25 October 2013

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

Dear Sir or Madam

Re: Exposure Draft ED/2013/7 Insurance contracts

Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board) welcomes the opportunity to submit its views on the exposure draft *Insurance Contracts.*

We support the Board's effort to develop an IFRS for the accounting for insurance contracts. In our opinion it is important to get a final standard on insurance contracts within reasonable time.

We agree with the main features of the exposure draft, including recognition, measurement and presentation of the contractual service margin. We do however not agree with the proposed mirroring approach. In addition to the questions asked, we also have included some additional comments on other areas of concerns. They relate to the use of the portfolio as unit of account, and the scope of the insurance standard.

In general, we find the exposure draft difficult to read and understand. Effort should be made to clarify the conclusions and to simplify the language, and to improve the illustrative examples. This document would also have benefitted from a more thorough final copy editing before issuance.

See the attachment to this comment letter for our response to the specific questions raised in the exposure draft and our additional comments on unit of account and scope issues.

Please do not hesitate to contact us if you would like to discuss any specific issues addressed in our response.

Yours faithfully,

Erlend Kvaal
Chairman of the Technical Committee on IFRS of Norsk RegnskapsStiftelse

CC: EFRAG

Scope

Question 1: Adjusting the contractual service margin

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if differences between the current and previous estimates of the present value of future cash flows if:

(a) differences between the current and previous estimates of the present value of future cash flows related to future coverage and other future services are added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative; and

(b) differences between the current and previous estimates of the present value of future cash flows that do not relate to future coverage and other future services are recognised immediately in profit or loss?

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

We agree that the differences between the current and previous estimates of the present value of future cash flows that do not relate to future coverage and other future services are to be recognised immediately in profit or loss. These are (updated) estimates of incurred obligations and are not to be spread over future periods.

The issue of the treatment of updated estimates of the present value of future cash flows related to future coverage and other future services is more complicated. We see arguments in favour of both a locked in contractual service margin (CSM) and a floating CSM subject to a floor at zero. We would like the Board to further clarify what the Board considers that the CSM constitutes. Is it a deferred profit margin or is it compensation for future services? To the extent that the CSM is a deferred profit margin we support the proposed solution in the ED. To the extent that the CSM is compensation for future services provided to the holder of the insurance contract, we support the locked approach presented in the previous ED.

On balance our view is that the CSM is predominantly a deferred profit margin, and we thus support the proposed solution in the ED. We do agree that the adjustments made to the CSM should be subject to a floor. However, in order to achieve faithful representativeness, there should be a reversal of prior losses before a positive CSM is restored after the CSM floor has been activated.

The ED indicates that parts of the CSM is a compensation for future services. If that is the case, we see arguments for placing the floor on the CSM above zero. However due to the uncertainty as to the actual content of the CSM, we support the simplifying assumption of setting the CSM floor at zero.

We believe that the understanding of the development of the CSMs will be of great importance to the users of the financial statements of insurance providers. Full and transparent disclosures of the movements of the CSMs are thus of utmost importance. We support the disclosure requirements related to the CSM and would like to see this information disaggregated by major insurance portfolios or classes of insurance contracts.

Question 2: Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items

If a contract requires an entity to hold underlying items and specifies a link between the payments to the policyholder and the returns on those underlying items, do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if the entity:

(a) measures the fulfilment cash flows that are expected to vary directly with returns on underlying items by reference to the carrying amount of the underlying items?

(b) *measures the fulfilment cash flows that are not expected to vary directly with returns on underlying items, for example, fixed payments specified by the contract, options embedded in the insurance contract that are not separated and guarantees of minimum payments that are embedded in the contract and that are not separated, in accordance with the other requirements of the [draft] Standard (ie using the expected value of the full range of possible outcomes to measure insurance contracts and taking into account risk and the time value of money)?*

(c) *recognises changes in the fulfilment cash flows as follows:*

(i) *changes in the fulfilment cash flows that are expected to vary directly with returns on the underlying items would be recognised in profit or loss or other comprehensive income on the same basis as the recognition of changes in the value of those underlying items;*

(ii) *changes in the fulfilment cash flows that are expected to vary indirectly with the returns on the underlying items would be recognised in profit or loss; and*

(iii) *changes in the fulfilment cash flows that are not expected to vary with the returns on the underlying items, including those that are expected to vary with other factors (for example, with mortality rates) and those that are fixed (for example, fixed death benefits), would be recognised in profit or loss and in other comprehensive income in accordance with the general requirements of the [draft] Standard?*

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

We do not support the mirroring proposals. We believe the need for matching already is covered by paragraph 26(a). The scope for the mirroring approach is limited to certain contracts and we think contracts with similar features should be measured in the same way. It could also be considered to remove the savings part of contracts qualifying for the mirroring approach from the scope of IFRS 4 and let them be covered by IFRS 9 to ensure the same accounting treatment as for other similar financial instruments. See also our comment to the scope of the exposure draft under "other issues" below.

