



**ASSOCIATION ACTUARIELLE INTERNATIONALE
INTERNATIONAL ACTUARIAL ASSOCIATION**

November 30, 2010

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

Dear Sir

Re: IAA comments on the IASB Exposure Draft *Insurance Contracts*

In response to the request for comments on the Exposure Draft *Insurance Contracts* (the ED), I am pleased to transmit on behalf of the International Actuarial Association (IAA) our comments and recommendations.

These comments have been prepared by the Insurance Accounting Committee of the IAA. If, upon reading these comments, you identify any points that you wish to pursue, please do not hesitate to contact the chairperson of that committee, Sam Gutterman, or any of the other members of the committee. We have been pleased to provide assistance to the IASB Board and staff on this project and we look forward to providing further assistance as the IASB moves to finalizing the revision to its final standard. The IAA will be pleased to develop the ideas presented in these comments further with you.

Yours sincerely

Yves Guérard
Secretary General

[Attachment](#): IAA comments

**A Commentary on the
EXPOSURE DRAFT ON INSURANCE CONTRACTS**
Released by the International Accounting Standards Board: 20 July 2010

International Actuarial Association and its Due Process

The International Actuarial Association (the “IAA”) represents the international actuarial profession. Our sixty-two Full Member actuarial associations, listed in an Appendix to this statement, represent more than 95% of all actuaries practicing around the world. The IAA promotes high standards of actuarial professionalism across the globe and serves as the voice of the actuarial profession when dealing with other international bodies on matters falling within or likely to have an impact on the areas of expertise of actuaries.

The IAA is pleased to be given the opportunity to provide input to the IASB on this important Exposure Draft. These comments have been prepared by its Insurance Accounting Committee, the members of which are listed in an Appendix to this statement. It has also been subject to the due process required for it to constitute a formal view of the IAA, and will be posted to the IAA’s official web site

General Comments

Overall, the IAA supports the model proposed in the IASB Exposure Draft for all insurance contracts within the scope of the ED. The use of the present value of the fulfilment cash flows, based on risk-adjusted expected values, as the basic objective seems appropriate. In particular, we support the reflection of the specific characteristics of the liability, including illiquidity, in the discount rate and the need for an explicit risk adjustment.

Our primary recommendations and comments regarding the Exposure Draft on insurance contracts are as follows.

1. *Importance of project.* The development of a soundly based, high quality financial reporting standard for insurance contracts is extremely important, both for insurance entities and the economy as a whole. We encourage the IASB to continue to develop a financial reporting standard for insurance contracts that appropriately reflects the economic basis of insurance. We believe that a global standard will ultimately benefit not only the large multinational insurers, but all members of the insurance industry and its stakeholders.
2. *Overall measurement attribute.* We believe that, to the extent practical, the overall measurement principles that underlie the final insurance contracts standard should be grounded in sound economic principles and consistent with the business model of the reporting entity. While the proposal goes a long way to eliminating inconsistencies between economic reality and financial reporting, there are still several areas where the proposed standard is in conflict with those principles and hence does not achieve the desired level of transparency. In addition, we are concerned with accounting mismatches between insurance contracts and financial instruments, such as invested assets of insurers, and with inconsistencies in measurement between insurance contracts, financial instruments and service contracts that have led to proposals for and challenges to unbundling. We point out these areas below. Should sound economic measurement

principles not be achieved, the standard may encourage manipulation through such vehicles as reinsurance and organizational restructuring, to achieve more favourable results.

3. *Risk adjustment.* The objective for the risk adjustment is described in an inconsistent manner within the ED. To avoid misapplication, an explicitly stated overall measurement objective should be provided. Consistent with a principle-based standard, it should include appropriate criteria for such an adjustment, without needless constraints, with an emphasis on disclosure where appropriate. The diversification effect of risks across portfolios should be recognized, since these effects are inherent in the economics and the pricing of the insurance contracts that are part of a portfolio. Both the reporting entity and investors would reflect such potential effects in both the price that the reporting entity is willing to be relieved of the obligations and rights of the contracts and the price that a potential purchaser would be willing to pay (and also observable in prices for portfolio transfers, business combinations and reinsurance transactions).
4. *Acquisition costs.* We agree with the proposed treatment of acquisition costs but we believe it should extend to all acquisition costs, not just to incremental costs. To be consistent with the economics of a portfolio of contracts across distribution channels and across jurisdictions, all acquisition costs should be included in the expected cash flows in building block 1. Limiting consideration of acquisition costs to those that are incremental is inconsistent with the unit of account used in the other parts of the measurement model in the ED.
5. *Subsequent measurement of residual margins.* This is an area to which insufficient attention has yet been directed. Since for certain longer duration insurance contracts the residual margin may turn out to be larger than the corresponding risk adjustment, the desired approach and principle should be consistently and clearly stated. The approach proposed for most insurance contracts, of allocating this in proportion to incurred benefits and claims, should be revisited, applying a more principle-based approach, such as using the passage of time or expected cost of the most relevant services provided (e.g., insurance protection or investment management) instead. The decision that the run-off be locked in at inception should also be revisited, as it is inconsistent with revenue recognition principles in that it capitalizes the impact of assumption changes rather than recognizing its effect in proportion to the services provided.

Note that the view of the IAA regarding whether to include a residual margin is evenly divided. Regardless, the IAA believes that all acquisition and relevant overhead costs should be included in the expected cash flows of the portfolio of insurance contracts, and not implicitly in the residual margin.

6. *Unbundling.* The scope and measurement objective for any unbundling, be it mandatory or voluntary, should be clearly stated to avoid divergent interpretations. The examples provided in the ED are not all consistent with its stated principle. The resulting values should be meaningful and add value to the users of financial statements; otherwise we prefer fewer situations where unbundling should be applied.
7. *Transition.* The transition rules are not appropriate for longer duration insurance contracts that use the building block measurement approach since, for many insurers, this will create inconsistent financial results between the in force and new business and, at best, may be

confusing to users, possibly in some cases for more than a decade, and at worst, may seriously misrepresent economic reality. Because the liabilities for “transition contracts” that may remain in force for decades do not recognize any residual margin, certain blocks of in-force business incur losses, due in part to the exclusion of overhead costs from the explicit measurement of the expected cash flows in the measurement of the liability. Although the transition rules in the ED do not specify that they do not apply to short-term business, we note that they are equally inappropriate and a full retrospective application would not be onerous.

8. *Measurement guidance.* No further measurement guidance is needed. Because of the wide variety of insurance contracts and conditions and the availability of relevant data, specific rules may result in application that is inappropriate. It is far better that clearly stated principles be presented in the final standard. Nevertheless, carefully crafted examples of application in certain selected areas may prove helpful where multiple interpretations might arise, as long as they do not create cookbook rules that preparers or auditors feel must be followed.
9. *Professional guidance.* The IAA intends to provide implementation assistance for the resulting insurance contracts standard available to actuaries worldwide. This assistance will include a monograph on discount rates that is currently under development, and preparations for a paper/monograph on the use of various risk adjustment methods, if needed. We have already completed a book on stochastic modelling. In addition, we anticipate the development of International Actuarial Notes to support the technical application of the standard. The historical actuarial tradition is to provide sound and objective professional advice to our insurance-related clients through application of actuarial standards of practice and a rigorous professional discipline process where called upon.

Specific Comments in response to Questions raised in the Exposure Draft

The following are our comments relating to the specific questions raised in 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?

IAA Comments

Overall, the IAA supports the model proposed in the IASB Exposure Draft for all insurance contracts within the scope of the ED. The use of the present value of the fulfilment cash flows, based on risk-adjusted expected values, as the basic objective seems appropriate. Nevertheless, if possible, we believe that an effort should be made to develop a consistent overall principle-based objective, as we discussed in our general comments. If one cannot be described through a label or description, it is important that the underlying measurement principles be based on sound economics and the business model of the reporting entity. To the extent that this is not achieved, the standard will encourage manipulation through such vehicles as reinsurance, revised product design and organizational restructuring, to achieve more favourable results.

While it is difficult to develop a single measurement principle combining both fulfilment value and a residual margin, we believe that an appropriate measurement principle for fulfilment value (the first three building blocks) might be:

Fulfilment value: the amount an insurer would rationally pay (or accept) to be relieved of its obligation to support the amount and timing of fulfilment cash flows, such that the insurer is indifferent between paying for such relief and fulfilling the insurance contracts.

Question 2 – Fulfilment cash flows

Q2 (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?

IAA Comments

As stated in our response to Question 1, the IAA supports the use of fulfilment value (the risk-adjusted expected present value of the fulfilment cash flows) as the overall objective. Nevertheless, we offer the following observations about expenses.

From the viewpoint of faithful presentation of the economics of the insurance business model, we believe that all relevant expenses relating to a portfolio of insurance contracts should be included in the fulfilment cash flows. We suggest that the IASB maintain its principle based “incremental to the portfolio” position and therefore include all acquisition costs and delete the example of excluding general overheads as stated in B62(f), B63 in the application guidance.

Based on the economics of the insurance business model, users of the financial statements, including investors, insurers, insurance regulators and policyholders, expect that the insurance

contract liability will provide for all the expected costs of fulfilling the obligations of the insurance contracts. Insurance contracts are usually priced, and portfolio transfers and business combinations are assessed, in a manner that includes allowance for some indirect or overhead costs. Although the existence of a residual margin does mitigate this, the proposed amortization pattern of the residual margin (passage of time or, in many cases, incurred benefits and claims) is unlikely to be consistent with the pattern of emergence of such costs.

To avoid these misleading representations, all relevant expenses, except those that are abnormal, should be included in the expected cash flows of insurance contracts or the amortization of the residual margin should be revised to better reflect its basis. Services should be considered, including a charge to cover indirect costs and general overheads. The approach proposed in the ED may encourage outsourcing, simply for accounting arbitrage reasons which may be inconsistent with sound economics.

We agree with the guidance in B63 that states that an insurer shall allocate costs that cover more than one portfolio to individual portfolios. That clarifies that those costs are to be considered to be incremental at the portfolio level. We believe that some indirect or overhead costs that relate to maintenance activities of insurance portfolios should be included as costs “incremental at the portfolio level”. We note that, in part due to information often required to be provided in regulatory filings, such allocations have not proven to be a significant source of manipulation.

Q2 (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?

IAA Comments

The level of guidance provided in Appendix B of the ED is appropriate for a principles based standard. However, we suggest a modification of paragraphs B38 and B39 to make it clear that probability-weighted cash flows are not always needed to accomplish the measurement objective of a statistical mean. In fact, because of the confusion that the phrase “probability-weighted” has caused, it may be useful to include in the parenthetical phrase in paragraph 22(a) the word “mean” or an estimate of the statistical mean might be referred to for clarification. Alternatively, the measurement objective might be expressed as:

.... an estimation of the expected present value of the cash flows resulting from the fulfilment of the insurance contract. This notion can be based upon a probability-weighted average that reflects the range of possible scenarios that can have a meaningful effect on the expected value.

This is particularly important for property & casualty unpaid claim liabilities where the most appropriate approach may involve multiple deterministic approaches to estimate the expected (mean) cash flows, using various drivers of aggregated claims data. While the goal of these methods can be to estimate an unbiased expected (mean) value, these methods do not necessarily explicitly involve the calculation of a mean using probability weighted estimates of all possible future scenarios.

The objective of this important component of the measurement of the liability is to capture, in an explicit manner, the expected value of the relevant cash flows. Due to the different risks involved in various insurance contracts, different methods are, and should be, used to develop these estimates. For example, a contract with a single guaranteed benefit can be measured by discounting the expected cash flows with the applicable risk free illiquid discount rate and adding the risk-adjusted expected amount of the guaranteed benefit. As indicated in the ED, sophisticated and refined approaches will be needed in some cases to capture, for example, the expected values of cash flows subject to options and minimum guarantees provided.

In Appendix B, we understand the purpose of paragraph B38 is to describe that the measurement objective is to estimate a mean, and that paragraph B39 indicates that the approach used to estimate the mean can vary depending on the circumstances. We believe these paragraphs could state more clearly that deterministic methods applied to aggregate statistics may be appropriate under the proposed model if the measurement objective of such methods is to determine an unbiased mean. A suggestion as to how paragraphs B38 and B39 could be amended to accomplish this goal is as follows:

- Replace the initial sentence of paragraph B38 with the following two sentences:

The starting point is to develop an explicit and unbiased estimate of the present value of future cash outflows less the future cash inflows considering the value of the uncertain outcomes. This is based on the statistical concept of an expected value: that is, a probability-weighted average that reflects the range of possible scenarios that can have a meaningful effect on the expected value.

- Add the following two sentences to the beginning of paragraph B39:

The expected present value of cash flows should be estimated using approaches appropriate for the contracts being measured. This may involve the use of basic methods using averages or average factors applied to aggregated data, or the estimation may involve complex modeling that simulates many future outcomes at the contract or risk level, or some other approach that meets the measurement objective of an expected value.

