

# *Shaping the future of insurance accounting*

A summary of PwC's views  
on the recent exposure  
drafts

November 2013





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# Introduction

A new standard for insurance contracts is an opportunity to create more consistent and comparable reporting among insurers and to improve the way in which the performance of insurance business is presented to investors. The development of a comprehensive standard is essential because the current standard (IFRS 4), that was only intended to be a transition standard, does not provide the level of transparency and comparability needed by the users of financial statements.

In June 2013 the International Accounting Standards Board ('IASB') issued a revised exposure draft ('ED') asking for comments on the five key areas that had changed from its 2010 ED on the accounting for insurance contracts. At the same time, the Financial Accounting Standards Board ('FASB') in the United States issued its first ED regarding its proposed changes to US GAAP for insurance contracts. This paper outlines our response to the IASB ED, and summarises our views provided to the FASB.

In developing our responses, we have taken account of the increasing use of IFRS globally, which means that the proposals need to be relevant for a wide range of companies operating in highly diverse economies. The global reach of the insurance industry also points to the increasing importance of having a single standard as insurers need increased access to global, rather than local, financial markets. Our discussions with clients from around the world have provided valuable insights that have helped us to formulate our views, although we have found that opinions differ significantly between countries.

In its current draft form, the proposed standard would be one of the most complex standards to be adopted. In addition, it will likely frame the insurance reporting landscape for at least the next generation. With this complexity in mind, the IASB has listened to the need for practical expedients that will help companies in certain cases adopt and maintain the provisions of the proposals more easily and at a lower cost. We have made a number of suggestions in our comment letter that we believe will help achieve this objective. However, we believe that some complexity is necessary for the wide variety of insurance contracts and insurance business models that exist around the world, while at the same time considering the need for a high quality standard that will stand the test of time. On balance, we believe that a certain level of complexity is justified and reflects the fact that some insurance contracts are complex in nature and often contain multiple components.

***“We re-emphasise that the development of a comprehensive standard for insurance contracts is essential because the transitional arrangements established in IFRS 4 do not provide the level of transparency and comparability necessary for the users of financial statements.”***

From PwC's response to the IASB exposure draft

## Our key messages

Overall, we continue to support the proposed model in the IASB ED that measures the current value of the future cash flows and services of insurance contracts. In our response we broadly agree with changes made to the model proposed in the original ED such as:

- Adjusting the contractual service margin for changes in cash flows related to future coverage and other services.
- The revised transition requirements.
- The notion of revenue.
- The recognition of discount rate changes in other comprehensive income (“OCI”), although we believe it should not be mandatory, rather it should be optional at the portfolio level.

Our response highlights our concern with:

- The proposed accounting for contracts that include a linkage between the payments to policyholders and the returns on underlying items, particularly with regard to the treatment of options and guarantees.

We are pleased that the IASB has responded to comments made on the previous ED and has carried out an extensive outreach programme. Given the complexity of the proposed standard, we believe preparers need more time to fully test the proposals. We have recommended that the IASB continues to work closely with the industry during its re-deliberations and that once this process is complete a review draft of the final standard is made available. This would provide sufficient time for preparers to perform adequate field tests of the proposal and resolve any material issues identified during the re-deliberation process.

***“We urge the Board to continue working closely with the industry during its re-deliberations to understand and provide input on the implications of any amendments to the proposals”***

From PwC’s response to IASB exposure draft



***“... we continue to support the development of a global converged standard for insurance contracts and urge the Board to keep working with the FASB ...”***

From PwC’s response to IASB exposure draft

In our responses to both the IASB and the FASB we continue to support the development of a global converged standard for insurance contracts and we urge the Boards to keep working closely together to achieve this goal. The continued lack of an understandable, consistent global standard of accounting for insurance contracts is reducing the attractiveness of the industry to investors. Although we have issued separate letters in response to the IASB and FASB EDs, our views in the letters are substantively aligned.

However, we believe the need for a new standard for insurance accounting is more significant outside of the United States and we believe that if the Boards cannot resolve their differences in a timely manner, the IASB should finalise its standard. If convergence cannot be achieved, we suggest that the FASB only makes targeted changes to existing US GAAP. A comprehensive revision of US GAAP without convergence does not justify the significant costs that would be incurred, given that consistent accounting practice exists today under US GAAP that is reasonably well understood by users.

# Summary of our comments on the five key areas for re-exposure by the IASB

## Introduction

The IASB's proposals for the measurement of insurance contracts are set out in the revised ED that was issued in June 2013. For a summary of the main proposals, see our Practical Guide to IFRS (August 2013).

