CEIOPS | Westhafen Tower, 14 floor, Westhafenplatz 1
60327 Frankfurt | Germany

Sir David Tweedie
Chairman IASB
30 Cannon Street
London EC4M 6XH
United Kingdom

Contact: Carlos Montalvo Rebualta
Phone: +49 (0) 69 95 11 19 2 2
Fax: +49 (0) 69 95 11 19 1 8
Email: carlos.montalvo@ceiops.eu

10 December 2007

Reference: IASB Discussion Paper "Preliminary Views on Insurance Contracts"

Dear Sir Tweedie,

I am pleased to provide you with CEIOPS' comments on the IASB Discussion Paper "Preliminary Views on Insurance Contracts".

If you wish to receive further clarifications, CEIOPS would be happy to respond.

Best regards,

Thomas Steffen
CEIOPS Chair

CEIOPS Comments on the IASB Discussion Paper

Preliminary Views on Insurance Contracts

Introduction

CEIOPS welcomes the opportunity to comment on the IASB's Discussion Paper *Preliminary views on insurance contracts*. The work of the IASB has particular significance within Europe not only because EU listed groups are required to report under IFRS, but also because many European countries have already adopted IFRS as their national accounting framework.

CEIOPS is strongly in favour of an accounting standard for insurance contracts and is grateful to the IASB for its valuable work in this area. CEIOPS is keen to achieve a reporting regime under Solvency II which allows insurance undertakings to use their financial reporting as a basis for regulatory reporting, with a minimum number of solvency adjustments applied to satisfy the specific needs of supervisors. In this context we support an approach of maximum commonality between Solvency II and IFRS and have a particular interest in the proposals made in this Discussion Paper.

CEIOPS believes that reliability and relevance of accounting and supervisory information will be enhanced compared to the current frameworks. The advantages of achieving a capital adequacy regime under Solvency II which is as far as possible consistent with IFRS accounting practice are numerous. In particular, benefits arise if both are produced through compatible and commonly audited systems.

In light of this general approach, we wish to express our support for the underlying accounting principles on which the IASB's Discussion Paper is built. We believe the IASB's approach to accounting for insurance contracts is closely in line with our own work on Solvency II, and although the exact terminology used may occasionally differ, we believe that in practice the two regimes are capable of achieving very similar outcomes. We welcome the similarity of approaches taken in defining insurance technical provisions under both the Solvency II valuation rules and this Discussion Paper. Both sets of rules aim to achieve a reliable set of principles which reflect the economic reality of insurance contracts. We intend to have a close look at terminology differences and foster convergence of terms used where possible.

There was intensive debate on the accounting for gains at inception. Although this issue is distinct from the measurement of insurance liabilities, there is a consensus among CEIOPS members on stressing that the two issues are very closely inter-related and have to be examined in parallel by the IASB. Please refer to the section on day one gains for further details.

Our comments and answers are articulated by reference to the Solvency II principles. In this letter we intend to focus first on key issues. We also include answers to the questions formulated in the Paper.

General Comments

Under Solvency II, it is envisaged that technical provisions shall be current, market consistent, and made up of explicit building blocks – criteria that are indeed those of the Discussion Paper. In fact, we may contend that the concern expressed in § 4 (c) of the Discussion Paper[1] will no longer hold under such a regime, which clearly distinguishes the accounting question (what assets and liabilities does an insurer have?) and the supervisory question (what assets should an insurer hold?). The latter is addressed explicitly through capital requirements and adequacy rules.

Current Exit Value

CEIOPS is thus very much in favour of an explicit building blocks approach, which aims at defining a Current Exit Value of insurance liabilities reflecting common (market) assumptions on a number of parameters within the valuation of the liability, namely a Best Estimate of cash flows under the contract, discounted using a risk-free interest rate, to be complemented by a Risk Margin reflecting a market valuation of the risk associated with the liabilities.

However, we would like to raise the following issues which arise from the use of current exit value as presented in the Discussion Paper.

Service Margin

Our first issue is with the novel concept of service margin. Whilst we do not conceptually oppose the idea of a service margin, we think it is not well defined in the Discussion Paper and therefore creates confusion. Clarification would be needed to ensure proper valuation and consistent application of this margin.

