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**Association Suisse des Actuaires**
**Schweizerische Aktuarvereinigung**
**Swiss Association of Actuaries**

Zurich, 30 November 2010

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

**Re: Exposure Draft Insurance Contracts**

Dear Sirs

The Swiss Association of Actuaries is the professional association of actuaries practicing in Switzerland. We have over 1'000 members of which about one half are fully qualified. We are therefore pleased to provide you with the following comments:

While we appreciate the proposal's conceptual merits deriving from its current and market-based approach to the measurement of insurance contracts, we have several major concerns, the main one being the forseeable volatility of income: while this may be manageable for pure risk based (non-life) portfolios, it is not conducive at all to the institutional asset management that is usually part of life insurers' business model. Relatively at the surface, the residual margin with its locked in assumptions would add its own to this volatility, but more deeply, we regret that the Board has not included a measurement approach to insurance liabilities that could be used together with IFRS 9's Amortized Cost Measurement, alleviating short-term income volatility commensurately with the long-term nature of most life insurance. We urge the Board to provide such an alternative measurement approach, or else, we don't see how fixed-income based and participating savings business would be borne by stock-based carriers.

Moreover, with the emergence of current and market-based solvency reporting next to financial reporting, insurers will have to entertain a further sophisticated, complex and model-based view of their business. It is therefore of utmost importance to align these views as much as possible, both to contain costs, and for transparency in communications with stakeholders. The Board has succeeded in formulating the ED's proposals largely in terms of principles, which provides much appreciated flexibility for implementation within national and international contexts, and we very much hope that this will be upheld in the Board's further deliberations.

Finally, we would like to emphasize, that the Swiss Association of Actuaries is prepared to give its members guidance on specific technical issues of implementation, and to endorse or adapt guidance from international bodies such as the International Actuarial Association or the Groupe Consultatif.

Yours sincerely
Swiss Association of Actuaries

Hanspeter Tobler — President

Holger Walz — Managing Secretary

**Appendix: Response to the Invitation to Comment**

**Question 1 – Relevant information for users (paragraphs BC13–BC50)**

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?

We agree with the broad direction of the proposed measurement model as it represents a big step towards depicting the actual economics of insurance business. We also welcome that the Board's measurement model is principles-based and thereby capable of accommodating various implementation approaches. We urge the Board to continue along these lines in further formulating the ultimate measurement model so as to permit alignment with applicable current and market-based measurement approaches to solvency reporting, both to permit re-use of investments in complex models necessitated by solvency reporting, and also to facilitate communications with stakeholders. Furthermore we note that the Board has not developed a measurement model for insurance contracts that could be used together with IFRS 9's amortized cost model on the asset side. We encourage the Board to provide such a measurement approach as an alternative to the ED's proposed measurement model, because it could provide a way for taking some of the volatility out of periodic results. Volatility in P&L due to the mismatch between an insurer's assets and liabilities, in our opinion, is likely to confuse users of insurers' financial statements, thus failing to help them understand insurance business and potentially contributing more to increasing insurers' cost of capital than reducing it by virtue of transparency.

**Question 2 – Fulfilment cash flows (paragraphs 17(a), 22–25, B37–B66 and BC51)**

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

We agree. Particularly for long-term insurance contracts, there is no viable alternative to cash flow based measurement approaches, even though these approaches can be heavily dependent on assumptions about conditions in the distant future.

(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?

In general, we are comfortable with the guidance provided in Appendix B. However, we find that paragraphs B38 and B39 are not sufficiently conclusive in determining that contracts with embedded derivatives require stochastic modeling to determine the time value of options and guarantees. Also, guidance on measuring policyholder dividends, such as contained in the staff's Note of November $8^{th}$, should be included in the ultimate standard.

We also suggest to remove "general overheads", item B61(f), from the list of excluded cash flows (paragraph. B61), since it may unnecessarily interfere with paragraph B63 (expenses incremental at the portfolion level) in systematically selecting the expense components to be projected, e.g., in alignment with cash flow projections for solvency reporting.

**Question 3 – Discount rate (paragraphs 30–34 and BC88–BC104)**

(a) Do you agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability? Why or why not?

We agree. It would be inconsistent for otherwise identical policyholder cashflows to be valued differently because different insurers held different assets to back those liabilities.