Question 3: Presentation of insurance contract revenue and expenses

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if, for all insurance contracts, an entity presents, in profit or loss, insurance contract revenue and expenses, rather than information about the changes in the components of the insurance contracts?

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

We do see advantages and disadvantages for both the summarised margin model suggested in the 2010 exposure draft and for presenting insurance contract revenue and expenses as suggested in the current exposure draft.

We believe that the summarised margin model is conceptually better than the gross presentation suggested in the current ED. The summarised margin model would also be easier to apply. However, we recognise that volume information could be useful information for the users. Changes in the insurance liability can be a good measure of (gross) revenue in the insurance industry.

Under current industry practice, also premiums that represent investments components are presented as revenue. This is not in accordance with the general notion of revenue, and we therefore (strongly) support that investment components should be unbundled and not be included in the profit and loss statement. We are however somewhat concerned that the unbundling can be difficult and that the entities will have an incentive to argue that unbundling cannot be made, and that investment components in practice will be included in revenue. We recommend the inclusion of more guidance and/or an illustrative example on how to unbundle the investment component.

Given that a sound basis for unbundling of investment components is established, we share the view that financial statements would provide relevant information that faithfully represents the entity's financial performance if insurance contract revenue and expenses are presented in profit or loss.

Question 4: Interest expense in profit and loss

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if an entity is required to segregate the effects of the underwriting performance from the effects of the changes in the discount rates by:

(a) *recognising, in profit or loss, the interest expense determined using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows; and*

(b) *recognising, in other comprehensive income, the difference between:*

- *(i)* *the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date; and*
- *(ii)* *the carrying amount of the insurance contract measured using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows?*

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

We are of the opinion that it is important to present the effect of changes in discount rate for the insurance contracts, consistent with the corresponding changes in related assets. Our preferred solution is that the effect of changes in discount rate for insurance contracts shall be presented in the statement of profit or loss/ profit or loss section. Any net gains or losses due to changes in discount rates and duration mismatches are real economic effects. Asset and liability management is an important activity in the insurance industry and its effects should be presented in the profit or loss in the period they arise. In addition the split presentation would for many insurers represent extra complexity and efforts, and could also result in mismatches when selling bonds before maturity (realising gains in profit or loss).

However, the decision to present the effects of changes in discount rates in profit or loss is dependent on the presentation requirements presently being discussed for IFRS 9 where one business model leads to presentation of value changes for certain financial assets in OCI. If consistency is not achieved with our preferred solution, we are of the opinion that there should be an option to present the effect of changes in discount rates in profit or loss.

We would also like to point out that the use of OCI is discussed in the framework project, and that it could be necessary to re-consider the use of OCI for insurance contracts when the framework is finalised,

Question 5: Effective date and transition

Do you agree that the proposed approach to transition appropriately balances comparability with verifiability?

Why or why not? If not, what do you suggest and why?

We agree with the proposed approach to transition. Under the 2010 exposure draft, it was suggested that the residual margin for contracts in-force at transition would be set to zero. This would be easy to apply, but would not give a faithful representation of the profit in the years following implementation of the standard. We believe that the entities will be able to prepare reasonable estimates of the remaining service margin, and this service margin should be reported through profit and loss. Under the modified retrospective approach, comparability between new and existing business is also improved.

Question 6: The likely effects of a Standard for insurance contracts

Considering the proposed Standard as a whole, do you think that the costs of complying with the proposed requirements are justified by the benefits that the information will provide? How are those costs and benefits affected by the proposals in Questions 1–5? How do the costs and benefits compare with any alternative approach that you propose and with the proposals in the 2010 Exposure Draft?

Please describe the likely effect of the proposed Standard as a whole on:

(a) the transparency in the financial statements of the effects of insurance contracts and the comparability between financial statements of different entities that issue insurance contracts; and

(b) the compliance costs for preparers and the costs for users of financial statements to understand the information produced, both on initial application and on an ongoing basis.

We would emphasize that it is important that a standard for insurance contracts is issued within reasonable time. A new standard will improve transparency and comparability between different entities that issue insurance contracts compared with current practice.