We assume the service margin is part of the overall current exit value of the insurance liabilities, i.e. would be required by market participants to take over the rights and obligations attached to the service component of the insurance portfolio.

---

[1] *« In some cases, accounting for insurance contracts has been heavily influenced by supervisory concerns. This has sometimes resulted in methods that do not clearly distinguish clearly between an accounting question (What assets and liabilities does the insurer have ?) and supervisory question (What assets should an insurer hold to give sufficient assurance of satisfying its existing obligations ?)"*

Subject to further clarification and guidance we understand that in principle the service margin could be an evaluation of the risks associated with those cash flows that arise under the service component of an insurance contract.

However, we wonder how useful an explicit service margin in addition to the risk margin may be. We think cash flows and risks associated with the service component can be reflected within the current estimate and risk margin, since the expenses to be incurred as part of the service component could be included in the best estimate on the one hand, and risks associated with those cash flows could be part of the risk margin on the other hand.

It should be made clear that the service margin should not be used as a plug to "smooth" profits.

Day One Gain

We acknowledge that, because the premium may provide evidence of the margin that market participants would require, but has no higher status than other possible evidence, the measurement model put forth in the Discussion Paper can result in gain at inception (by which we merely mean a difference between the premium received and the exit value).

As mentioned in earlier papers or by the IAIS, CEIOPS believes that gain at inception should be allowed only if the undertaking has an appropriate and reliable risk margin.

We also wish to emphasize that the risk margin (and service margin, if any) should be risk based and unbiased and cannot be used as a plug to "smooth" profits: its calibration should be market consistent and consistent over time, regardless of potential consequences on profit at inception. Hence, observation of gain at inception should not lead to re-measurement of the insurance liability.

However, we recognize that the accounting treatment/presentation of gain at inception is linked to a number of other IASB projects, dealing with financial statements presentation and performance reporting, or revenue recognition. We understand the IASB has not yet conducted a profit recognition project that would consider appropriate treatment of day one gains.

Our reading of the Discussion Paper[2] is that the gain at inception would be recognized through profit and loss. We also note that other treatments exist in other IFRS, such as deferral to equity or separate liability followed by subsequent release.

CEIOPS is of the opinion that the present version of the Discussion Paper does not deal with profit recognition at sufficient length and is in fact pre-empting a debate

[2] Particularly § 85 and Example 2 in App. G, as well as wording of question 4

about performance reporting and revenue recognition, including the treatment of gain at inception, as well as that of premiums, changes in liabilities and other insurance expenses and income referred to in questions 18-20, which we would expect to require proper discussion and consultation. We believe that it is of utmost importance that these issues should be addressed as soon as possible so as to allow for a comprehensive standard on insurance contracts.

We do not think it is appropriate for this Discussion Paper to decide on recognition of day one gains through profit and loss. The IASB should first consider a consistent treatment of day one gains across the financial sector and in other IFRS and on-going projects. We would be concerned that even a transitional discrepancy on such a vital aspect of some businesses could have strong adverse consequences in terms of competition and trump the resulting financial statements' usefulness and understandability for users.

Own credit standing

CEIOPS believes that an entity's credit characteristics are not relevant in the measurement of its liabilities for the following reasons:

(i) The financial statements of an insurance undertaking are devised within the hypothesis that it will meet its obligations. Under the going-concern hypothesis, we do not see how any of the projected probability weighted scenarios used to calculate its liabilities should result in anything but a full carrying out of its obligations, which equates to ignoring evolutions of its credit standing.

(ii) We are not convinced by the analogy with assets made in appendix H: while the holder of debt issued by some other participant has no say on the issuer's ability to repay, and therefore must reflect that ability in her book by taking into account her credit standing (same as reinsurance assets, see question 12), the issuer of debt must stick to her commitment to repay it, and reflect any downgrade only once her creditors have agreed to partial settlement (only then does her constructive or legal obligation change).

(iii) We do not think that credit characteristics should be reflected in a current exit value because they are not consistent with the concept: any transferee would expect the liability to be neutral of own credit standing of the transferor. Hence the exit value would not allow for a depreciation of the liability.

Guaranteed insurability

CEIOPS shares the IAIS view that "all future cash inflows under a contract should be allowed for in the measurement of the insurance liability, to the extent that they are integral to the fulfilment of the obligations under that contract".