Question 3 – Discount rate

Q3 (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?

IAA Comments

We agree that the discount rate for these contracts should reflect the characteristics of the insurance contract liability.

Further, we recommend that, since paragraph 32 refers to measurement in general and not solely to the determination of discount rates, it should be moved to the section on general measurement.

Q3 (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?

IAA Comments

We agree with the proposal. A difference in discount rates that correspond to the characteristics of the cash flows due to the level of liquidity of an insurance contract is appropriate to consider. We also note that the measurement of the effect of illiquidity on interest rates currently is an emerging area of practice. That is the reason why the IAA is currently undertaking the development of a monograph on discount rate related issues, to describe current practice in this measurement area.

We believe it best to provide the principle, as in paragraph 30, with minimal guidance on its implementation. Over time, as practice emerges, any guidance may quickly become out-of-date and subject to misinterpretation. As a result, the reference to liquidity in paragraph 30 is sufficient, and that in paragraph 34 could be deleted, although it is important to note that liquidity relates to the contract rather than the actual assets. Note that the surrender rights of policyholders are already considered in expected cash flows and, to avoid double counting, need not be considered in the measurement of discount rates.

Q3 (c) Some have expressed concerns that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts. Are these concerns valid? Why or why not? 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?

IAA Comments

We agree with the concerns, as we are concerned about volatility introduced by temporary changes in market sentiment, particularly as they relate to contracts of considerable duration. Nevertheless, we remain opposed to the reflection of changes in non-performance by the insurer. There are several possible approaches to addressing this problem, including incorporating such volatility resulting from changes in temporary market sentiment into OCI, using current asset rates that reflect changes in market interest rates, and to lock in initial discount rates. This is an area that requires additional research.

Some believe that the differences between measurements using the approach in the Revenue Recognition Exposure Draft, those applying the accounting guidance in IAS 39 for financial liabilities and those using the proposed approach may, if not harmonized to avoid inconsistent results, provide an incentive to make increased use of unbundling, securitization or reinsurance, all for reasons other than economics. For example, a few of our members believe consideration might be given to permitting the use of an effective interest method for insurance contracts consistent with that permitted under IFRS 9 for financial liabilities, if that is consistent with the business model of the insurer. Such a choice should be irrevocable and locked in at the outset of the contract, using the same initial measurement approach as proposed in the ED, unless the contract becomes onerous (including a current risk adjustment).

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.

IAA Comments

A large majority within the IAA supports the use of an explicit risk adjustment. It is universally understood that insurance contracts are subject to significant risk and uncertainty. The question raised is whether risk and uncertainty should be reflected explicitly in a separate risk adjustment or implicitly in a composite margin formulation. Our reasons to support the use of an explicit risk adjustment include the following:

1. Risk and uncertainty are closely related to, and indeed are inherent in, the fulfilment of insurance contract obligations. Any decision made about insurance contracts should, by necessity reflect their risks and uncertainty. Insurance is, by definition, a transaction where the transfer of risk and fulfilment of the relevant obligations are the focus of the agreement. Unless that risk is reflected, the economic substance of the transaction is not faithfully represented. The more explicit the measurement, the more transparent the information provided to users of an insurer's financial statements. In fact, since the entire purpose of insurance is to pool those risks, it would not be appropriate to “hide” this element of the cost of offering these contracts in a composite margin. We believe that providing insight into the inherent risk and uncertainty will enhance the information provided and be a notable advance on outdated, traditional approaches that provide for it implicitly.
2. Due to the nature of the risk and uncertainty inherent in insurance contracts, their liabilities should include a positive risk adjustment, even where there is no residual margin. That is, if there is an onerous contract test, the risk adjustment should be included in that test.
3. Without an explicit risk adjustment, it is more likely that elements of conservatism or smoothing may be included in the estimates of expected value of cash flows, thus increasing the possibility of manipulation of reported values.
4. Many different risk adjustment methods have been used over the last century, although most explicit risk adjustment methods have been used in pricing and business combinations rather than in general purpose financial reporting. As this application becomes reality, further enhancement of these methods can be anticipated.
5. The reporting of a risk adjustment will encourage insurers to think more explicitly about the risk/uncertainty in their obligations, especially those risks involved in the tail of their probability distributions that may, otherwise, not be considered.
6. An explicit risk adjustment can better reflect the effect of skewed tail distributions in estimating the risk adjustment.
7. An explicit risk adjustment reduces the extent to which the margin operates as a plug. Without an explicit risk adjustment, the release of a composite margin will provide even less relevant information to users because of its composite nature, and thus may be ignored by users except as general information about the amount of deferred profits and the other factors that constitute that margin. Specifically, since the release of the plug is

unlikely to adequately follow the economics of the provided service, additional issues are likely to arise from financial reinsurance and other approaches that might bring the profit release more in line with the current economics of the situation.

8. At the same time, we do not believe that a decision regarding the use of a risk adjustment can be made in isolation, without considering the usefulness of the subsequent measurement of the composite (or residual) margin. We have the following concerns with the current FASB DP composite margin proposal:
 - Although it is often thought that the composite margin is “simple”, we caution that the currently proposed formula for the subsequent measurement of a composite margin may require considerable resources to operate and be difficult to interpret, given that it substitutes actual for expected experience throughout the coverage and claims periods, in succeeding reporting periods. This can result in a shock-absorber effect that may conceal useful information about contract performance. Further, such a “true-up” may result in counter-intuitive information, and the reconciliation may be difficult to explain. This retrospective adjustment type feature has caused considerable interpretation challenges in U.S. GAAP FAS 97 applications.
 - We do not understand how the composite margin can effectively apply to claims liabilities.
 - i. If the building block model is used for the pre-claims period, the amount reported for two similar claims liabilities would differ, depending upon features of the originating contract that are not relevant to the outstanding obligation, and would always depend upon the date of the origination of the original contract.
 - ii. If the premium allocation method is used for the pre-claims period, the application of a composite margin is currently undefined and might prove misleading at best and inconsistent with a corresponding building block liability for a coverage period just a couple of months longer in length. Indeed, it would require otherwise identical claims liabilities to differ by their coverage cohort. That would not be logical or reasonable, and would be inconsistent with the measurement of liabilities under IAS 37, which we believe should be treated consistently. We believe that those claims liabilities would not faithfully represent the characteristics of those obligations if no adjustment or margin is applied (so that their risk and uncertainty is not fully considered). However, if a risk adjustment is introduced to reflect the deviation risk in the claims liability, the FASB proposal would be enhanced.
 - iii. In property & casualty (general) insurance, claims liabilities are often substantially larger or smaller than the corresponding pre-claim liability. The degree of uncertainty can also change dramatically at or after the time of claim. A composite margin, as specified, cannot adequately reflect these changes.

9. Although regulatory regimes should not necessarily influence general purpose financial reporting, it is notable that an explicit risk adjustment is consistent with emerging regulatory schemes for insurance, e.g., Principle-Based Approach (U.S.), Solvency II in Europe, Canadian accounting, the established regulatory regime for Australian general insurance, and similar approaches in other countries.

In conclusion, although we recognize that the determination of a risk adjustment and a residual margin compared with the use of a composite margin may be somewhat more complex, our conclusion, based on the arguments above, is that the benefits from the use of an explicit risk adjustment are greater than those of not having one. In addition, it may not be simpler subsequent to its initial determination.

Question 5 – Risk adjustment

Q5 (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?

IAA Comments

Although we agree with the intended concept of use of the fulfilment value, we do not agree with the proposed wording currently used in paragraph 35, since we believe it to be potentially misleading and conceptually unclear.

We take this position for the following reasons:

1. This approach may be subject to significant judgment by management and thus may reduce the comparability of the financial statements of different entities. Nevertheless, it should be noted that, based upon the objective of risk adjustments and differences in risk appetite for these non-market risks, it may not be appropriate for entities to have comparable values in their financial statements. Disclosure of the effect of risk appetite on the parameters of the method applied would provide a more complete view of the level of risks the entity has entered into and its assessment of them. It is not clear that there is a single clear yard-stick parameter that might be applied, e.g., the risk averseness of owners, participants in the capital market, or that of the entity's management. The use of “through the eyes of management” may be practically more workable and relevant to users, provided systematic approaches are applied and adequately disclosed.
2. We believe that the risk adjustment would not be relevant to users if the risk adjustment principle refers only to the cash flows exceeding those expected and is not as appropriate as other objectives given elsewhere in the ED. (We believe that references to risk adjustments should be consistent throughout.) The stated objective is based on a one-sided test for uncertainty, which is inconsistent with any assessment of a rational insurer or potential investor. In effect, the liability value before residual margin would be the expected value plus a stop-loss premium. This is not how prices are set, nor how risks should be measured. Prices are set using a two-sided objective, allowing for the possibility of costs less than, as well as more than expected, e.g., as expressed in paragraphs 17(a) and 22(c). In principle, the liability value before residual margin should

be what the insurer requires to make an appropriate profit in the course of fulfilling the liability.

3. The effect of such a two-sided objective can be captured by appropriate calibration (selection of the parameter(s)) in the selected risk adjustment technique. That is often expressed as the amount needed to provide an appropriate rate of return on the capital that the insurer needs to support the liability, in accordance (on an entity-specific basis) with the insurer's appetite for risk. The risk adjustment may be better measured as the difference between fulfilment value and the expected present value.

We believe that the description of the objective of a risk adjustment given in paragraphs 17(a) and 22(c) is more appropriate than the one described in paragraph 35. The effect of a two-sided objective can be captured in the selection (calibration) of the parameters in the selected risk adjustment technique. We suggest the following two possible wordings for paragraph 35 that would be consistent with our understanding of the intent of the IASB:

The risk adjustment is the amount that lies on the boundary between the price that the insurer would be prepared to pay, to be relieved of the uncertainty about the amount and timing of the ultimate fulfilment cash flows, and the price where the insurer would prefer to retain the uncertainty.

or

The risk adjustment is an amount the insurer would rationally pay to eliminate the uncertainty about the amount and timing of the ultimate fulfilment cash flows, such that the insurer is indifferent between paying for such relief and fulfilling the insurance contracts.

Further we suggest that the IASB consider developing a measurement attribute for the entire measurement of the insurance contract liability (see our response to Question 1) instead of providing one only for a single technical measurement element. The emphasis on this element could overemphasize the relevance of that individual element, thus distracting from the meaning of the entire measurement. We believe that the principle should emphasize the importance of current measurement on a sound economic base to the extent possible.

Q5 (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?

IAA Comments

We do not agree that the techniques for estimating the risk adjustment should be limited to the three describe in the ED for the following reasons:

1. Limiting the techniques to three is inconsistent with the principle based ethos of IFRS.
2. CTE has limited applicability. It is best used for portfolios with "fat tails".
3. Other techniques may be more appropriate in certain circumstances.

4. New techniques will be developed in the future which would be more appropriate in certain circumstances, in particular to reflect risks such as changes in circumstances (B72(d)) and risk of error (B72(d) and B72(e)).
5. Actuarial standards of practice and generally accepted actuarial practice can assist in limiting the techniques used by companies to those that are appropriate in the circumstances.

We believe that companies should be required to disclose the techniques used, the reasons for their choice and their key parameters.

Q5 (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?

IAA Comments

We believe that disclosure of relevant significant aspects of the risk adjustment is important to its effective application. Nevertheless, we do not believe that the approach suggested in the ED is either the most appropriate, or the most cost effective, way to do so.

1. In some cases, this may require considerable additional analytical work for those entities using another method in measurement in what is often a very short financial closing period.
2. Inclusion of this requirement might bias the selection of method toward a CL when, as indicated in the ED, this method may not be appropriate in all cases. When another method is used, this requirement may result in different CL's for different portfolios for a business group, which may result in confusing, rather than useful information for users. In addition, if this is not the most appropriate approach, it may provide misleading information.
3. This disclosure may be appropriate and practical in some cases, such as for the claims liability for certain risks, but in others, such as for long-term life insurance, in which many experience assumptions are involved, e.g., mortality, morbidity and policyholder behaviour, it may be difficult to determine in a consistent manner.
4. Other disclosures (including the types and levels of uncertainty that go into the decision on the method(s) used, reasons for use of different methods in different types of portfolios, or risks, and key parameters) may provide as much useful information and insight. In addition, one might consider the CTE level applied and why it was chosen, the size of the risk adjustment in relation to the present value of expected cash flows, and the expected frequency at which the actual benefits/claims paid will exceed the present value of the expected cash flows for the portfolio, where it is practical to derive such numbers.

Q5 (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?

IAA Comments

We believe that a portfolio level of aggregation is appropriate, provided "portfolio" is defined in such a way that disparate coverages within a single contract can be considered and aggregated with similar coverages from other contracts, whether stand-alone or in different combinations.