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

We agree with the proposals. We would like to note, though, that we are not convinced of the theoretical concept of liquidity premium, especially in a context of solvency reporting when viewed in isolation. However, for the purposes of financial reporting, we do support discounting at spreads above the risk-free yield curve. Specifically, we would like to see guidance formulated in such a way, that existing concepts – such as the assumptions of Solvency II for risk-free interest rates and liquidity spreads – can be applied.

(c) Some have expressed concerns that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts. Are those concerns valid? Why or why not? If they are valid, what approach do you suggest and why? For example, should the Board reconsider its conclusion that the present value of the fulfilment cash flows should not reflect the risk of non-performance by the insurer?

We believe concepts such as the ultimate forward rate as proposed in Solvency II will be adequate. It's essential to us, that all insurers in the same market use the same approach to ensure consistency and comparability.

**Question 4 – Risk adjustment versus composite margin (paragraphs BC105–BC115)**
Do you support using a risk adjustment and a residual margin (as the IASB proposes), or do you prefer a single composite margin (as the FASB favours)? Please explain the reason(s) for your view.

We prefer the IASB's proposal based on a risk adjustment.

**Question 5 – Risk adjustment (paragraphs 35-37, B67-B103 and BC105–BC123)**
(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?

We do not believe that the proposed objective for measuring risk margins would be operational in practice since the way that insurers operate their business provides little reliable or systematic evidence for determining an amount for which they would rationally be willing to rid themselves of their portfolios. Any risk adjustment according to the proposed objective would therefore necessarily appear contrived. We note that (risk) margins, besides capital requirements, are first and foremost, subject to regulatory minimum conditions. In current and market oriented solvency regimes, that is, solvency regimes, with balance sheet items that, to the extent possible, are consistent with current market prices, reference should be made to those regulatory minimum margins. That, to us, would provide the maximum realistically possible comparability between insurance markets.

(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?

In order to accommodate the (minimum) requirements of current, market-based regulatory reporting regimes and emerging practice in those contexts, we believe, the choice of techniques should be left open. However, we also think, in order to promote comparability within a market, that insurers subject to the same regulatory oversight should use the same methods for the same line of business.

(c) Do you agree that if either the CTE or the cost of capital method is used, the insurer should disclose the confidence level to which the risk adjustment corresponds (see paragraph 90(b)(i))? Why or why not?

We disagree: if CTE or cost of capital is used to determine the risk margin, the confidence level should not have to be disclosed. Rather, the methodologies applied determining the risk adjustment should be disclosed.

(d) Do you agree that an insurer should measure the risk adjustment at a portfolio level of aggregation (ie a group of contracts that are subject to similar risks and managed together as a pool)? Why or why not? If not, what alternative do you recommend and why?

We agree. However, since inter-portfolio diversification is not allowed under the proposal, aggregation levels must necessarily be high, e.g., in life insurance, one could admit three aggregates: individual, group, and unit-linked, consistent with the requirements of solvency reporting of life companies in Switzerland.

(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?

With an open approach to risk adjustment, we believe it is not necessary to give guidance on any specific method.

**Question 6 – Residual/composite margin (paragraphs 17(b), 19–21, 50–53 and BC124–BC133)**

(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?

While we appreciate the rationale of "zero-profit-at-issue", we are not supportive of the proposed residual margin that is based on locked in assumptions and is mechanically run off over the life-time of the portfolio. The proposed residual margin is reminiscent of an amortized cost measurement and perhaps would have a place in an alternative measurement approach that could go with measuring assets at amortized cost under IFRS 9. It is important that where the residual margin is insignificant in comparison to total reserves, that insurers are not forced to make the significant administrative effort to implement this.

(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?

We agree, to the extent that the Board maintains the residual margin in the proposed form.

(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?

We disagree. If the Board maintains the residual margin, we propose the same, broad level of aggregation as for the risk margin.

(d) Do you agree with the proposed method(s) of releasing the residual margin? Why or why not? If not, what do you suggest and why (see paragraphs 50 and BC125–BC129)?

We agree, to the extent that the Board maintains the residual margin.

(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?

n/a

(f) Do you agree that interest should be accreted on the residual margin (see paragraphs 51 and BC131–BC133)? Why or why not? Would you reach the same conclusion for the composite margin? Why or why not?

We agree, to the extent that the Board maintains the residual margin in the proposed form.