In particular, we do not think it relevant to isolate either beneficial or onerous cash flows and ponder the nature of the resulting assets and liabilities, and consistent with this we would advise against any separately recognised customer relationship asset (hence our preference for option (b) under question 6).

However, we recognize that for comparability and reliability reasons more guidance should be given on how to apply building block A in relation to future premiums; in that respect we favour the introduction of specific criteria along the line of guaranteed insurability, which allows to reflect better the economic reality inherent in open-ended or renewable insurance contracts which may for example be entered into in life or health insurance (hence our preference for option (a) under question 7).

Entity Specific Cash Flows

We agree with the overall measurement objective of the paper. We think that the three building blocks should indeed be subject to the following three principles:

(i) market consistency

(ii) comparability

(iii) similar obligations with similar risk profiles lead to similar liabilities

In this context, we agree that inter-portfolio diversification benefits should not be reflected within liabilities.

Also, we note that, while market cash flows are appropriate in principle, they should be used only where they are reliable, easily accessible and relevant to the liability being measured – i.e. they reflect identifiable characteristics that are sufficiently "homogeneous" on the reference market. Thus where market consistent, comparable and reliable cash flows are not available for reasons inherent to the portfolio, entity specific cash flows which reflect the entity's own cost structure will be considered a suitable proxy and will be favoured over artificial reconstruction of one-off "market" cash flows that would exclude too widely and strictly evidence of the undertaking's own experience in managing the portfolio.

Answers to specific questions raised in the Discussion Paper

Set out below is a list of all questions posed in this paper. Responses are most helpful if they:

(a) comment on the questions as stated

(b) indicate the specific paragraph or paragraphs to which the comments relate

(c) contain a clear rationale

(d) describe any alternative the Board should consider.

Respondents need not comment on all of the questions and are encouraged to comment on any additional issues.

The Board will base its conclusions on the merits of the arguments for and against

each alternative, not on the number of responses supporting each alternative.

Question 1

Should the recognition and derecognition requirements for insurance contracts be consistent with those in IAS 39 for financial instruments? Why or why not?

In theory, we think recognition and derecognition requirements should follow the contractual obligations as they arise and are extinguished. As a result we favour consistency with IAS 39 principles as they appear to reflect such consistency.

However, we would point out that recognizing contractual obligations under such framework will not be straight-forward as the binding date of an insurance contract is often quite difficult to determine and depends on multiple factors such as initial insurance proposal, withdrawing delays, legal delays to enforceability, etc.

Practically, current practices have shortcut these issues by favouring recognition upon inception rather than at binding date. This also has a strong influence on consistency and relevance of corresponding reinsurance contracts, which may have the same inception dates but would ordinarily be signed later than the underlying insurance contracts.

As a result, CEIOPS doubts that the benefit of recognition in accordance with IAS 39 would be sufficient to outweigh the costs and practical issues surrounding such a significant change to current practice. If the Board ultimately concludes that there is no need for such a significant change, it is important to note however that insurers should still be expected to recognise onerous contracts immediately upon binding.

Question 2

Should an insurer measure all its insurance liabilities using the following three building blocks:

(a) explicit, unbiased, market-consistent, probability-weighted and current estimates of the contractual cash flows,

(b) current market discount rates that adjust the estimated future cash flows for the time value of money, and

(c) an explicit and unbiased estimate of the margin that market participants require for bearing risk (a risk margin) and for providing other services, if any (a service margin)?

If not, what approach do you propose, and why?

As stated earlier, we agree with the three building blocks approach, but have some reservations and need more guidance on some aspects of it, particularly:

- definition of “contractual cash flows”;
- exclusion of entity specific cash flows;
- service margin.

Question 3

Is the draft guidance on cash flows (appendix E) and risk margins (appendix F) at the right level of detail? Should any of that guidance be modified, deleted or extended? Why or why not?

The draft guidance on cash flows (appendix E) and risk margins (appendix F) seems to be at the right level of detail at this moment.

We expect more detailed guidance to be issued both within the supervisory framework under Solvency 2 and professional guidance; while not a requirement under the IFRS framework, we recognize that the use of such guidance is not in itself contradictory with the aims of the current exit value model.

