profit or loss, and not in other comprehensive income, is appropriate.

Question 14

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

We generally agree with the proposed principle-based disclosure requirements.

The Board proposes as an objective that an insurer should disclose information to help users of financial statements understand the amount, timing and uncertainty of future cash flows, supplemented with some specific disclosures intended to help the insurer satisfy that principle. By specifying an objective, the Board eliminates the need for detailed and prescriptive disclosure requirements to meet the specific information needs for the various types of insurance contract.

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

We think that the proposed disclosure requirements will meet the proposed objective.

In situations when the information provided in accordance with the specific disclosures is not sufficient to meet that objective, the draft IFRS would require the insurer to disclose whatever additional information is necessary to meet that objective.

(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.

We have no additional suggestions for specific disclosures.

In situations when the information provided in accordance with the specific disclosures is not sufficient to meet that objective, the draft IFRS would require the insurer to disclose whatever additional information is necessary to meet that objective.

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

The proposals concerning unit-linked contracts comprise:

1) Unbundling of the investment component reflecting an account balance that meets specified criteria
2) Presenting the assets backing unit-linked contracts and the portion of the liabilities from unit-linked contracts linked to these assets separately from the insurer's other assets and insurance contract liabilities. Similarly, the Board proposes that insurers should present single line items for both income and expense from the pool of assets underlying unit-linked contracts and from the portion of the liabilities linked to those assets, separately from income and expense from the insurers' other assets and insurance contract liabilities.

Consistent with our response to question 12, **we agree** with the principle of the requirement to unbundle certain components of insurance contracts, which are <u>not</u> closely related to the insurance coverage specified in the insurance contract.

Question 16

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

We support an expected loss model for reinsurance assets.

(b) Do you have any other comments on the reinsurance proposals?

We believe that the building blocks approach is almost impossible to apply for reinsurance assets, and that the residual margin derived by applying that technique is arbitrary and subject to significant management bias. In addition, we also consider the practical challenges in applying the modified measurement approach in the context of reinsurance contracts.

Practical consideration(s) and alternative proposal:
Challenges to apply the building blocks approach: For most types of reinsurance contracts purchased by the cedant, it is usually not possible for the cedant to calibrate the net premiums paid or expected to be paid (i.e., the net cash outflows – premiums less commissions and brokerage) with the expected cash inflows (claims) to determine the Day 1 gain (or the Day 1 residual margin in the case of an expected loss) for which protection is purchased, and to mirror the liability for policies issued. Difficulties in determining the Day 1 gain include:

i. The reinsurance purchased would be in respect of an unknown portfolio (nature, amount, timing and premium rates) of underlying insurance/reinsurance contracts, which have not yet been written or accepted (in an extreme case, may never be written if the insurer loses its license, or ceases to write a portfolio of business for any reason), and would be written over the next year.

ii. The reinsurance premiums paid/payable is not yet known (for proportional treaties) and are at best a lower end estimate (for minimum and deposit premiums for excess of loss treaties).

iii. The building blocks approach would be very difficult to apply for excess of loss contracts (e.g., risk excess of loss treaties, stop loss and umbrella treaties, or clash covers) due to their rating methods (i.e., burning cost, flat rates with min/max) and the premium adjustment, since these are features that exist only for the reinsurance contracts but not the underlying direct insurance contract liabilities that they are supposed to mirror.

iv. The arbitrariness of the figures used for measurement could in many cases render the financial statements irrelevant and unreliable – i.e., less reliable than level 3 measurements.

We believe, therefore, that all purchased reinsurance contracts for non-life business should be subject to ordinary "policyholder prepayments accounting" from the perspective of a policyholder, i.e., by amortizing the premiums paid over the coverage period. Further, a Day

1 gain should be prohibited (as stipulated in the current IFRS 4) except perhaps for situations where an insurer can prove that it is probable that a Day 1 gain exists on initial recognition. A Day 1 gain should continue to be prohibited for financial reinsurance contracts.

Reinsurance of life business is typically quite specialized and bears no semblance to the pool of direct risks accepted by the direct insurer. Therefore, it may not be amenable to the building blocks approach.

Consequently, we believe it would not be possible to apply the building blocks approach to most reinsurance contracts purchased by cedants.