There are several potential problems if coverages cannot be disaggregated in this way, including those cited in the following comments.

Insurers, regulators and industry bodies have significant experience and expertise measuring and monitoring experience at the risk level for a portfolio of insurance contracts. Some work has been done in a limited number of jurisdictions on the correlations between these risks under normal, and some stressed, market conditions, although this work is evolving.

Many of our members believe that, contrary to the ED, the diversification effect of risks across portfolios should be recognized, since these effects are inherent in the economics, and the pricing, of insurance contracts that are part of a portfolio. Note that the restriction in paragraph 36 is inconsistent with paragraph 35, since an investor would reflect such benefits. Both the reporting entity and investors reflect such potential effects, both in the price that the reporting entity would be willing to accept to be relieved of the obligations and rights of the contracts and in the price that a potential purchaser would be willing to pay (and also observable in prices for portfolio transfers, business combinations and reinsurance transactions). Wider diversification affects the uncertainty of the pool, even though not as a direct result of the combination of similar risks within the pool.

During the coverage period, this wider diversification would be reflected in an increase in the residual margin at issue. However, during the post-claims period, this offset cannot be made. Consequently, in practice, if such a diversification effect is not permitted, it is likely that a somewhat lower level of confidence (or applicable factor in the risk adjustment method used) may be applied in some cases. It should be considered, in such cases, whether it is more appropriate to consider this effect implicitly, in the choice of parameters, or explicitly as a factor in the risk adjustment.

An alternative that might be considered is to permit a broader approach to the application of portfolios in this area, reflecting the level at which contracts and risks are managed, rather than just the level managed as a pool of similar risks.

Q5 (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?

IAA Comments

Although these paragraphs serve as useful background information, we prefer that measurement guidance be provided at the principle level, with adequate information provided to clarify the applicable principles so that they can be interpreted consistently. We would prefer that technical guidance be provided through actuarial associations that are experienced in developing and providing educational guidance for such technical matters of an actuarial nature.

In some areas the detail is reasonable: for example, the criteria given in paragraph B72, originally developed by the IAA and the IAIS. In others, the guidance may be interpreted as rules, which should be avoided wherever practical. Importantly, we do not believe that further, or detailed, guidance should be developed or applied, unless it is done in response to a particular need for clarification.

We offer a few specific comments.

- B76. Although in some cases the probability distribution is relatively easy to estimate, in many long duration contracts involving multiple risks, it may be difficult to consistently estimate, due to the need to aggregate risks.
- B86. Note that this is just one cost of capital technique while, in fact, there is a family of techniques, most relating to alternative approaches to the development of economic capital. In addition, the description of the cost of capital method ignores any statutory minimum capital requirements even though, in some cases, statutory minimum capital may be used as a reference, from which calculated economic capital can be assessed. Insurers often determine their capital needs on a basis that provides an adequate probability that the statutory minimum requirement will not be breached, and markets take the statutory minimum into account in assessing capital adequacy. Ignoring statutory minimum capital is to ignore an important aspect of economic and commercial reality. As a result, such an assessment of this capital level should be conducted in any case.

Question 6 – Residual/composite margin

Q6 (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?

IAA Comments

There is a range of views within the IAA about the recognition of initial gain at issue. About half of the Committee on Insurance Accounting prefer an initial gain to be allowed, while some prefer a rebuttable presumption of no gain at issue.

We note that the inclusion of a margin that eliminates gain at issue may be a reasonable rule, given the definition of cash flows included in the ED guidance. If gains at issue are to be allowed, then non-incremental acquisition and general overhead costs should certainly be included in the expected cash flows (building block 1). To do otherwise could force an entity to show a profit at issue that might be in excess of the present value of the expected profit on the business. This approach (that is, including all costs) would both reduce the amount of the residual margin and increase overall transparency, by reducing the implicitly determined residual margin. We see this as desirable. Inclusion of overheads in expected cash flows may reduce, but not necessarily eliminate, the concern about the proposed transition rule. Note that the IAA believes that, even when a gain at issue is not recognized, building block one should include non-incremental acquisition and relevant overhead costs.

We will not go into a detailed discussion of the arguments of the proponents for allowing a gain at issue here, since it appears that the Board does not wish to pursue this option. Nevertheless, if there is an interest in these views, we will be pleased to provide them. Primarily this concern represents a desire for the insurance contract liability to represent a current value of the cash flows resulting from fulfilling the insurance contracts.

Q6 (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?

IAA Comments

We agree. We believe that it is appropriate to reflect any indicated loss currently, as part of profit and loss. As a result, the residual margin should not be allowed to become negative, at issue or after issue.

We also agree that an explicit risk adjustment should be included in any onerous contract test.

Q6 (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?

IAA Comments

We agree that margins should be measured at a portfolio level, but we believe that further subdivision should not be too granular.

We believe that the significant issue associated with the level of margins at a cohort level is whether and to what extent to permit the offset of negative and positive values. This is distinct from the need to use a finer level of subdivision in the underlying calculations, which is a technical issue that should not be subject to specific guidance in this standard.

However, we do not agree if the cohort is to be described as contracts with a similar date of inception. It is not clear that “similar date of inception” would be interpreted consistently. If interpreted, for example, as monthly, this would result in a much more granular evaluation than is done today and would require significant cost, while the results would play out in a short time frame. We suggest rewording “similar date” as “same reporting period”.

It should be noted that the risk adjustment is determined for portfolios of similar risks, with limited meaning for subdivisions of a portfolio of contracts, except as an apportionment of the portfolio's risk adjustment. Thus, the residual margin for a subdivision of a portfolio of contracts also reflects such an apportionment, with limited economic substance in its own right.

In principle, given that the basis of insurance is the pooling of risks where more profitable contracts support those that are less profitable, we believe that negative values should only be eliminated at the level of the entire portfolio. In some cases, there can be deliberate cross-subsidization of some risks by others within the same portfolio. In other cases, this may be imposed by external constraints on underwriting or accepted for marketing, public relations or administrative reasons. Too fine a subdivision will thus distort the apparent profitability of the portfolio.

In practice, whether it is feasible to aggregate at the entire portfolio level depends on whether residual margins are locked in. If they are, then the highest level of aggregation possible is by similar date of inception within the portfolio. This is the level at which, currently, property & casualty insurance unearned premiums are commonly tested for adequacy.

If residual or composite margins are re-measured, then it would be feasible to eliminate negatives at the level of the entire portfolio, for similar inception periods within a portfolio or within a portfolio for contracts with inception dates in the reporting period and all earlier contracts combined. While the principle suggests that the entire portfolio basis should be used, we believe that a division between new contracts and older contracts would provide useful information to users, but that there is no merit in further subdivision of business written previously.

Q6 (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)?

IAA Comments

If the Board continues to require a residual margin, we do not believe that the current approach is reasonable. Based on a review of modeled results of long duration contracts, the use of expected benefits and claims does not always appear to give reasonable results. For contracts with a steep cost curve (e.g., life and health insurance with coverage over a relatively long duration), the pattern of amortization of the residual margin is inconsistent with the factors that make up the residual margin. In addition, and in particular due to this increase in expected benefits and claims in many contracts, the accretion of interest results increases the residual margin balance, in extreme cases by several times its initial value. We find this to be problematic and in most cases difficult to understand and explain to users.

An alternative approach might be considered to enhance the usefulness of the information provided:

- Use the coverage amount as a base, if practically no other services than the coverage are provided under the contracts. For example, for term life insurance contracts it would be the face amount (sum assured) and for hurricane coverage, it would follow the expected incidence of hurricanes, during the hurricane season.
- Another approach, currently applied in Australia's Margin on Services method, is to amortize the residual margin over a selected profit driver using an actuarial technique. For example, for predominantly investment contracts, such as unit-linked and some forms of participating contracts, a different profit carrier may be more desirable. Since the principal service provided is investment management, a profit carrier based on assets under management may be more appropriate. We recognize, however, that it may be difficult to describe a principle-based distinction between alternative profit carriers.

In any case, we recommend the provision of a principles-based concept for the systematic release of the residual margin, referring to the provision of services under the contracts, rather than detailed guidance regarding the kind and quantification of services. The starting point could be a release pattern according to passage of time, unless that release pattern differs significantly from the provision of services.

In addition to the systematic release, an approach advanced by certain members of the IAA Insurance Accounting Committee is to re-measure the residual margin at every report date, reflecting changes in expectations about future experience. The resulting change in residual

margin balance being released would use the same methodology as was used at inception. This position has been advanced for the following reasons:

1. Locking in the residual margin is inconsistent with the principle in the Revenue Recognition Project (revenue in proportion to performance). In the ED, profit or loss from changes in assumptions in future periods is recognized before anything is performed. There is also a major conceptual inconsistency between a requirement for no gain at inception and a requirement to capitalise assumed future gains when more favourable assumptions are adopted.
2. Locking in the residual margin is inconsistent with the economics of the transaction. For example, it is incorrect to view the residual margin as the only consideration for the performance obligations, since the entire charge for coverage and administration is the price charged for the future performance obligations.
3. The liability might be overstated if a contract that was originally expected to be profitable becomes onerous.
4. Minor impairments of circumstances subsequent to initial measurement can cause even highly profitable contracts to show a loss in the period they are recognized.
5. A rules-based solution might motivate management to manipulate results by intentionally estimating cash flows and risk margins as high as possible and using a discount rate as low as possible. This could reduce the residual margin and, consequently, bring the difference into income either by changing assumptions or by putting in place reinsurance whose premiums are based on significantly less conservative assumptions or, if residual margins are counted as equity by analysts, by estimating the present value of the fulfilment cash flows initially as low as possible (even if that increases the probability that estimates would need to be increased later).
6. Since the residual margin is a plug, its value to users in understanding the current rights and obligations of the insurer may be problematic at best. In addition, it has no informational value if it is not re-measured.

It would be useful for a principle for subsequent measurement to be adopted, although the IAA has yet to agree upon one. One approach would be similar to that adopted by the Australian Margin on Services method, where in terms of the fulfilment value, the residual margin allows for adjustments reflecting the difference between the fulfilment value at the end of the period on the old and new valuation bases.

Recalibration would be a change in estimate, as defined in IAS 8. As a result, the movement of the residual margin would be transparent and easy to determine. Where market prices are directly reflected in measurement, as in the case of a replicating portfolio, the effect of changes in those prices would not in part be offset by a change in residual margin (since they are in part offset by the change in the replicating portfolio). If the residual margin becomes negative, it is not applied to the insurance contract liability or asset, but continues to be calculated and disclosed. If it becomes positive again, it is applied again.

We recommend the following wording for paragraph 50:

An insurer shall recognise the residual margin determined at initial recognition as income in profit or loss over the period where services are provided in a systematic way that best reflects the pattern of services provided:

- a) on the basis of the passage of time, but*
- b) if the pattern of services differs significantly from the passage of time*
 - (i) in the case of contracts providing mainly insurance coverage, on the basis of the expected timing of incurred claims and benefits*
 - (ii) in the case of other contracts, on the basis of the expected timing of services provided under the contract, according to the volume of services provided*

Changes in the estimate of the present value of the fulfilment cash flows, other than those changes of the value resulting from changes in observed market prices, are off-set against the carrying amount of the residual margin, as long as the remaining residual margin is positive. If changes in accounting estimates result in a negative calculated residual margin and this is later reversed, the residual margin is recognised again. The adjusted residual margin is systematically released in proportion to the pattern described above, on the basis of current assumptions.

Q6 (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?

IAA Comments

We believe the method proposed may not reflect the release from risk appropriately. We believe the methodology under a principle based approach should use any knowledge about release-of-risk that is available. This may reduce the accounting mismatch that would otherwise arise between the margin and the value of the assets supporting the margin.

[We note that the formula in the Basis for Conclusions is incorrect and has been corrected in the FASB Discussion Paper.]

Q6 (f) Do you agree that interest should be accreted on the residual margin (see paragraphs 51 and BC131)? Why or why not? Would you reach the same conclusion for the composite margin? Why or why not?

IAA Comments

At least to the extent that the margin calculations are based on present value concepts, the majority of actuaries believe that interest should be credited on the residual or composite margin. Basing them on factors that do not back-end their allocation will minimize or reduce possible accretion of the margin balances.

However, there are a significant minority who believe interest should not be credited. Reasons for this minority position are largely based on the lack of economic meaning that the residual margin has as part of the liability:

1. Most importantly, in cases where the expected benefits and claims are back-loaded, the residual margin balance can increase significantly with little relation to the economic substance of a portfolio of insurance contracts.
2. Being artificial and a non-current measurement, crediting interest on the balance implies a credible and meaningful quantitative assessment that is not warranted.
3. Since both these margins consist of several implicit components that are not related to the substance of a portfolio of insurance contracts, their measurement should be as simple as possible.
4. Interest relates to items that represent future cash flows, while the residual/composite margins, although initially determined based on present values, consist of several factors, some of which do not consist of cash flows.