We welcome the tentative conclusion of the Board that the calculation of insurance liabilities should be market consistent. This important characteristic of the new framework should increase the comparability of accounting information across entities having similar portfolio of insurance contracts.

It is however important to analyze further this principle, especially to the extent that it would force reporting entities to replace their own expected servicing costs by those that market participants would incur.

We understand that the exclusion of entity specific cash flows may conceptually derive from the objective of obtaining "current exit" valuation of insurance liabilities and is consistent with the approach followed in the Discussion Paper recently published by the Board on Fair Value Measurement. However, we do not believe that the objective of "current exit value" for insurance liabilities should necessarily lead to the rejection of entity specific cash flow in all cases as explained further below.

Our position on the issue of "entity specific cash flows" is better explained by splitting out the different elements or facets of this issue.

First, we concur with the principle that insurance liabilities should not capture cash flows generated by other assets and liabilities or arising from synergies between the insurance liability and other assets or liabilities. We understand this as meaning that the cash outflows considered would be the cash flows strictly required to settle or transfer the obligation, i.e. cash flows that are necessary to service the obligations towards the policyholders/beneficiaries (with appropriate margins) and that would be transferable to any transferee. To this extent, the measurement would indeed not capture entity specific elements that are not strictly linked to the contracts.

Secondly, we theoretically concur with an objective that the valuation of technical provisions should be consistent with the estimates that other market participants would make. However, it can be observed that there are important practical limitations to the ability to achieve this objective and therefore believe that it needs to be further articulated instead of being presented as an absolute principle.

On this basis, we see the market consistency of measurement only as an overall objective, to be followed as far as practically possible and provided that the resulting information remains relevant and reliable for the readers of the financial statement.

It can be observed that only some variables can be estimated on the basis of *reliable* and *relevant* market data. We could agree with a principle requiring the use of available market references for variables and/or contracts that are truly common, homogeneous for all market participants as it is highly probable in this case that the market references will also be reliable and relevant for the reporting entity.

We would expect this to be the case for most financial variables (interest rates, inflation…). It could also be possible for some variables on insurance risk but only if the contracts *and* the variables present characteristics that are largely common, homogeneous on the reference market. For example, this could be applied to well diversified portfolios of common, homogeneous life contracts (on which many variables like mortality tables are readily available and reliable). Hence, this would not be possible if there are differences between the specific portfolios of the undertaking and the market references, and we understand that this is consistent with the Board's distinction between entity and portfolio-specific elements.

The fact is that relevant and reliable information on most expenses and on most insurance and reinsurance risk will typically not be available and there are not so many common, homogeneous contracts with relevant and reliable data on variables. Furthermore, it is not always practically possible to split the multiple elements intervening in the calculation of cash flows and to check the consistency of each element with market references (if they ever exist). Therefore, the objective of market consistency in valuations cannot be fully achieved in practice and could actually lead to hazardous estimations of the actual risks faced by the insurance undertaking.

In this context, we are of the opinion that the market consistency of valuation should remain as an overall objective subject to a practicality condition, i.e. that relevant and reliable market references should be mandatorily used for homogeneous contracts and variables only. Otherwise, we would expect insurers rather to use their own estimates of expenses and adjust the valuations where necessary in light of their past experience.

Question 4

What role should the actual premium charged by the insurer play in the calibration of margins, and why? Please say which of the following alternatives you support.

(a) The insurer should calibrate the margin directly to the actual premium (less relevant acquisition costs), subject to a liability adequacy test. As a result, an insurer should never recognise a profit at the inception of an insurance contract.

(b) There should be a rebuttable presumption that the margin implied by the actual premium (less relevant acquisition costs) is consistent with the margin that market participants require. If you prefer this approach, what evidence should be needed to rebut the presumption?

(c) The premium (less relevant acquisition costs) may provide evidence of the margin that market participants would require, but has no higher status than other possible evidence. In most cases, insurance contracts are expected to provide a margin consistent with the requirements of market participants. Therefore, if a significant profit or loss appears to arise at inception, further investigation is needed. Nevertheless, if the insurer concludes, after further investigation, that the estimated market price for risk and service differs from the price implied by the premiums that it charges, the insurer would recognise a profit or loss at inception.

(d) Other (please specify).