Challenges to apply the modified measurement approach: In our response to question 8 (b), we have highlighted some practical concerns in applying the modified measurement approach on reinsurance contracts. To apply the modified measurement approach (effectively a "policyholder prepayments accounting" approach), the following are required:

i. The 12 months criteria for short duration contracts should be more principle-based, and to be extended, so that reinsurance contracts that are of more than 12 months duration, and reinsurance contracts of 12 months duration but include underlying contracts of more than 12 months (e.g., construction and engineering risks), can apply the modified measurement;

ii. A cedant should not be permitted to recognize a Day 1 gain on reinsurance assets, unless the reinsurer can prove that it is probable that such a gain exists.

Question 17

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

We do not agree with the proposed transition requirements.

Our disagreement(s) and alternative proposal:

Measurement inconsistency between 'in-force' contracts [prior to transition] and future contracts: The requirement to measure existing 'in-force' insurance contracts' residual margin as zero is not consistent with contracts recognized initially subsequent to transition. We think that insurers should be permitted to estimate the residual margin as at transition date and release this margin over the remaining coverage period.

(b) If the Board were to adopt the composite margin approach favoured by the FASB, would you agree with the FASB's tentative decision on transition (see the appendix to the Basis for Conclusions)?

We do not agree with the composite margin approach. We have no comments on the FASB's tentative decision on transition.

(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?

We would support delaying the effective date of IFRS 9 if the new IFRS on insurance contracts has a mandatory effective date later than 2013, so that insurers would not face two rounds of major changes in a short period.

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

The amount of time needed to adopt the requirements of the proposed IFRS would depend largely on the sophistication of the insurer and its information technology support. Many of the requirements in the ED require major system overhaul. We think that a minimum period of 3 years is not unreasonable.

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

We have the following additional comments:

1. *Regulatory restrictions on the transfer of profits:* In the situation where there is regulatory restriction on the transfer of profit from a pool of contracts, e.g., in relation to participating contracts, such restrictions may require disclosure in the notes to the financial statements.

2. *Contracts with renewal options:* Under the ED, many long-duration insurance contracts (e.g., life contracts and riders) with an option to renew [with consequent rates revision, which depends on portfolio experience], may be classified as short duration contracts. We think that this may be an unintended consequence, which the Board may benefit to review before issuing the final standard.

Question 19
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.

We do not have any comment on the Board's assessment of the benefits and costs of the proposed accounting for insurance contracts.

Conclusion

Although it is conceptually relevant to measure insurance contracts in terms of the proposed building blocks, further considerations and guidance are required in some measurement areas, notably, aggregation of insurance contracts, claims cash flows, liquidity adjustments, risk adjustment techniques, and contract boundary. We do not agree with the Board's proposals on accretion of interest on the residual margin, the proposed criteria for the modified measurement approach, the mandatory scoping of financial guarantee contracts, the measurement proposals for reinsurance assets and the transition requirements.

Our recommendations for the final insurance contracts standard are broadly summarized below:

I. Provide additional application guidance on areas noted. We do not think that relevant guidance in relation to common application circumstances would undermine the Board's objective of a principle-based standard.

II. We recommend that the Board reviews its current position and consider the use of current interest rates, instead of historical lock-in rate, to accrete interest on the residual margin.

III. Review the proposed criteria for the modified measurement approach to allow all non-life insurance contracts to be measured using the modified measurement approach, regardless of duration. The Board should also provide as an 'option', instead of a mandatory requirement, for reinsurance contracts to adopt the modified approach.

IV. We think that financial guarantee contracts should not be expressly brought into the scope of the IFRS on insurance contracts. Instead, non-insurer issuers of such contracts should be given the option to account for financial guarantees as financial instruments or as insurance contracts.

V. We recommend that purchased reinsurance contracts should be subjected to an ordinary 'policyholder prepayments accounting' from the perspective of a policyholder, i.e., by amortizing the premiums paid over the coverage period.

VI. On transition, we think that insurers should be permitted to determine the residual margin of existing 'in-force' contracts as at transition date.

We hope that our comments will contribute to the IASB's deliberation on this exposure draft. Should you require any further clarification, please contact Ms Soh Siew Luie or Ms Janet Tan at their emails Siew_Luie_Soh@mof.gov.sg or janet.tan@icpas.org.sg respectively.

Yours faithfully

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Secretariat	Executive Director
Accounting Standards Council	Institute of Certified Public Accountants of Singapore