Our understanding is that the current Exposure draft is more complex to apply than the 2010 Exposure draft, for example relating to the unlocking of the contractual service margin and the transition requirement. On the other hand, the model in the 2013 Exposure draft increases comparability between the entities that issue insurance contracts, and we believe that the benefits of the approach in the 2013 Exposure draft justify the cost. It is however difficult to foresee all the consequences of the 2013 Exposure draft, and it would have been preferable to have the result from the field testing before the deadline for comments.

Question 7: Clarity of drafting

Do you agree that the proposals are drafted clearly and reflect the decisions made by the IASB?

If not, please describe any proposal that is not clear. How would you clarify it?

In general, we believe that the exposure draft is difficult to read and understand. Effort should be made to clarify conclusion and to simplify the language. We recognise that this will only be possible to some degree as insurance contracts are complex. This makes the illustrative examples all the more important. However, the illustrative examples included are also difficult to understand. Firstly, we suggest to include a straight forward example illustrating the main principle of the standard. Secondly, each of the current illustrative examples cover two or more issues. Preferably, each example should cover only one issue.

Additional comments on other issues

In addition to the above questions, we would like to comment on the scope of the exposure draft and the portfolio principle (unit of account) as we have some concerns relating to these issues.

Unit of account issues

We disagree with the wording in the ED regarding unit of account as expressed in paragraph 22 and B39-B67. We believe that it should be made clear that the unit of account is the insurance contract as defined in paragraph 8-10 and B31-B35. In reaching the estimates necessary to fulfil the requirements of the ED the entity issuing the insurance contracts would naturally use data drawn from similar insurance contracts. However in principle only the cash flows relating to each individual insurance contract should be used in the accounting for that contract. Entities might as a practical implementation of the standard use a portfolio approach as described, but entities should not be forced to apply the portfolio approach.

We recommend that the principles for the accounting for embedded derivatives are expressed in IFRS 9 only. Repeating the regulations in one standard covering certain contracts would create uncertainty regarding its application to contracts covered by other standards. Thus we recommend that paragraph 10(a) is removed from the final standard.

Scope issues
The ED defines an insurance contract as a contract under which the issuer accepts significant risks other than financial risk, transferred from the holder of the contract to the issuer by agreeing to compensate the holder of the contract if a specified uncertain future event adversely affects the holder of the contract. To the extent that the compensation is a financial compensation, the insurance contract is a financial instrument. Therefore, the accounting by the issuer depends neither on the characteristics of the contract nor on the business model of the entity, but on the pre-existence of a non-financial risk that could or could not adversely affect the holder of the contract.

Two contracts with identical cash flows for the entity would be scoped into either IFRS 4 or IFRS 9 depending on whether or not the cash outflows compensate the holder for an adverse effect of an outcome of a non-financial risk that existed prior to the inception of the contract. At its most morbid this assessment peaks in subjectivity when it comes to the assessment of "compensation" and "adversely affects" in life insurance.

As this scope decision would be based upon subjective assessments of a third party, it is of importance that the different resulting recognition of assets and liabilities and measurement and presentation of revenue is as equal as possible. In our opinion the most significant difference would be in the presentation of revenue where we expect to see a pressure for the assessment of contracts being within the scope of IFRS 4 as opposed to IFRS 9.

In the ED the existence of significant insurance risk is a significant determining factor for the identification of an insurance contract. We do not support the exemption of reinsurance contracts from the requirement of significant insurance risk. Thus we recommend the deletion of the second part of paragraph B19. That second part is currently an example of accounting by form, or rather name, over substance.

Paragraph B21(a) states that the non-prolongation of a contract is an economic loss for the entity. As this is a consequence of the contractual terms we disagree that it constitutes an economic loss to the entity. We recommend that the term is substituted with opportunity loss or a similar expression.

We do not understand, and thus would like to see more guidance on, the difference between the variable described in paragraph B26(k) and B27(g). It is not clear to us how a change in a climatic or geological variable is specific to a party to the contract. However we understand that the consequence of a change in a climatic or geological variable could be so described in the contract as to become specific to the holder of the contract.

We do not agree with the definition of highly interrelated relating to investment components as described in paragraph B32(b). We do support the separation of distinct investment components. We also agree with the condition that distinct investment components cannot be highly interrelated to the degree that the entity is unable to measure the investment component without considering the insurance component. However, we do not agree with the criterion that looks at the contractual terms and states that if the lapse or maturity of one component in a contract causes the laps of maturity of the other, then the components are assessed to be highly interrelated. This is a form issue in the contract and not a faithful representation of the distinctiveness of an investment component. We recommend the deletion of paragraph B32(b).