CEIOPS strongly supports implementation B of the calibration of the risk margin (§ 78 of the Discussion Paper), i.e. "treat[ing] the observed price for the transaction with the policyholder as an important reasonableness check on the initial measurement of the insurance liability, but does not use it to override an unbiased estimate of the margin that market participants require".

This would lead us to endorse option (c) under question 4.

However, this does not imply, as stated in this option, that "if the insurer concludes, after investigation, that the estimated market price for risk and service differs from the price implied by the premiums it charges, the insurer would recognize a profit or loss at inception". On this issue, please refer to comments in the section titled "day one gain".

Question 5

This paper proposes that the measurement attribute for insurance liabilities should be the amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity. The paper labels that measurement attribute 'current exit value'.

(a) Is that measurement attribute appropriate for insurance liabilities? Why or why not? If not, which measurement attribute do you favour, and why?

(b) Is current exit value' the best label for that measurement attribute? Why or why not?

(a) The amount an insurer would pay at the reporting date to another entity to transfer its remaining contractual rights and obligations immediately seems to comply with the main criteria for a risk-based measurement that may be used to support the supervisory review and capital requirements under Solvency II. As such, we believe it is the right attribute for insurance liabilities.

(b) The suggested label may however be perfectible in that it emphasizes an "exit value" that is likely to be more theoretical than actual, as in most cases we would expect the liabilities to be settled by the issuing insurer rather than any other "market" participant.

Question 6

In this paper, beneficial policyholder behaviour refers to a policyholder's exercise of a contractual option in a way that generates net economic benefits for the insurer. For expected future cash flows resulting from beneficial policyholder behaviour, should an insurer:

(a) incorporate them in the current exit value of a separately recognised customer relationship asset? Why or why not?

(b) incorporate them, as a reduction, in the current exit value of insurance liabilities? Why or why not?

(c) not recognise them? Why or why not?

As stated in the general comments, we believe isolating beneficial policyholder behaviour is not appropriate and the subsequent recognition of a separate customer relationship asset would be misleading.

Therefore we would advise that (b) insurers incorporate expected future cash flows resulting from beneficial policyholder behaviour in the current exit value of insurance liabilities, along with unfavourable beneficial policyholder – in effect fully measuring the option that the contract may have granted for the policyholders to opt in or out of it.

Question 7

A list follows of possible criteria to determine which cash flows an insurer should recognise relating to beneficial policyholder behaviour. Which criterion should the Board adopt, and why?

(a) Cash flows resulting from payments that policyholders must make to retain a right to guaranteed insurability (less additional benefit payments that result from those premiums). The Board favours this criterion, and defines guaranteed insurability as a right that permits continued coverage without reconfirmation of the policyholder's risk profile and at a price that is contractually constrained.

(b) All cash flows that arise from existing contracts, regardless of whether the insurer can enforce those cash flows. If you favour this criterion, how would you distinguish existing contracts from new contracts?

(c) All cash flows that arise from those terms of existing contracts that have commercial substance (ie have a discernible effect on the economics of the contract by significantly modifying the risk, amount or timing of the cash flows).

(d) Cash flows resulting from payments that policyholders must make to retain a right to any guarantee that compels the insurer to stand ready, at a price that is contractually constrained, (i) to bear insurance risk or financial risk, or (ii) to provide other services. This criterion relates to all contractual guarantees, whereas the criterion described in (a) relates only to insurance risk.

(e) No cash flows that result from beneficial policyholder behaviour.

(f) Other (please specify).

While we maintain that the proposed criteria should be viewed as an elaboration of the building block A principle that the liability should be based on explicit, unbiased, market-consistent, probability-weighted and current estimates of the contractual cash flows rather than as an arbitrary recognition criterion for an asset that has no individual justification, we do think that criterion (a) provides a satisfactory basis from which to elaborate adequate guidance on building block A.

Question 8

Should an insurer recognise acquisition costs as an expense when incurred? Why or why not?

Yes, we think that acquisition costs should be expensed as they are incurred. Any other accounting treatment would undermine the current exit value principles as it would understate the insurance liabilities on a purely accounting, and what is more, entity specific, basis.

Question 9

Do you have any comments on the treatment of insurance contracts acquired in a business combination or portfolio transfer?