**Question 7 – Acquisition costs (paragraphs 24, 39 and BC135–BC140)**

(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?
We disagree with the proposal's level of incrementality. We believe, acquisition costs incremental at the level of the portfolio and not just at the individual contract level, should be included in the initial measurement. Also, acquisition expenses for lost sales should be included - in short, the same acquisition costs as under current US GAAP (FAS 60) should be used.

**Question 8 – Premium allocation approach**
(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?

The Board should permit but not require the premium allocation method. That would avoid having to artificially split many non-life portfolios into short-duration and long-duration components.

(b) Do you agree with the proposed criteria for requiring that
approach and with how to apply that approach? Why or why
not? If not, what do you suggest and why?
We agree with the proposed criteria on the assumption that paragraph 54(a) "The coverage period [..] is approximately one year or less." allows for judgement in extending the treatment to contracts with a coverage period somewhat beyond one year. Regarding application of the premium allocation approach, we think the proposed discounting and accretion at interest of the pre-claims liability up to a one-year time horizon would generally not produce results significantly different from current practice of (undiscounted) unearned premium and therefore does not warrant the additional effort.

**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?
While the proposed contract boundary principle works well in many cases, there are certain portfolios, such as Swiss motor business, for which the proposal would lead to inconsistent practice. Swiss motor business is generally managed on a one-year basis, with annual repricing. Contracts typically are concluded for a multi-year period, however. For repricing, some insurers formally maintain complete liberty and these, according to the proposal, would apply the short-duration model, while other insurers commit to repricing only on a portfolio-basis. These would be subject to the proposed building block approach and would have to project cash flows over a multi-year period, e.g. 5 years, on business, that for all practical purposes is identical and managed identically on a one-year basis. We recommend that the concept of repricing fully reflecting risk be stated as a principle with focus on the effectiveness of repricing at the portfolio-level rather than at the level of the individual policyholder. The portfolio-level is the more relevant level for shareholders.

Additionally, the contract boundary principle fails to provide an adequate principle for projecting future cash flows in lines of business that are subject to special laws such as the Swiss group pensions business. During the working years of a policyholder, in the so-called accumulation phase, this business is typically underwritten for an initial period of several years and then becomes annually renewable. While the proposed contract boundary principle would limit projections to, on average, less than 2 years, insurers are subject to long term future losses due to mandatory minimum annuitization rates when participants retire. Therefore, the business is managed on the assumption that the insured base will retire with them and the projected losses at annuitization are reserved for on a portfolio-basis over the entire working period of the insured base up to retirement. Occasional changes of carrier by an employer are handled according to the so-called “revolving door” principle, i.e., each group contract is paid their accumulated account value, but portfolio-basis reserves for future annuitization losses stay with the carrier. As this business is under considerable scrutiny by the supervisor and the legislature, we would propose to use carriers’ contract boundaries as used for the purposes of regulatory reporting.

**Question 10 – Participating features**

(a) Do you agree that the measurement of insurance contracts should include participating benefits on an expected present value basis? Why or why not? If not, what do you recommend and why?

We agree - participating features have traditionally been an integral part of many insurance contracts and this may return in the future, and participation by policyholders in an insurer's operational surplus can be an essential feature of insurance. It might be pointed out that to the extent that participation in surplus is subject to management’s discretion, the notion of "expected value" obtains a declarative or subjective character, and that the ED does not really accommodate this aspect of measurement, nor does it contain a presentation objective for this aspect of insurers' business model.

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

We support the IASB's position to include participating financial instruments that do not transfer significant insurance risk in the IFRS on insurance contracts, since such contracts are typically sold by insurance companies and are managed alongside portfolios of participating insurance contracts or as part of such portfolios.

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

We see no reason to require that there must exist insurance contracts participating in the same surplus as tentative (non-insurance) investment contracts. In our view, that requirement can be deleted.

(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?
In the case of, e.g., participating (formal) insurance contracts that fail to transfer signifcant insurance risk, application of paragraphs 64 and 65 should be subject to judgement, provided results are not significantly affected.

**Question 11 – Definition and scope**
(a) Do you agree with the definition of an insurance contract and related guidance, including the two changes summarised in paragraph BC191? If not, why not?

We agree.

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

As we interpret paragraph 4(g), insurance contracts with insurers' own employees, e.g., for workers compensation, might have to be excluded from financial reporting. That is impractical for administrative reasons, and given that those policies don't represent a signifcant part of large, listed insurers' overall portfolios, we think that these policies should not have to be removed from the reported base.