Question 7 – Acquisition costs

Q7 (a) 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?

IAA Comments

Similar to other expenses and all other aspects of the ED measurement principles, we believe acquisition costs should be accounted for “incrementally at the portfolio level”: that is, direct costs and systematic allocations of costs that relate to the portfolio initiation activities should be included in the initial measurement. This should include all acquisition costs and would be consistent with both sound economics and the business model of insurers.

We believe that the example in B61(f) in the application guidance should be altered to read: “...the incremental costs of selling, underwriting and initiating insurance contracts and expenses related to the initiation of a portfolio”.

The following examples demonstrate that the notion “incremental at the level of individual contract” is not conceptually robust, based on the underlying economics of insurance contracts and the insurance business model. Nor is it easy to apply, whereas the notion “incremental costs relating to the portfolio” is relatively robust, provides useful information, and is relatively easy to apply.

- Most career agents’ compensation arrangements contain characteristics of incremental acquisition costs. However, it is difficult to pull out the incremental costs at the contract level from the salaries of career agents, because the method of salary determination is complicated and is not directly linked to each contract.
- At one extreme, offering insurance through the internet, with all clerical, assessment and underwriting functions handled by salaried staff, will generate very low recognition of

acquisition costs and, because unrecognized costs are expensed with no offset, high losses at issue. At the other extreme of current practice, a model whereby acquisition is on a commission basis will generate higher costs and much lower losses at issue. Not permitting acquisition costs at the portfolio level will simply encourage entities to outsource this expense on a per contract sold basis, thus qualifying them for inclusion in building block 1 cash flows.

- Placing all staff on a piecework basis could further reduce these losses. A franchise model, where all activities are contracted out, with a fee charged to cover head office overheads, could eliminate losses at issue altogether.
- There are costs incurred in connection with applications that an insurer has determined not to accept: for instance, costs of medical selection. Although these costs may not be allocated to the incremental acquisition costs at the contract level, they are costs of activities to acquire a new business portfolio. In practice, it might be difficult or impractical to separate these from other costs.

These examples demonstrate that the notion “incremental at the level of individual contract” may not be as conceptually robust as it might appear, based on the underlying economics of insurance contracts and the insurance business model. Therefore, we recommend changing the definition of “incremental acquisition costs” to include costs that are incremental at the portfolio level.

Regardless whether or not our recommendation is accepted, we have a problem with the definitions of “acquisition costs” and “incremental acquisition costs”. In particular, the portion of the latter that 'would not have been incurred if the insurer had not issued that particular contract' seems inconsistent, or at best incomplete. This is because the latter could be interpreted to exclude all, or almost all, underwriting and initiating costs, even if incremental to the application as applied for, since they will have been incurred before the issuance of the contract. As a result, we recommend that, if our recommendation is rejected, the definition of incremental acquisition cost should be changed to:

The costs of selling, underwriting and initiating an insurance contract, actually issued, that would not have been incurred if the insurer had not attempted to issue that particular contract, but no other direct and indirect costs.

The wording in B61(f) would also need to be changed to be consistent with this definition.

Question 8 – Premium allocation approach

Q8 (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?

IAA Comments

We recommend that the Board should permit, but not require, the modified measurement approach for pre-claims liabilities. Since the modified measurement approach is simply an approximation of the result that is generated through the building block model under the assumption that this approach should generate approximately the equivalent result, an entity

should not be precluded from using the standard approach. For example, this would allow entities, such as those with predominately longer duration coverages but with some shorter duration contracts, to retain a single measurement approach and a single presentation in the performance statement, without a loss of consistency in measurement.

Q8 (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?

IAA Comments

Criteria

We disagree with proposed criteria. With regard to the proposed criteria for requiring the modified approach, we understand that the proposed coverage period of approximately one-year is intended to be interpreted strictly: that is, contracts that might otherwise be considered short duration would not be eligible for the modified approach.

For example, there are some property & casualty insurance contracts, such as catastrophe reinsurance and surety contracts, where the coverage period may be longer than one year, but the economic substance of the arrangement is the same as similar coverages that have a one year or shorter term. Another example is a reinsurance contract covering insurance contracts written in one year, where each ceded contract has a coverage period of one year (that is, short duration), but this extends coverage for two years and is beyond the boundary.

For such contracts that might be somewhat longer than one year, the result is a more complicated building block model, coupled with a different presentation. (Gross premium and gross loss statistics are not included in the income statement for contracts not subject to the modified approach.)

Instead of having the threshold set at approximately one year, it is our view that the guidance should allow for judgment on a principle basis (rather than the use of a rule) in selecting the appropriate model. While the guidance could be framed so that the modified model typically would apply to single year contracts, it should not prohibit application to contracts of more than one year if the unearned premium approach provides a reasonable approximation to the fulfilment cash flows plus the residual margin for such contracts during the pre-claims period. This allows the simplified approach to be used for certain agreements that are longer than one year, where the economic substance is essentially the same as those of single year or shorter agreements, thereby allowing for consistent measurement and presentation for contracts that are substantially similar.

Application

We are also concerned with the application of the proposed approach. While we believe the approach introduced in the Exposure Draft is, in concept, reasonably consistent with the earned premium approach that is common practice in many jurisdictions, there are other features of the model that, we assume, are intended to make the measurement more consistent with the building block approach. As a result, the elements of the approach that deviate from common practice today add layers of complication to an approach whose intent is be relatively simple to apply but, arguably, with limited corresponding benefit. These layers of complication include:

- Consideration of interest in premium instalments to be received in determining the pre-claim obligation, described in paragraph 57(a). Currently, premium collection is not tied to accounting for the premium for short duration contracts. If these two are tied together, as under paragraph 57(a), then the date of receipt of the premium must be tracked and used in premium recognition. This is not trivial and could be costly, since it would require significant changes to existing systems. It would affect instalment billings, audit billings, and endorsement billings. This would result in significant complication of the current process, while producing a trivial difference in the vast majority of cases. We recognize that, in such conditions as a hyperinflationary economy the difference may not be trivial. We would prefer that such situations are treated more generally, since this is not an issue specific to insurance contracts.
- The accretion of interest, described in paragraph 59. Accreting interest adds complexity to the measurement and presentation of the pre-claim liabilities. Since the modified model only applies to short duration contracts and as a result would not be expected to be of significant size or released over a lengthy period, accreting interest on unearned premiums would probably have minimal impact in the vast majority of cases. Nevertheless, in other economic conditions this conclusion may not be correct. An appropriate compromise is that interest should not be accreted, unless significant.
- The onerous contract test, described in paragraph 60. While we agree with the concept of the recognition of onerous contracts, the approach described requires that the calculation be performed at a cohort level within a portfolio, where the cohort is described as contracts with a similar date of inception. It is not clear how similar date of inception would be interpreted. If interpreted as monthly, this would result in a much more granular evaluation of premium adequacy than is done today and would require significant effort, while the results would play out in a short time frame. Since these are, by definition, short duration contracts, there is seldom information in the pre-claim period that would provide significantly different views regarding the expected economics of the business, particularly across a broader spectrum of business and similar reporting periods.

Consequently, we recommend that the application of the modified approach be performed in a manner that is more consistent with the earned premium approach that is common practice today, is easy to apply and understand, and produces decision useful information. Thus, we recommend the following:

- Amend paragraph 57(a) to delete the word “*present*”, and then add “*adjusted for the time value of money, if significant*” before the word “*less*” at the end of the sentence.
- Amend the end of paragraph 59 to include the phrase, “*...if the effect of discounting produces an earning pattern that differs significantly from the application of paragraph 58.*”

The intent of both these changes is to limit the consideration of the time value of money under the short duration approach to those very limited circumstances where the effect of such accretion is significant, similar to the principle introduced in paragraph 58 for seasonality of losses. This amendment would enable companies to maintain a simplified measurement and presentation model in the large majority of cases.

- Amend paragraph 56 by deleting the word “*present*” and adding “... (*adjusted for the time value of money, if such an adjustment is made under paragraph 57(a)*)” after the word “*value*”.
- Amend paragraph 60 to require that the onerous contract test be performed taking into account the reporting period and at the level in which management manages its business, which might be at a portfolio level or, in some cases, at a more aggregated level.

In addition, we recommend that paragraph 57 (b) be amended to include “*acquisition costs and transaction-based taxes*”. This would result in the consistent treatment for such taxes under the building block and modified approaches, allow consistent treatment with current practice, and treat such taxes in a manner that is consistent with incremental acquisition costs, which is appropriate since both are incurred expenses that are directly associated with the issuance of a contract. Note that we deleted “*incremental*”, consistent with our response to Question 7.

The current wording in paragraph 56 can give the impression that, while the pre-claims obligation is locked in, the expected present value of future premiums to be deducted from the pre-claims obligation is to be measured on a current basis. If that is not intended, it should be made clear. It would be more consistent with the Revenue Recognition Project to distribute any change in the estimate of the future premiums over the contract duration. Further, we understand that the proposed modified approach is more in line with Revenue Recognition Project, since changes in assumptions about cash outflows do not affect the total liability, as long as the liability is adequate. We believe that this is appropriate if the residual margin is recalibrated.

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 or why not? If not, what would you recommend and why?

IAA Comments

We generally agree with the proposed boundary principles, except for the following points. Many contracts are subject to rate regulatory actions. The issue can have an important impact on the length of the coverage period that would be included in the contract boundaries. In some cases it is quite difficult to develop an estimate of the effect of the applicable regulations over a long period of time. In other cases the existence of such a regime may be considered to affect the practical ability of the insurer to set a price that fully reflects the risk. Nevertheless, we believe that, unless the effect of these actions can be reasonably estimated based on such factors as historical approvals, the effect of such rate regulation should not be considered to affect the ability to reflect expected costs fully, in part because all insurers offering similar contracts will be subject to these conditions. In some cases, such as the upcoming U.S. health care reform, estimates of this effect will be quite difficult, since it may not be possible to derive a useful and reliable estimate. In such a case, the insurer would be expected to adequately describe this regulatory risk as part of the disclosure of the risks and uncertainties of the cash flows arising from these insurance contracts.

In fact, we are not sure what the concept of “fully reflecting the risk” means. Assuming that the new price must reflect the change in the individual risk exposure fully and fairly, the new price is effectively neutral for the policyholder. Changing the insurer would not change the price and, therefore, the insurer is expected to have to continue the coverage. Hence, the insurer cannot

motivate the individual policyholder to cease the contract. Therefore, we believe that the emphasis should be on the ability to reprice freely to the extent that it can, rather than fully reflect the change of risk.

An example of where a change should not necessarily be considered a contract boundary is property coverage of an automobile which, at outset, is only based on the type of automobile to be covered. The policyholder is obliged to report any change of automobile, and the premium rate is revised automatically according to the expected accident claims or to a contractual list of premiums for the new automobile, compared to the old one. We do not believe such a contractual right under this type of re-underwriting (such as aging of the car, aging of the insured or a change in marital status in a life or health insurance contract) should represent a contract boundary. If it were, it would be difficult to identify the day it occurs and, if a new initial acquisition cost is not incurred, the residual margin would have to be re-determined, with significant reporting consequences. Consequently, we recommend a change in the wording to “... *that more than fully reflects that risk*”.

Another of our concerns relates to reinsurance contracts. The ED is unclear about whether the contract boundary is at the expiry of the reinsurance agreement or at the expiry of the coverage period of an insurance contract covered under the reinsurance agreement. We believe that, for practical purposes, the latter is desirable; otherwise, there could be an accounting mismatch between an insurer's direct and ceded business.

Question 10 - Participating features

Introduction

For most, if not all, participation regimes, we agree that the measurement of insurance contracts should include any participating benefits on an expected present value basis. We hope that the following clarifies our suggested treatment of participation features. For the purpose of the following comments, we provide two definitions, the first of which is of ‘participation features’ (PFs):

Participation Features (PF): Enforceable obligations on the insurer (issuer) established by a current contract to return a specific part of the surplus remaining after performing all or specific other obligations under that contract (normally together with that of other contracts) as additional benefits to current or future contracts.

Many PFs reduce the risk borne by the insurer by initially charging premiums that are greater than initially expected to be needed to fund the guaranteed benefits. Subsequently if these initial expectations are met, a large part of the resulting surplus is returned to policyholders (two-step or retroactive pricing). The retroactive pricing refers directly to entity-specific surplus rather than to market factors (as a derivative would). Essentially some of the risk is transferred back to the policyholder through a higher premium, with the policyholder expecting to acquire additional benefits or an overall reduction in cost.

Therefore, the risk mitigation effect of PFs indicates that the risk reducing capacity of PFs should be reflected in the risk adjustment. In addition the surplus pattern emerging under IFRS should reflect this transfer of risk.