We would think this question should not pre-empt the on-going debate on fair value measurement. Insurance contracts in a business combination should be treated as are other liabilities.

Question 10

Do you have any comments on the measurement of assets held to back insurance liabilities?

In staying consistent with the current exit value measurement principle, we would not re-consider alternative treatments of assets as we agree that inter-portfolio or asset-liability synergies should not impact the valuation of individual portfolios.

Question 11

Should risk margins:

(a) be determined for a portfolio of insurance contracts? Why or why not? If yes, should the portfolio be defined as in IFRS 4 (a portfolio of contracts that are subject to broadly similar risks and managed together as a single portfolio)? Why or why not?

(b) reflect the benefits of diversification between (and negative correlation between) portfolios? Why or why not?

(a) We agree with the statement of the Board, namely that "the unit of account does not affect the present value of the future cash flows" and hence, in practice, the valuation can be based on the portfolio as defined in IFRS 4.

(b) As regards the treatment of diversification benefits (arising from diversification between portfolios), they should not be included in the exit valuation of the liability. Diversification effects should be addressed in the capital requirements (it ensure consistency with Solvency II).

Question 12

(a) Should a cedant measure reinsurance assets at current exit value? Why or why not?

(b) Do you agree that the consequences of measuring reinsurance assets at current exit value include the following? Why or why not?

(i) A risk margin typically increases the measurement of the reinsurance asset, and equals the risk margin for the corresponding part of the underlying insurance contract.

(ii) An expected loss model would be used for defaults and disputes, not the incurred loss model required by IFRS 4 and IAS 39.

(iii) If the cedant has a contractual right to obtain reinsurance for contracts that it has not yet issued, the current exit value of the cedant's reinsurance asset includes the current exit value of that right. However, the current exit value of that contractual right is not likely to be material if it relates to insurance contracts that will be priced at current exit value.

(a) We agree in general that reinsurance assets and insurance liabilities should be measured in the same way to avoid any valuation inconsistency between these categories. Consequently, we believe a cedant should measure its reinsurance assets at current exit value.

(b) This would indeed entail the consequences described in (i), (ii) and (iii). However we should note that:

(i) In practice, insurance undertakings may find it easier to measure the risk margin of a liability net of reinsurance, which would result in a net risk margin on the liability side and no risk margin on the asset side.

(ii) Endorsement of an expected loss model for reinsurance *assets* does not contradict our position on own credit standing inclusion in insurance *liabilities*.

Question 13

If an insurance contract contains deposit or service components, should an insurer unbundle them? Why or why not?

Even if in principle we are not against the unbundling of the different components of an insurance contract, in practice in assessing whether to require that an insurer unbundle deposit components, we should consider the following points (we see them as linked one to another):

(i) The criterion envisaged by the IASB, based on interdependency and on the availability of non arbitrary unbundling might be not readily applicable in practice.

(ii) Insurance contracts are issued and managed by undertakings as a single product; hence, where the contract is not obviously the reunion of two separate products that have been bundled together, requiring to unbundle different components might be misleading in representing the nature of the insurance contract and the insurance business in general.

(iii) Costs and benefits of unbundling in terms of valuation and presentation in the financial statement (as the unbundling issue is closely linked to how present premiums in the face of the financial statement – as revenue or deposits).

Mainly, we are against the approach envisaged by the Board when components are interdependent but can be measured separately (§ 228 c) of the Discussion Paper). The rationale is the following. Firstly, this approach could lead to an inconsistent valuation of the insurance component (can we say that it still follows a Phase II valuation once it is accounted for under that approach?) and secondly we should ask whether this is the presentation of an insurance contract we want to see in the future financial statements of insurers: is this the presentation that best represent the nature of both an insurance contract and of the insurance business? Indeed we do not see a real "value added" in having interdependent components measured separately in terms of more useful and meaningful information to users. Therefore, we could argue along that line and recommend that it would not be *meaningful* to measure both components separately in cases where both components are interdependent.

Question 14

(a) Is the current exit value of a liability the price for a transfer that neither improves nor impairs its credit characteristics? Why or why not?

(b) Should the measurement of an insurance liability reflect (i) its credit characteristics at inception and (ii) subsequent changes in their effect? Why or why not?