(c) Do you agree that the contracts currently defined in IFRSs as financial guarantee contracts should be brought within the scope of the IFRS on insurance contracts? Why or why not?
We agree.

**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?
We agree with the princple that non closely-related contract components be unbundled from the insurance component, that is accounted for under the appropriate IFRS as the case requires.

**Question 13 – Presentation**
(a) Will the proposed summarised margin presentation be useful to users of financial statements? Why or why not? If not, what would you recommend and why?

While the summarized margin approach is conceptually the "correct" income statement for the proposed measurement model, and we commend the Board for its effective format, it functions much like what traditionally is considered a source of earnings statement (technical analysis) and in that will no doubt be welcomed by users. However, in our opinion, meaningful presentation of insurers' operations goes beyond a source of earnings statement and we note that the exposure draft falls short of treating the full set of primary financial statements, i.e., there are no proposals for the balance sheet, cash flow statement, or statement of changes in equity. Moreover, we miss illustrative examples, such as the waterfall diagram in the “Snapshot” accompanying the exposure draft. We therefore cannot assess the overall merit of the ED's presentation concept as we do not see, how transparently the full set of primary financial statements would convey the business model of insurers to the users of financial statements.

Specifically, with insurers' operational cash flows (premiums, benefits and claims, expenses, commissions) relegated to mere movements into and out of deposited funds, we expect insurers' cash flow statement to rise in prominence. To us, in this respect, the ED is incomplete, and we strongly regret that a comprehensive and coherent presentation model for insurance contracts is not being exposed.

(b) Do agree that an insurer should present all income and expense arising from insurance contracts in profit or loss? Why or why not? If not, what do you recommend and why?

We agree as far as the ED's proposals are concerned. Under any alternative approaches, especially involving amortized cost measurements, matching requirements are likely to result in certain components of asset and/or liability changes being shown in other comprehensive income.

**Question 14 – Disclosures**

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

We agree.

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

Yes.

(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.

The present value of future policyholder dividends.

**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?

We agree.

**Question 16 – Reinsurance**

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

Although we agree with the expected loss model for determining the effect of non-performance of reinsurance assets, we note that to reflect the non-performance of reinsurance assets in measurement but not to reflect the non-performance of the corresponding liabilities, is inconsistent. However, we are not in favor of reflecting an insurer's own credit risk in liability measurement.

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

No.

**Question 17 – Transition and effective date**

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

We disagree with the proposals as they would recognize the value of in-force business all at once at transition and introduce a bias in earnings for years to come during run-off of the in-force at transition. Rather, we propose to use the difference between IFRS 4 Phase I net liabilities and the expected present value of cash flows as the initial risk adjustment, or risk adjustment plus residual margin, should the Board maintain the residual margin.

(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)?

n/a

(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?

Yes.

(d) Please provide an estimate of how long insurers would require to adopt the proposed requirements.
It is difficult for us to give a reliable opinion about how long it would take the Swiss insurance industry to implement the proposed requirements, since the proposals constitute a fundamental departure from current practices. A multi-year period will almost certainly be required.

**Question 18 – Other comments**
Do you have any other comments on the proposals in the exposure draft?
We believe the recognition requirements of paragraphs 13 and 14, i.e., recognizing an insurance contract at the earlier of its date of signing and it's effective date of coverage, should not be interpreted to necessitate changes to insurers' current administration systems and processes, just in order to accelerate bringing policies onto the books before their effective date. We understand from BC226(b) that the purpose of the ED's proposal is to gard against the situation that contracts that have already been signed but are not yet effective, may become onerous before their effective date - in our view, this may occasionally be a legitimate concern but it is of general scope and should be correspondingly addressed, similarly to "subsequent events" in an IFRS of its own so that other industries can benefit from it as well.

**Question 19 – Benefits and costs**
Do you agree with the Board's assessment of the benefits and costs of the proposed accounting for insurance contracts? Why or why not? If feasible, please estimate the benefits and costs associated with the proposals.
Unfortunately we have difficulties sharing the Board's assessment that the proposed IFRS's improvements to financial reporting will come at "reasonable costs", irrespective of any benefits that may eventually materialize. The only way that we might agree with such an assessment, is if the Board is willing allow sufficently broad interpretation of the principles proposed in the ED so that investments in systems and procedures in the context of market-based solvency

reporting can be leveraged. Ideally, it should be possible to obtain financial reports from market-based regulatory reports by way of few and transparent modifications.