There is also a wide range of retroactive premium adjustment clauses. These transfer entity-specific losses (often in addition to PFs) to policyholders through a right of the insurer to change premiums retrospectively. There are also collective prospective premium adjustment clauses, intended to avoid or substantially reduce future losses by adjusting future premiums to reflect observed entity-specific trends. These features involve measurement issues similar to those of PFs.

The measurement of PFs and similar features is best guided by general principles, especially considering the range of such features worldwide.

In some jurisdictions, specific forms of PF are referred to as “discretionary features”, since the fulfilment of the obligation, that is, the ultimate distribution to policyholders, is at the discretion of the insurer. However, there is a current obligation and these amounts can never contribute to the benefit of the insurer: that is, they are excluded permanently from profit. As such, “discretion” deals with an allocation of the resulting funds: that is, who receives what amounts when, rather than an accounting issue distinguishing between equity and liability. The amounts resulting from a PF are clearly a liability to a third party, but the recipient is at the discretion of the insurer.

We suggest a distinction be made between such features and discretionary benefits. The latter can be defined as follows:

Discretionary Benefits (DB): Additional benefits, provided under an insurance contract, whose amount and timing is at the discretion of the insurer, without constraints of commercial substance.

The main accounting issue for DBs, which is not an issue for PFs, is whether they should be recognized. If recognized, the measurement of DBs depends on their intended trigger: that is, whether they are distributed to return some of the excess premiums (surplus) or whether they are intended to achieve a certain minimum return to policyholders (even if that might cause a severe reduction of insurer’s profit). In the first case, DBs would be measured similarly to PFs. In the second case, DBs would be measured in a manner similar to that for guaranteed benefits. When determining the risk adjustment in both cases, the amounts at the discretion of the insurer would be considered.

Q10 (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?

IAA Comments

We understand the reference to “expected present value basis” to be referring to an overall consistent measurement of the contract in compliance with the principles set out in paragraphs 17, 23, 30, 35 and 47. We agree with this principle-based approach.

We are however concerned that the application of that term may not adequately provide for appropriate accounting in some participation regimes. The following is a discussion of these concerns.

Contract Boundary Issues

We understand, from paragraphs 32 and B61 (j), that measurement is about current obligations under PFs: that is, resulting from current contracts, to be fulfilled under current or future contracts, and expected payments under DBs that are intended to result from the existence or generation of surplus from current contracts, under both current or future contracts. However, contract boundaries are also relevant here. Considering the purpose of PFs (and some DBs) to refund unused portions of premiums, it is sufficient if the guidance requires consideration of cash flows 'resulting' from premiums within the contract boundary.

However, issues with the contract boundary arise if the obligations under a PF are not fulfilled by an immediate payment in cash. In some cases the obligation might be fulfilled by increasing performance obligations under current or future contracts that, potentially, may be profitable for the insurer. In such cases, the cash flows originally triggered by the PF are to be distributed in the distant future, in the performance of the additional performance obligation. Here, the obligation under the PF is not paid out, but is transformed into another obligation. This raises the issue of whether the profits under such additional performance obligations should be anticipated in determining the current obligation under the PF: that is, by reducing the obligation under the PF to amounts to be paid in future.

We believe that the cash flows from allocations of policyholder dividends (bonuses) to future contracts are beyond the contract boundary of current contracts. Consequently, the related current obligation under the PF cannot be measured on an expected cash flow basis but should instead be looked upon as a nominal amount, equivalent to an assumption that terms of future contracts require the distributions to be paid in cash directly, to the extent required by the present obligation under current contracts.

Allocations under current contracts are often associated with different sub-portfolios, as described in paragraph 20 for the purpose of initially measuring the residual margin. If the allocation to particular contracts is subject to the insurer's discretion, we do not believe that it is appropriate to anticipate gains arising after the allocation and to reflect those gains in the residual margin of particular contracts. We believe that they should be considered when the allocation actually occurs. Therefore, we recommend adding the following to paragraph 26:

If the obligation under a particular current contract is expected to increase in future, not as a result of a premium payment under that contract, but at the discretion of the insurer in fulfilling a present obligation under a collective of contracts (that might include the particular contract), the cash flows resulting from that increase in the obligation are outside the contract boundary and should be reflected at the time of the increase in the obligation. The present obligation to the collective of contracts is, therefore, not measured on the basis of those expected cash flows but rather assumes that the insurer executes its discretion in fulfilling that obligation in such a manner that its value is as unaffected by future events and economic developments as is practical. The same applies in cases where it is expected that obligations under future contracts are increased. Here, it is to be

assumed that the future contracts are issued in such a manner that the value is as unaffected by future events and economic developments as practical.

Cash Flow Issues

The main issue in respect of paragraph B61 (j) concerns the expected amount of surplus under a PF that constitutes the current obligation to current and future contracts or the expected amount of DBs. This amount is typically based on statutory accounting principles and is referred to as the “participation measurement basis”. The three building blocks for premiums and guaranteed benefits include assumptions about expected surplus. IFRS values may anticipate future surplus not yet considered in the participation measurement basis or may defer some of the surplus already considered in the participation measurement basis. For example, the participation measurement basis may anticipate future premiums beyond the contract boundary and may include overheads excluded under IFRS.

Therefore, the “realistic” expectations for future payments under the PF: that is, those based on the participation basis, are inconsistent with the amounts recognized under IFRS. Consequently, the clarity of paragraph B 61 (j) could be improved by adding the words: “... *to the extent that the respective performance is considered at the measurement date in the measurement according to this or another IFRS.*”

Q10 (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?

IAA Comments

This should be read in connection with our response to question 10 (c), where we suggest that, rather than using the term discretionary participation feature, PF as defined above be used.

We support the inclusion of investment contracts that share in the same surplus as insurance contracts already covered by IFRS 4. Similarly, service contracts with DBs should also be included, if it is expected that DBs are intended to return a portion of surplus to contracts. We believe that the existence of a PF, especially if it constitutes a collective feature, should be measured in a consistent manner. We believe that the existence of a PF should render the entire contract subject to the guidance of the insurance standard and that this should be accomplished by expanding the scope of the standard to include all contracts that incorporate significant insurance risk and contracts with significant PFs. This would also cover all service contracts containing PFs, not within the scope of the ED. Alternatively, the guidance for PFs in the insurance standard could be reproduced in the measurement guidance for financial instruments and for service contracts.

Investment contracts with PFs that establish a collective obligation with insurance contracts should not be measured separately because the resulting obligation under the PF cannot be split. A PF, by its nature, represents an inherent part of the rights and obligations of the contract. In that regard, we agree with the ED.

Therefore, we believe that the scope of the insurance contracts standard should be extended to cover both insurance contracts and other contracts with a PF (at least until the measurement of these contracts are specifically dealt with in the context of, say, the Board's liability and equity project), based on the following:

1. PFs can only be measured on a fulfilment basis since they refer specifically to entity-specific, surplus; and
2. as defined above, they are found almost exclusively in insurance entities.

Q10 (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?

IAA Comments

We do not fully agree with the proposed definition of a Discretionary Participation Feature. We are concerned that the definition unnecessarily combines two separate characteristics that have significantly different accounting consequences (see above Introduction to Question 10) and does not comply with the principle of substance over form. We are also concerned that the definition refers to the need of at least one insurance contract to be present in the same participation source.

As outlined in our comment to ED5 in 2003, we do not believe that the definition of a DPF is appropriate. The definition requires that the feature has to include both discretion and a linkage to surplus.

1. The definition does not require that each or both features have commercial substance: that is, all discretionary or surplus linkages are covered, while a feature without any discretion or linkage to surplus is not covered. This is inconsistent with the principle of substance over form. This would result in a need to search for any discretion or an unused linkage to surplus.
2. It is not the combination of both features that creates the relevant issues. Any realistically expected discretionary benefit, regardless whether it is “linked” to surplus, raises both recognition and measurement issues. The ED solves that issue by defining contract boundaries including non-enforceable cash flows like DBs. Any linkage to surplus (PF as defined above), whether containing some discretion or not, affects measurement issues, but not necessarily recognition. The artificial combination of both issues in one definition of a feature has resulted in confusing board discussions.
3. The ED restricts the application of the definition of a DPF to the classification of investment contracts: that is, to determining whether they are within the scope of the insurance standard or not. Hence, in addition to the fact that we believe that service contracts with PF should also be covered by the insurance standard, the question arises whether the definition of the DPF properly identifies all contracts that should be subject to the insurance standard. We believe that the feature requiring applicability of the insurance standard is the PF: that is, the linkage to surplus. The existence of discretion is not relevant. Specifically, an investment contract or service contract with a PF, even if it

lacks any discretion, should be subject to the insurance standard, at least when the feature operates with insurance contracts. In contrast, an investment contract or service contract with discretionary benefits that are only linked to surplus in a formal or irrelevant manner, need not to be subject to the insurance contracts standard.

If the IASB does not agree with our recommendation that any contract with a PF should be included in the scope of the insurance standard, we suggest that, as a minimum, the definition needs to require application of the principle of substance over form.

Q10 (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?

IAA Comments

We agree in principle that references to coverage or coverage period are replaced by references to the PF. However, we believe that, in some cases, the reference to coverage should be replaced by a reference to services provided.

Specifically, in the case of contracts with PFs, the residual margin should also be amortized on the basis of services provided, not on the PF. The residual margin is deferred profit of the insurer after PF and, therefore, has nothing to do with the PF itself.

Question 11 – Definition and scope

Q11 (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?

IAA Comments

With respect to the definition of an insurance contract, we offer the following suggested improvements:

- a) We agree with the changes summarized in BC191. The term compensation is clearer than indemnification. The emphasis on the timing of the risk is economically significant and, hence, appropriate.
- b) We are not convinced that the requirement in B25 (derived from a similar rule in U.S. GAAP (BC191(c)), that there must be a scenario of commercial substance where cash outflows exceed premiums, both estimated on a present value basis, is appropriate. We believe that the reference to significant insurance risk does not need such a loss test, nor does it represent a significant improvement in IFRS 4. We believe that the requirement that there must be a pre-existing risk, now in B12, adequately eliminates the danger of misuse, because a contract in which the premium is higher than the maximum possible benefit would not normally involve the transfer of a pre-existing risk, since such a contract creates a new risk.

In fact, insurance contracts transfer the risk of adverse deviation for a price, while the insurer pools a large number of similar risks effectively to reduce the deviation risk. Consequently, the result may be that, at the portfolio level, there is virtually no longer

any risk of loss, but rather just a significant risk of deviation from the expected profit. It also might turn out that the insurer will earn less than required to provide an adequate return for the entrepreneurial activities undertaken, after considering overhead, non-incremental acquisition cost and a compensation for capital provided.

In any event a loss notion test relying on expected premiums might not be appropriate because of premium elements that contain other than expected benefits and claims (such as allowances for expenses and expected profits). If it is decided that this concept is included in the final standard, it may be more appropriate to consider whether, at least, expected profit should be omitted from the test.

If an insurer intends, because of its volatility, to transfer that risk to another insurer through reinsurance, thereby reducing its capital requirement, the accepting entity bears the same risk as the direct insurer, but measures the risk on a portfolio level. For a full transfer of such a risk on original terms, U.S. GAAP provides that the transferring contract would be a reinsurance contract, without the need to prove that a loss is possible. In such a case, deviation risk is a pre-existing risk for the direct insurer, even if no loss is possible and therefore, under Phase I, the transfer was seen as a reinsurance contract. We believe this is appropriate and therefore recommend that B25 be omitted since B12 on its own is sufficient for this purpose. Otherwise, B25 should be amended to exclude from the loss test contracts that transfer the original risk of insurance contracts.

c) Reference to a contract

The ED refers to contracts without providing a definition of that term. In some cases, it requires bundling of (legal) contracts (paragraph B28), while, in others, unbundling of a single (legal) contract (paragraphs 8-10). Bundling and unbundling should be based more on the concept of “substance over form”, rather than establishing rules based on legal contract provisions and interpretations. Under this concept, the contract to be considered should be the relevant economic relationship rather than the legal contract.

We recommend that the guidance in ED, *Revenue from Contracts with Customers*, paragraphs 8-24, be considered.

The IAA believes there should be no requirement to artificially split insurance contracts that contain many bundled, and interrelated, features. The IFRS for insurance contracts should refer to the whole insurance contract, consistent with the *Revenue from Contracts with Customers ED*. The requirement to measure those financial components of the contract for which replicating portfolios exist makes unbundling redundant. See also our response to Question 12 on unbundling.

Referring to that principle eliminates the need for the bracketed insert in B28. We are not aware that this requirement has any practical relevance, while compliance could impose a significant burden.

d) Insurable interest

The current requirement for insurable interest in Appendix B should be narrowed or even eliminated. While the IAA recognizes the desire to differentiate gambling from

insurance, the need to apply a test of insurable interest after issue may unduly complicate the application of the ED.