As stated in the general comments above, we do not think credit characteristics should be reflected in the measurement of an insurance liability. This appears to us consistent with the current exit value measurement principles and an adequate reflection of economic reality.

Question 15

Appendix B identifies some inconsistencies between the proposed treatment of insurance liabilities and the existing treatment under IAS 39 of financial liabilities. Should the Board consider changing the treatment of some or all financial liabilities to avoid those inconsistencies? If so, what changes should the Board consider, and why?

We recognize that there are inconsistencies between IAS 39 and the approach proposed under phase 2, and we do believe that the IASB should strive to reduce such inconsistencies as far as possible.

However, we believe that the current exit value is an appropriate measurement attribute for insurance liabilities, and would favour due consideration to be given to alignment of standards dealing with non-related issues, but we are aware that this could result in a trade-off between conceptual adequacy of the insurance liability standard, for instance, and consistency with other standards. We believe conceptual adequacy should weigh heavily on such trade-off.

Question 16

(a) For participating contracts, should the cash flows for each scenario incorporate an unbiased estimate of the policyholder dividends payable in that scenario to satisfy a legal or constructive obligation that exists at the reporting date? Why or why not?

(b) An exposure draft of June 2005 proposed amendments to IAS 37 (see paragraphs 247–253 of this paper). Do those proposals give enough guidance for an insurer to determine when a participating contract gives rise to a legal or constructive obligation to pay policyholder dividends?

(a) Yes, we believe scenarios in a participating contract should incorporate policyholders dividends payable to satisfy a legal or constructive obligation existing at the reporting date, as currently defined under IAS 37[3]; however, we are aware that the Board has been discussing constructive obligations recently, and would not support a restriction of the field implied by the present definition as it applies to participating features in an insurance contract. CEIOPS is of the opinion that an appropriate economic valuation of insurance contracts requires consideration of participation features obligations beyond what is legally enforceable.

(b) The detailed level of guidance is critical in assessing whether there exists a constructive obligation. Possible restrictions to the current definition of constructive obligations, which we understand may derive from the proposals we refer to above, would have inappropriate consequences.

[3] « an obligation that derives from an entity's actions where: (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to the parties that it will accept responsibilities; and (b) as a result, the entity has created valid expectation on the part of those other parties that it will discharge those responsibilities. »

Question 17

Should the Board do some or all of the following to eliminate accounting mismatches that could arise for unit-linked contracts? Why or why not?

(a) Permit or require insurers to recognise treasury shares as an asset if they are held to back a unit-linked liability (even though they do not meet the Framework's definition of an asset).

(b) Permit or require insurers to recognise internally generated goodwill of a subsidiary if the investment in that subsidiary is held to back a unit-linked liability (even though IFRSs prohibit the recognition of internally generated goodwill in all other cases).

(c) Permit or require insurers to measure assets at fair value through profit or loss if they are held to back a unit-linked liability (even if IFRSs do not permit that treatment for identical assets held for another purpose).

(d) Exclude from the current exit value of a unit-linked liability any differences between the carrying amount of the assets held to back that liability and their fair value (even though some view this as conflicting with the definition of current exit value).

We believe accounting mismatches, insofar as they do not reflect actual economic mismatches, should indeed be eliminated as much as possible.

However, we do think that mismatches may still arise as a result of different features in different standards; the opportunity of maintaining such features should be assessed on every standard's merits.

Questions 18-20

Should an insurer present premiums as revenue or as deposits? Why?

Which items of income and expense should an insurer present separately on the face of its income statement? Why?

Should the income statement include all income and expense arising from changes in insurance liabilities? Why or why not?

As stated in the general comments, we believe these questions cannot be properly considered outside of a formal consultation and assessment process that will seek to define overarching criteria and principles for revenue and profit recognition.

Question 21

Do you have any other comments on this paper?

We also look forward to the IASB's future work on disclosure requirements for insurance contracts; Solvency II imposes comprehensive public disclosure obligations on insurers and CEIOPS recognizes the benefits of convergence of undertakings' disclosure requirements.

Furthermore, we believe the current exit value measurement attribute, because it relies heavily on market data and modelling, is set to benefit greatly from disclosure at an appropriate level, which would enhance both its relevance and reliability.