Any suggestion that the requirement of the last sentence in B14 could be interpreted as requiring the preparer to demonstrate that, before a benefit is paid, it must explicitly demonstrate that the insured event had an adverse effect on the beneficiary, should be eliminated. Such a requirement would be onerous on any insurer. In practice, that requirement, now in IFRS 4, has, of necessity, been ignored for life insurance. Based on our experience, no life insurance contract world-wide contains a requirement to prove, on request, the existence of an insurable interest as a pre-condition for payment of a benefit. Nevertheless, life insurance has universally been assumed to be within the scope of IFRS 4. We recommend that the paragraph be modified so that such a requirement in the contract would not be needed. In the life insurance context, insurable interest is considered, where appropriate, at the time of underwriting and, therefore, a requirement to prove the presence of insurable interest at time of claim or benefit would not be appropriate. We suggest that the following sentence be added to B14:

However, the contract does not need to include such a precondition if it is customary to assess insurable interest at issue or if the nature of the insured risk and the form and purpose of the contract indicate that it is appropriate to assume the presence of an insurable interest, as is usually the case for life and health insurance.

e) Financial Risk and Financial Variables

The Board should consider distinguishing between market and non-market driven variables, rather than between financial and non-financial variables, in the guidance on the definition of insurance contracts. Otherwise, we suggest that an appropriate definition of the term “financial risk” be included. Subsequently in the ED, a distinction is only made between market and non-market variables, with a requirement that market variables can be directly observed in markets.

Changes in variables are triggered by events. Events can be distinguished between those that reflect changes in views of other, mainly market, participants relative to unchanged items and those that reflect actual changes in the characteristic of items, i.e., real events. The former could be referred to as market driven variables, and the latter, non-market driven variables. For example, a storm index and a bankruptcy index are not market driven variables. An inflation index, since it is derived from market variables, is a market driven variable.

It is important to distinguish between market and non-market driven variables on account of the very specific trigger for the former. Non-market driven variables can be distinguished further, for example, physical variables, variables resulting from business activities, variables affecting one party adversely (causing insurance risk if transferred), etc.

The potential confusion resulting from the term of a “financial variable” becomes clearer in the context of credit insurance. If the adverse results of a bankruptcy are transferred, it is insurance risk; if the adverse consequences of change in credit rating (a third party view, not a real event) are transferred, it is not insurance risk. However, an actual

bankruptcy could also be understood to be a “financial variable” since it is a purely financial event, not a physical one, although it is clearly not a market driven variable. Similar distinctions also arise in loss-of-use insurance.

f) Definition of Policyholder

The appendix to the ED defines a policyholder as the “*party that has a right to compensation under an insurance contract if an insured event occurs.*” Because there can be a number of parties involved in an insurance contract: legal counterparty (for example, the party entitled to exercise an option under the contract); the premium payer; the beneficiary; and the insured person (object in certain cases), the term policyholder is often used in a manner inconsistent with the definition provided.

For example, rather than the beneficiary receiving benefits, the reference might be to the premium payer or contract owner. Conceptually, it is not necessary that the beneficiary receive such benefits since those need not be compensation for insured events. In the case of participating features, they might constitute a repricing feature: that is, a refund of an unused part of the premium. Participating benefits might be off-set against premiums payable and, therefore, would be to the benefit of the premium payer (compare paragraphs 8 (a) (ii), 90 (b) (iii), B61 (j)). In several spots, the ED refers to policyholders in the context of premium payment or executing options, whereas this is the role of the premium payer or legal counterparty, not necessarily the person entitled to receive the compensation (compare paragraphs 26 (a), 28, 34, B17, B19 (b), B32, B53 (d), B61 (a) and (g), B85). B30 refers to the death of the policyholder – an event that would clearly not result in compensation to the policyholder (similarly B55 (b)).

The problem appears to be that the ED uses a well-defined term, the “policyholder”, the legal counterparty of the insurer, in another context and, as a result, raises the danger of confusion. B61 (a) recognizes that the actual payment might not be to the policyholder but rather be made on behalf of the policyholder to compensate for an insured event under a third party liability insurance.

Therefore, we recommend that the use of this word be reviewed. Preferably, it should be used in a manner consistent with common current usage, i.e., use “policyholder” when reference is made to the insurer's legal counterparty. Often, it might be helpful to refer to payments under the contract rather than being specific as to who gets the money. A suitable term for the party referred now in the ED as policyholder might be something like “protected party”. Alternatively, a brief discussion of these different applications of this term could be included as part of the definition.

Q11 (b) Do you agree with the scope exclusions in paragraph 4? Why or why not? If not, what do you propose and why?

IAA Comments

We have the following comments about the scope exclusions given in paragraph 4:

- We agree with the scope exclusions in paragraph, 4 because we believe that the topics are better addressed in specific guidance. Nonetheless, we do not see any reason for them to have significantly different measurement principles. For example, we believe that

warranties not provided through an insurance contract should have the same measurement principle as similar coverage provided through insurance contracts (the point we made in our comment letter regarding the revision to IAS 37).

- Inclusion of fixed fee service contracts. We see no reason to exclude fixed fee service contracts that would qualify as insurance contracts, such as roadside assistance, from the scope. Just because standalone roadside assistance is not legally regulated as insurance does not mean that it is inappropriate to consider these contracts as insurance for this purpose. We note that such services are also provided within many insurance contracts.

Q11 (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?

IAA Comments

We agree with the inclusion of financial guarantees within the scope of the standard. The insurance standard is the best fit for these contract features, since the contracts transfer risk related to a third party. We also believe that the markets would have been better served if these contracts had been subject in the past to the proposed measurement and disclosure requirements for insurance contracts.

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?

IAA Comments

We believe it is appropriate to unbundle certain components of an insurance contract, but we do not agree with the proposed criterion for this purpose. The criterion “closely related” lacks sufficient clarity to be implemented in practice as the basis for a principle for unbundling. The resulting values should be meaningful and add value to the users of financial statements. Otherwise we prefer fewer situations where unbundling should be applied. We suggest that the criterion for unbundling with respect to insurance contracts should follow the approach described in paragraph 15 of the IASB’s exposure draft *Revenue from Contracts with Customers*. The criterion is that an entity should segment single contracts and account for certain goods and services as separate contracts when their price is independent of the price for other goods and services in that contract. This criterion could be applied to insurance contracts. We believe this criterion can be combined with the guidance in paragraph 8(c) of the ED, which refers to goods and services that have been combined for reasons that lack commercial substance, to provide appropriate guidance for unbundling. For example, a savings plan (a deposit rider with no life insurance component) added to a term life insurance contract only for the convenience of billing or record-keeping could be considered as a case in which unbundling should be considered .

We believe that it may be appropriate to separate service components in insurance contracts when the service component is an ancillary benefit to the insurance contract for which the premium would not differ between whether it is sold in conjunction with the service element or not. We believe that it is appropriate to unbundle derivatives embedded in insurance contracts

that would not, by themselves, constitute an insurance contract. In other words, we would retain the criteria in the current IFRS 4 for separating embedded derivatives.

Nevertheless, the example in paragraph 8(a) describes a contract type (apparently a variable or unit-linked contract) for which unbundling is typically difficult, in some cases arbitrarily determined, and in our view not appropriate. We are concerned that the intent of the Board is to require unbundling when the separation would be artificial and an explicit rule would be required to effect implementation. We recommend that the Board delete paragraph 8(a). The example in paragraph 8(b) does not appear to satisfy either the criterion included in the ED or the above, as the account value is closely related to the insurance component. We believe such a contract should be measured using the building block model of the ED, based on the contract's expected cash flows. In addition, we see little added value to the user in the amount of the account value. In contrast, it may be appropriate for certain embedded derivatives that do not themselves constitute insurance contracts and that are not closely related or inter-related to the host insurance contract, to be unbundled.

The wording in paragraph 9 provides guidance on how to assign cross-subsidization effects in order to unbundle deposit components of insurance contracts. This guidance asks insurers to artificially assign the cross-subsidy effects to the insurance component, in order to make components appear not to be closely related when, in fact, they are. The existence of cross-subsidies and the difficulty of assigning the cross-subsidy effects is evidence that the components are closely related. We believe this paragraph should be removed, since it actually represents an example of inappropriate unbundling.

Question 13 – Presentation

Q13 (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?

IAA Comments

We believe the summarized margin approach may be useful and we find that it is broadly in line with the proposed measurement approach. We suggest that the Board expand the guidance in paragraph 72(a) to make clear that amounts added to the margins on inception of new contracts should be a separate component of the change in the margin.

Nevertheless, we believe the presentation would be more useful if it were to include additional amounts reflecting the quantum of the items that result in the experience adjustment for long duration contracts. The ED specifies that this information should be presented for short duration contracts, and it is currently presented in profit or loss under most accounting regimes. The amounts that give rise to the experience adjustment are the expected claims and expenses (including expected incremental acquisition costs) and the actual claims and expenses (including actual incremental acquisition costs). We are aware that the disclosure of the movement in the liability will reflect the expected amounts in the reconciliation of the beginning liability to the ending liability and that the actual payments will be disclosed as well. Nonetheless, we believe that the experience gain or loss presented in profit or loss lacks context unless actual and expected claims and expenses are also presented.

We believe it is important that appropriate volume measures be disclosed. These are so important to many components of the insurance industry that, for example, some observers have argued that their contracts should qualify for the short duration method, primarily out of a desire to be able to include some of them (such as earned premiums and incurred claims) in an insurer's income statement. This pressure may be reduced if appropriate volume measures are included in a single section of the disclosures. These products principally provide a service of risk protection, and the volume measures are considered integral to understanding the amount of business transacted and its profitability and to comparing these statistics over time for a company, and among competing companies.

Given the significance of reinsurance for many insurers, we suggest that more detail than is currently offered in the Exposure Draft be provided for ceded reinsurance in the income statement or as part of disclosure. For example, we believe that the detail provided for direct contracts in terms of earned premiums, incurred losses, risk adjustment/residual margins, and changes in estimates should be accompanied with the same level of detail for amounts ceded to reinsurance.

Q13 (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?

IAA Comments

Yes, we agree. We do not see a need to present any items of income or expense in Other Comprehensive Income (OCI). However, our position is based on the understanding that the movement in investments supporting liabilities will be presented in profit or loss. If some part of the movement in investments is presented in OCI, we recommend that the Board consider presenting the corresponding part of the movement in insurance liabilities in OCI as well.

The Board should also consider how other items, such as administration costs and changes in pension liabilities, are reported and how they affect insurance contract liabilities (e.g., effects on participation features) and provide consistent treatment for the movement in insurance liabilities. If such changes are reported in OCI, the effect of those changes on insurance contract liabilities should likewise be reported in OCI.

Note that some of our members believe that changes in the liability resulting from changes in financial market variables should be reported separately, preferably in OCI.

Question 14 – Disclosures

Q14 (a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?

IAA Comments

We agree with the principle as presented. We believe that this principle is consistent with the principles and practices already in place as a result of IFRS 7 and IFRS 4, which have proven to be useful and to be adequate. As always, a cost and benefit test should be applied to specific requirements.

Q14 (b) Do you think the proposed disclosure requirements will meet the proposed objective? Why or why not?

IAA Comments

In general, yes, we do believe the proposed disclosure requirements will meet the stated objectives. We note that, in our comments to Question 5(c) expresses our position on paragraph 90(b) (ii) that, if the insurer uses TVaR or the CoC method for the risk margin measurement, it should not be required to also use VaR for the confidence level method relating to the liability.

Nevertheless, if this disclosure is required, it is not clear at what level it should be measured: for the entity as a whole; by segment; or for individual portfolios. We believe the guidance for this disclosure should be clearer, to ensure greater consistency in disclosure and to promote more useful information. Since it is difficult to compare confidence levels that do not fully reflect diversification, this disclosure would be most consistent and meaningful if the disclosed confidence level is for the entity as a whole, on a net of reinsurance basis. Again, we do not agree with providing disclosure on confidence levels when another method is used (see our comments to Question 5 c).

The following comments relate to disclosure of reinsurance:

- In paragraph 75, clarify that items (a)(i) premium revenue, and (a)(ii) losses incurred, are meant to be presented and/or disclosed, gross before reinsurance ceded, amounts ceded as to reinsurers, and net of reinsurance ceded.
- In paragraph 90 (b)(i), clarify that the disclosure on risk adjustment should be prepared on a gross basis before reinsurance and also on a net of reinsurance basis, where the measurement of the risk adjustment related to the reinsurance asset is the difference between gross risk adjustment and the net risk adjustment.
- We suggest that it be made clearer that the ceded reinsurance contracts held by the insurer are not to be aggregated into portfolios of ceded reinsurance contracts. In addition, the measurement of ceded reinsurance can be based on the difference between gross and net measurements of the portfolios that are protected by the ceded reinsurance.
- Where a single ceded reinsurance contract provides protection for more than one portfolio of insurance contracts, the measurement of each reinsured portfolio on a net basis may require the allocation of fulfilment cash flows from the ceded reinsurance. Such allocations should be based on the portion of the expected recoveries from each portfolio, or some other approach that reflects the portion of the risk reinsured from each portfolio.

Q14 (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.

IAA Comments

We do not have any suggestions for additional disclosures at this time. If subsequent changes are made to the ED, we may reconsider this comment.

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?

IAA Comments

Single line treatment of unit-linked contracts in comprehensive income overlooks important elements of profit and loss. Single line treatment for the presentation of assets and liabilities related to unit-linked accounts properly conveys their linkage. Single line treatment in profit and loss, however, misrepresents the nature of the contracts, in which the insurer performs a service to the policyholders and charges fees for the service. The contracts are better represented if fees are reported as income and the costs to service the contracts are recognized as expenses in profit and loss. Fee income should follow the concepts in the proposed standard on revenue recognition or, if the contracts are classified as insurance contracts, the fees and expenses should be associated with the insurance contract, if unbundled from the deposit component of the contract. The insurance component would then follow the guidance for insurance contracts.

Question 16 – Reinsurance

Q16 (a) Do you support an expected loss model for reinsurance assets? Why or why not? If not, what do you recommend and why?

IAA Comments

We believe that the reinsurance liability credit recognized by the ceding company should equal the underlying direct liability plus an adjustment for the expected disputes with and default of the reinsurer. We support this expected loss model, as it is consistent with the measurement model for the underlying insurance contract liabilities. We also believe that any significant disputes need to be disclosed.

Paragraph 44 requires the cedant to “... *consider the risk of non-performance by the reinsurer on an expected value basis ...*” For clarification, we suggest making the following (italicized) insertion in that paragraph: “... consider the risk of non-performance by the reinsurer, *giving appropriate consideration to any rights of offset or collateral*, on an expected value basis ...”

Q16 (b) Do you have any other comments on the reinsurance proposals?

IAA Comments

We have several comments regarding matters associated with reinsurance:

- We agree with the statement in BC233, that “a cedant should measure its reinsurance assets on the same basis as its underlying direct insurance liability”, with further discussion in BC234. However, in several instances these concepts do not appear to have been carried into the Exposure Draft, and we believe that doing so would be helpful in clarifying the measurement objective. For example, when one of the direct and ceded reinsurance contracts are on the modified premium allocation method while the other is not.
- Ceded reinsurance and the modified approach. It is not clear whether the modified premium allocation approach for short duration contracts (paragraphs 54-60) would apply

to the measurement of liabilities for insurance contracts and fulfilment cash flows of ceded reinsurance. We believe that more guidance is needed here, to achieve the objective for contracts where the modified model is used for calculating the direct liability.

Many reinsurance contracts are written on a “risks attaching” basis (the reinsurance is applicable to each underlying contract that originates during the term of the reinsurance contract). In this context, it is not clear whether a reinsurance contract that provides protection for twelve months of risks-attaching, where each “risk” is a one-year contract but where the aggregate coverage period for all underlying policies spans two years, would be accounted for under the modified approach for short duration contracts. Such a contract obligates the reinsurer to reinsure insurance contracts that will be written in the future. We believe the ceding entity should not recognize a credit or gain from the reinsurance contract prior to issuing the direct coverage that would be reinsured under the agreement. The alternative would require the projection of cash flows, estimation of building blocks and the setting of residual margins based on expected cash flows at the inception of the reinsurance contract, before the underlying direct policies are written (that is, outside the contract boundary of the underlying policies) and accounted for on a direct basis.

A similar issue exists for assumed reinsurance. In this case we do not believe that the assuming reinsurer should reflect the liabilities associated with insurance contracts that have not yet been entered into by the ceding entity. Nevertheless, where the contracts that the reinsurer is obliged to fulfil according to the terms of the reinsurance treaty when they come into force are assessed to be onerous, then the present value of the amount of that insufficiency should be recognized as a liability of the reinsurer.

The measurement objective for the explicit risk adjustment that would be measured for ceded reinsurance contracts is not clear. For consistency in measuring direct and ceded amounts, we would expect that the measurement objective of the risk adjustment for ceded reinsurance contracts should be derived from the reduction in risk that results from existence of such reinsurance. This could be measured as the reduction in the risk adjustment between what was calculated before the application of the reinsurance (gross basis) and after the application of the reinsurance (net basis).

- Typically, ceded reinsurance is a significant part of risk management for insurers and is often very important in the financial results of the entity, particularly for property & casualty insurers. The presentation and comparability of ceded reinsurance in financial statements for insurers would be improved by measuring and presenting amounts ceded to reinsurance in a manner that matches the approach used for the direct business to which it applies. Accordingly, we recommend that the same model (e.g., the building block model or the modified approach) and a consistent measurement objective be used to measure and present ceded reinsurance, using the identical approach used for the direct amounts to which the reinsurance cessions relate. This would clarify that it is appropriate to calculate the risk adjustment on amounts ceded to reinsurance as the difference between the risk adjustment determined on a gross of reinsurance basis and a net of reinsurance basis. If the measurement, presentation and disclosure for amounts direct and ceded to reinsurance are not consistent, the result would not be useful for users of the financial statements.

- Consistent with the principle of no gain at issue of the direct contract, if there is a gain on a ceded reinsurance treaty, this gain should be limited to the loss on the underlying insurance contract, to avoid a gain on the net overall position of the cedant. If this principle is not applied to insurance contracts, then this comment would not be applicable. Note that some of our members do not believe that this should be applicable to other than quota-share reinsurance treaties.

Question 17 – Transition and effective date

Q17 (a) Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?

IAA Comments

We believe that the proposal (100(a)) to set the residual margin to zero upon transition is likely to have significant long-term unintended consequences in the context of life insurance.

Life insurance companies will appear to be significantly less profitable for several years, possibly as long as ten to fifteen years. In some countries, average contract durations are about thirty years, especially if there are many annuity contracts. This is because the transitional arrangement will lower the liability and make the reported profit appear to be much smaller than before. The residual margin contains, among other less specifiable amounts, overhead and non-incremental acquisition costs priced in the premium. While equity is significantly increased, there is no periodic revenue covering overheads and partly offsetting non-incremental acquisition costs for new business. This will make successful life insurers who are writing profitable new business and incurring upfront costs appear to be generating losses.

The consequence for life insurance is likely to be a severe distortion of economic reality at transition and continuing distortions until the new business written under the normal guidance becomes predominant.

These consequences could be reduced if, under the transition rule, cash flows, such as overhead and non-incremental costs, which are otherwise not included in expected cash flows, might be included.

There are several possible solutions to this problem:

- As proposed by the IASB staff, the initial residual margin could be the difference, if positive, between the entity's insurance contract liabilities immediately prior to first adoption, and fulfilment value. This is probably the least onerous approach in terms of time and effort for insurers at transition, but this difference would have to be separately disclosed. However, we do not believe that the reduction of comparability, considering the complexity of the measurement and resulting lack of comparability, is worth the resources needed. Further, the financial statements may be distorted for possibly more than a decade since portfolio under the transition rule is not comparable with portfolio under the full guidance.
- The initial residual margin could be retrospectively calculated. This would be reasonably straightforward for most property & casualty insurance, in that the claims liability would

not be affected anyway and short duration contracts would only involve less than a year's worth of retrospective look-back. A full retrospective calculation on the proposed locked-in basis would, however, be extremely difficult for most life insurers, except those with a very short history of operation. It might nevertheless be feasible if the initial residual margin is calculated on the basis of current assumptions and reasonable approximations are allowed in respect of past cohorts or pricing bases where the relevant information may no longer be determinable. However, we believe that the guidance in IAS 8, impracticability, might apply because in many cases the benefits exceed cost constraints and estimates needed, and accounting regimes should not require the impossible.

- The burden of retrospective calculation would be alleviated further if an entity is allowed to limit its determination to more recent business, with the residual margin on earlier business taken as zero, or as an extrapolation from more recent business. Earlier business might also be adequately reflected by applying the above mentioned difference to reporting prior first time application. A partial solution would be to set the initial residual margin equal to the expected present value of direct and overhead expenses excluded from the fulfilment value calculation.

If the ED proposal is not modified, we suggest that insurers be permitted to disclose what residual margins would have been, if applied *ab initio*, until the difference is no longer material. Since it is not stated whether paragraph 100(a) applies to short-duration contracts to which paragraphs 54-60 apply, we assume that it was not intended to do so. However, it may be appropriate, for clarity, to indicate this in the application guidance. We believe that it would be desirable to require full retrospective adoption for short-duration contracts because any other treatment could result in significant accounting arbitrage opportunities. The only way to avoid these is to establish a rule that would indicate that on post-transition reinsurance contracts covering pre-transition underlying insurance contract portfolios, the transition rules would apply.

We note that there is no reference to the treatment of ceded reinsurance assets in the transition. We believe that whatever transition rules are finalized, they should also apply to these assets.

Q17 (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)?

IAA Comments

In addition to the problems identified in answer to Question 17(a) above, this leaves a requirement to run off an inappropriate initial margin on an inappropriate basis. We do not believe that this is desirable.

Q17 (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?

IAA Comments

It would be desirable for the effective date of the IFRS on insurance contracts to be consistent with that of IFRS 9.

Q17 (d) Please provide an estimate of how long insurers would require to adopt the proposed requirements.

IAA Comments

At this time, it is quite difficult to estimate the amount of time insurers would need to adopt the proposed requirements, because insurers differ so dramatically, in terms of their contracts, current systems and practice, and the amount of available resources (including available external consultants/systems staff). In addition, practice is not sufficiently clear on the extent and type of approximations that will initially be used to determine estimates consistent with the proposed requirements. It will also depend upon the interpretations given to key elements of the ED, such as transition, unbundling and margins.

Estimates made by large international groups with long duration contracts containing complex participation features and financial guarantees, indicate a lead time of about three years until a first financial report can be provided. But that depends heavily on the form of the final standard, and the simultaneous demands on the same resources, including in some jurisdictions, new statutory requirements such as Solvency II. The demands of implementing transition rules will also certainly affect this period.

Question 18 – Other comments

1. Policy loans

We believe that the treatment of policyholder loans (policy loans) should be addressed in the ED. These loans to policyholders use the contract's value as collateral. Although they can be repaid at any time, they are often repaid out of the proceeds otherwise payable at contract termination, either when a surrender or death benefit is payable. In most jurisdictions the loan is usually, but not always for an amount less than the cash surrender value of the contract. The issue is whether these loans should be treated as separate assets or their relevant expected cash flows included in fulfilment cash flows. On this, opinion within the IAA is split. The incidence of lapses of these contracts, in part as a result of policy loans exceeding the surrender value, should be considered as an aspect of policyholder behaviour in setting measurement assumptions.

2. Recognition date

The IAA is split in its opinion as to whether the initial recognition date should be (1) the original contract date, or (2) the earlier of the original contract date and the effective date of the insurance coverage.

In the case of the recognition of an asset or liability prior to the initial effective date of the contract, about half of the committee members who prepared this statement do not believe this has value to a reader, unless the contract is onerous. Those holding this position believe that it would not be appropriate for a significant movement in interest rates between these two dates to generate a profit or loss as a result of the methodology employed by the ED, solely because the residual margin can not be recalibrated. For this reason, those members suggest a change in the wording of paragraph 14 to:

An insurer shall become a party to an insurance contract on the date when the parties begin to fulfil their contractual obligations (effective date of the contract), except in the cases of an onerous contract or a contract without a clear original effective date ... If the contract is onerous or if the contract is without a clear original effective date, the insurer shall become a party to an insurance contract on the earlier of the following two dates ... If the contract includes options to extend the obligation, where the extension is not interdependent with the obligation prior to the extension, the initial recognition guidance applies to each extension separately.

In addition, these committee members believe the added value does not justify the cost associated with obtaining the true contract date, which usually is not now collected or recorded in IT systems.

The members who agree with this approach do so on theoretical grounds.

3. *Contract modifications*

Unlike IAS 39, no guidance is provided on when a modification to an insurance contract should be treated as a modification and when it should be treated as a derecognition of the existing contract and the issuance of a new contract. It may be appropriate to provide guidance as to when a change to a contract should be treated a modification or a new contract. This is particularly important in relation to residual margins since, if there is a new contract, a new residual margin must be determined while, if the contract continues, a locked-in margin may be inappropriate to the modified contract.

4. *Mutual companies and future policyholders*

In many mutual insurers, there is a legal distinction between contractual participation rights to surplus, generated from participating contracts, and membership rights to the residual profit. In contrast, in some other cases there is no distinction and, as a consequence, applying the guidance of the ED might result in there being no reported equity, since any surplus could be seen as subject to participation rights to surplus. In such cases, it might be reasonable to show equity as decision-useful information for other creditors of the mutual insurer, if surplus ranks lower than debts of the mutual.

5. *Accounting mismatches*

The IAA has regularly recommended that accounting mismatches be eliminated wherever practical. However, based on the choices available with respect to financial assets, this is likely to remain a concern.

BC 44 (f) states that the ED proposed provides “a reduction in accounting mismatches that arises if changes in economic conditions affect assets and liabilities equally, but the accounting requirements do not adjust the carrying amounts of those assets and liabilities equally in response to those economic changes.”

We believe it is too early to conclude that accounting mismatches have been reduced to the extent possible. The potential for mismatches may arise if the measurement attributes of insurance liabilities and the supporting assets are inconsistent. In addition to what the financial reporting standards for financial instruments will be, there are some key

decisions about accounting for insurance contracts that the Board must make. The most important to the topic of accounting mismatches are:

- whether the discount rate is a current rate (as the ED proposes) or fixed at issue;
- whether the discount rate is consistent with changes to asset values;
- whether participating features and other linkages of fulfilment cash flows to other items are measured consistently with those other items; and
- what changes in values, if any, are charged to OCI rather than to income.

The potential for accounting mismatches also depends on how insurers apply IFRS 9 to the debt instruments that they own. Limits on the use of amortized cost may cause insurers to classify debt investments as measured at fair value when, depending on the decision of the Board with respect to the insurance contracts standard, the corresponding liabilities are affected by changes in economic conditions in a manner that would be more consistent with amortized cost.

Unlike financial liabilities, the ED on insurance contracts does not provide for an amortized cost option. A minority of the members of the IAA Committee on Insurance Accounting believes the Board should consider an amortized cost option for insurance contracts by exploring the possibility of a discount rate that is based on the rate required to equate the sum of the present value of benefits and expenses and the risk adjustment to the present value of premiums at inception. An alternative amortized cost approach would be to use the building block approach methodology in the ED, including the residual margin, but lock in the initial discount rate(s) at issue. Some insurers may wish to utilize unbundling to be consistent with assets that use an IFRS 9 amortized cost model, to avoid or reduce accounting mismatches. We are available to assist with discussions if the Board wishes to pursue this possibility.

We are also available to work with the Board to develop a comprehensive view of the potential for mismatches before it finalizes its decisions. As stated, this view must take into account not only the effects of decisions relating to the measurement of insurance liabilities, but also the anticipated application of IFRS 9 to insurers' investments.

6. *Measurement aggregation (unit of account)*

In the Exposure Draft, the term "portfolio of insurance contracts" is used as a defined term in a number of different places. As discussed in our answers to the questions above, we do not believe that it is appropriate to use the same concept in all of these contexts. The following summarizes these concerns. We believe that different levels of aggregation are appropriate for different purposes. We are also concerned that the use of a term that has a variety of customary usages is likely to cause confusion or disparate interpretations in its application. For this reason, we believe that it would be preferable to delete this defined term or to confine its use to a single context consistent with common usage and to specify the level of aggregation that is appropriate in each context.

Fulfilment cash flows (paragraphs 23 and B61)

Cash flows are not always managed, analysed, projected and reported on the basis of contracts or of portfolios of contracts. Where, for example, physical damage and bodily injury are combined under one motor insurance policy, it is common for claims in respect

of these two perils to be managed and reported separately, sometimes in conjunction with similar claims under other classes of insurance.

Because expected values are additive, such treatment does not affect the total of the expected cash flows and the reference to portfolio is unnecessary.

Expenses (paragraph B61)

The necessary distinction here is between costs that are incremental at the contract level and those other costs directly related to the contracts that include, for example, costs associated with web marketing and salaries of an underwriting or claims department. This is not affected by whether portfolio is used in its defined sense or more generally.

Risk adjustment (paragraphs 36, B79, B82, B83)

How far the effect of diversification is taken should be based on the extent to which claims or benefits can call upon the assets of an entity. In some cases, its net effect can be observed, so it is not a matter of speculation. For a typical insurer operating in a single market, this is the whole insurer. In other cases this extent is reduced by jurisdictional requirements, so that certain assets are only available to meet a subset of liabilities. Sometimes, possibly usually, these protected liabilities have recourse to assets outside the “ring-fence”. While reinsurance typically responds to particular benefits or claims, a reinsurance recovery, once paid, is no longer specific to a particular claim, but generally available unless the reinsurance itself is “ring-fenced”.

Diversification operates across the entire range of liabilities that have recourse to a common pool of assets or resources. A restriction of diversification to a narrower pool of liabilities, such as the currently defined portfolio (of contracts or claims), would be inconsistent with economic reality, unless the portfolio is re-defined as a grouping of liabilities that have recourse to a common pool of assets or resources, and is inconsistent with the measurement principle underlying the ED.

Thus, paragraph 36 is inconsistent with the principle stated in paragraph 35. We recommend that paragraph 36 should instead read:

Since all an insurer’s assets (including reinsurance assets) are typically available to meet the risks inherent in all of its liabilities, the risk adjustment shall reflect the effects of diversification that arise across all insurance contracts that have joint recourse to a common pool of assets.

The references to portfolio in paragraphs B79, B82, B83 are of a more generic nature and remain appropriate as is. If “portfolio of insurance contracts” remains a defined term, the phrase “of insurance contracts” might be better deleted.

Residual margin (paragraph 20) and liability adequacy (paragraph 60)

The issue in these applications is the level at which a residual margin should be aggregated before eliminating negative values, and at which any onerous contract test should be applied. The finer the subdivision, the greater the likelihood that these conditions will apply. See our comment on the issue of subdivision in response to questions 6(c) and 8(b).

Portfolio transfers and Business combinations (paragraphs 40 and 42)

Portfolio transfers and business combinations typically involve multiple portfolios, with a single price or fair value, which may also include elements that do not relate to the pre-claim insurance liabilities transferred, such as claim liabilities, investment assets, plant and equipment, intellectual property and goodwill. An apportionment will be required.

Presentation (paragraph 69)

This is where the definition of “portfolio of insurance contracts” is applicable and appropriate. We suggest that the current definition be dropped and the wording of that definition be incorporated in paragraph 69.

Transition (paragraph 100)

The usage here should follow that for the components of fulfilment value and, if our suggestions in response to Question 17 are adopted, residual margins and liability adequacy as well.

Question 19 – Benefits and costs

IAA Comments

We agree that there are major advantages in having a consistent and comparable basis across jurisdictions and between different classes of insurance that appropriately reflects the nature of that business. Subject to certain reservations about some aspects of the proposals as noted above, we believe that what is proposed in this ED, suitably amended, can achieve these advantages.

On the whole and subject to the same reservations, we accept the Board’s assessment as far as the ongoing costs are concerned.

Appendix A

Members of the IAA Committee on Insurance Accounting

Sam Gutterman	Chairperson
David Congram	Co-Vice-Chairperson
Francis Ruygt	Co-Vice-Chairperson
Gunn Albertsen	Den Norske Aktuarforening
Victor Hugo Cesar Bagnati	Instituto Brasileiro de Atuária (IBA)
Daniel N. Barron	Israel Association of Actuaries
Guy Castagnoli	Association Suisse des Actuaire
Antonella Chiricosta	Istituto Italiano degli Attuari
Alexander Dollhopf	Svenska Aktuarieföreningen
David Finnis	Institute of Actuaries of Australia
Mark J Freedman	Society of Actuaries
Kavassery S. Gopalakrishnan	Institute of Actuaries of India
Rokas Gyls	Lietuvos aktuariju draugija
Jozef Hancár	Slovenska Spolocnost Aktuarov
William C. Hines	American Academy of Actuaries
Armand Maurice Ibo	Institut des Actuaire de Côte d'Ivoire
Dragica Jankovic	Udru enje Aktuara Srbije
Burton D Jay	Conference of Consulting Actuaries
Ad Kok	Het Actuarieel Genootschap
Christoph Krischanitz	Aktuarvereinigung Österreichs (AVÖ)
Kurt Lambrechts	Association Royale des Actuaire Belges
Yin Lawn	Actuarial Institute of Chinese Taipei
Kristine Lomanovska	Latvijas Aktuaru Asociacija
Mike Lombardi	Canadian Institute of Actuaries
Ana Maria Martins Pereira	Instituto dos Actuários Portugueses
Brian Joseph Morrissey	Society of Actuaries in Ireland
Yoshio Nakamura	Institute of Actuaries of Japan
Marc F Oberholtzer	Casualty Actuarial Society
Manuel Peraita Huerta	Instituto de Actuarios Españoles
Andreja Radic	Hrvatsko Aktuarsko Društvo
Nithiarani Rajasingham	Singapore Actuarial Society
Ravi Clifton Rambarran	Caribbean Actuarial Association
Thomas Ringsted	Den Danske Aktuarforening
Jaanus Sibul	Eesti Aktuaaride Liit
Dieter Silbernagel	Deutsche Aktuarvereinigung e.V. (DAV)
Mateja Slapar	Slovensko Aktuarsko Društvo
Pentti Soininen	Suomen Aktuaariyhdistys
Bjarni Thórdarson	Félag Islenskra Tryggingastærðfræðinga
Arseny Timakov	Russian Guild of Actuaries
Charles Vincensini	Institut des Actuaire
Peter Withey	Actuarial Society of South Africa
Derek Wright	Institute of Actuaries
Jana Zelinkova	Ceská Spolecnost Aktuárù
Jesús Alfonso Zúñiga San Martin	Colegio Nacional de Actuarios A.C.

Full Member Associations of the IAA

Caribbean Actuarial Association
Consejo Profesional de Ciencias Económicas de la Ciudad Autónoma de Buenos Aires (Argentina)
Institute of Actuaries of Australia (Australia)
Aktuarvereinigung Österreichs (AVÖ) (Austria)
Institut des Actuairens en Belgique (Belgique)
Instituto Brasileiro de Atuária (IBA) (Brazil)
Bulgarian Actuarial Society (Bulgaria)
Canadian Institute of Actuaries/Institut Canadien des Actuairens (Canada)
Actuarial Institute of Chinese Taipei (Chinese Taipei)
Institut des Actuairens de Côte d'Ivoire (Côte D'Ivoire)
Hrvatsko Aktuarsko Društvo (Croatia)
Cyprus Association of Actuaries (Cyprus)
Česká Společnost Aktuárů (Czech Republic)
Den Danske Aktuarforening (Denmark)
Egyptian Society of Actuaries (Egypt)
Eesti Aktuaaride Liit (Estonia)
Suomen Aktuaariyhdistys (Finland)
Institut des Actuairens (France)
Deutsche Aktuarvereinigung e.V. (DAV) (Germany)
Hellenic Actuarial Society (Greece)
Actuarial Society of Hong Kong (Hong Kong)
Magyar Aktuárius Társaság (Hungary)
Félag Islenskra Tryggingastærðfræðinga (Iceland)
Institute of Actuaries of India (India)
Persatuan Aktuaris Indonesia (Indonesia)
Society of Actuaries in Ireland (Ireland)
Israel Association of Actuaries (Israel)
Istituto Italiano degli Attuari (Italy)
Institute of Actuaries of Japan (Japan)
Japanese Society of Certified Pension Actuaries (Japan)
The Actuarial Society of Kenya (Kenya)
Latvijas Aktuaru Asociācija (Latvia)
Lebanese Association of Actuaries (Lebanon)
Lietuvos Aktuariju Draugija (Lithuania)
Persatuan Aktuari Malaysia (Malaysia)
Colegio Nacional de Actuarios A.C. (Mexico)
Association Marocaine des Actuairens (Morocco)
Het Actuarieel Genootschap (Netherlands)
New Zealand Society of Actuaries (New Zealand)
Den Norske Aktuarforening (Norway)
Pakistan Society of Actuaries (Pakistan)
Actuarial Society of the Philippines (Philippines)
Polskie Stowarzyszenie Aktuaruszy (Poland)

Instituto dos Actuários Portugueses (Portugal)
Academia de Actuarios de Puerto Rico (Puerto Rico)
Russian Guild of Actuaries (Russia)
Udruženje Aktuara Srbije (Serbia)
Singapore Actuarial Society (Singapore)
Slovenska Spolocnost Aktuarov (Slovakia)
Slovensko Aktuarsko Drustvo (Slovenia)
Actuarial Society of South Africa (South Africa)
Col.legi d'Actuaris de Catalunya (Spain)
Instituto de Actuarios Españoles (Spain)
Svenska Aktuarieföreningen (Sweden)
Association Suisse des Actuaires (Switzerland)
Society of Actuaries of Thailand (Thailand)
Institute and Faculty of Actuaries (United Kingdom)
American Academy of Actuaries (United States)
American Society of Pension Professionals & Actuaries (United States)
Casualty Actuarial Society (United States)
Conference of Consulting Actuaries (United States)
Society of Actuaries (United States)