In the three years since publication of the IASB's previous ED and the FASB's Discussion Paper, the Boards, the industry and stakeholders have continued to discuss the accounting for insurance contracts. As a result of these discussions some of our views have changed and we are also pleased to note that many of our comments and those of other commentators on the IASB's previous ED have been reflected in its revised ED. We set out below our responses to the IASB on the five key areas of change from the previous ED.

### 1. Contracts linked to returns on underlying items

The area of the revised ED that has given rise to a great deal of debate concerns the treatment of accounting for contracts where one or more components are linked to returns on underlying items, often broadly referred to as participating contracts. These come in many forms. For some, such as unit-linked or variable contracts (referred to here as unit-linked contracts), there is a direct and immediate contractual link to underlying assets. For others, such as discretionary participating contracts, including Continental European participating contracts, UK with profit contracts and US type Universal Life contracts, the insurer has discretion regarding the amount and timing of returns on underlying items that are passed on to policyholders. Options and guarantees are often included in these contracts, such as minimum interest rate guarantees, guaranteed minimum death benefits or guaranteed annuity options. The existence of these options and guarantees as well as the available use of discretion in allocating returns complicates the measurement of these contracts.

The IASB recognised that where there is no possibility of a cash flow mismatch in a component of these contracts, that part of the liability should be measured in the same way as the underlying assets (which some describe as 'mirroring'). The revised ED requires the splitting of cash flows into directly varying, indirectly varying and fixed cash flows for some participating contracts as shown below:

#### Directly varying cash flows

Measure by reference to carrying value of the underlying items ('mirroring')

#### Indirectly varying cash flows

Measurement according to building block approach (changes in options and guarantees are recognised in profit or loss)

#### Fixed cash flows

Measurement according to building block approach (changes related to future coverage and other future services against contractual service margin)

Splitting the cash flows in these contracts can be performed in more than one way, which could lead to different accounting results. The IASB prescribed in its proposed application guidance how to split cash flows to prevent diversity in practice. Not only is this decomposition of cash flows complex, but the prescribed method may lead to values of options and guarantees that do not reflect how the contracts are priced or managed. In the simplified example included in the revised ED, the prescribed decomposition will lead to mirroring of 90% of the assets, a fixed amount and a written put option. From our discussions with insurers, we understand that they view and market these participating contracts as predominantly providing a fixed benefit (the guaranteed amount) with a written call option, which would lead to a very different accounting result than under the model prescribed in the revised ED.

Under the insurers' view of these contracts, the decomposition of the cash flows would not result in any mirrored amount. In addition, the lack of separately identifiable components in many discretionary participating contracts also complicates splitting up of the contracts' cash flows, because the different components can cross-subsidise each other. We believe that an approach which requires mirroring and splitting cash flows cannot work effectively for many discretionary participating contracts and does not properly reflect the management and economics of these contracts.

This said, we appreciate the difficulty in developing a measurement approach that works for all contracts that have a link to the returns on underlying items. Although these contracts share some similar features, we believe that two main contract groupings should be treated separately as described below.

### Unit Linked contracts

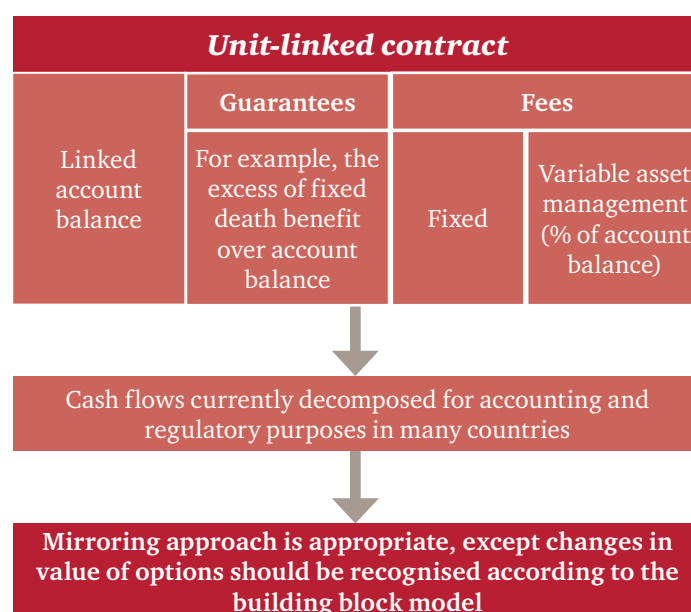
We agree that the mirroring approach in the revised ED is appropriate for unit-linked contracts, although we do not agree that all changes in the value of options and guarantees should be directly reflected in the income statement. We suggest amending the scope of the approach in the revised ED, so that it applies to contracts in which some or all of the benefits are determined by the price of units in an internal or external investment fund. This would accomplish two goals:

- To limit mirroring to contracts where there is a direct and immediate contractual link to underlying items.
- To avoid the lack of clarity that mirroring may not be appropriate for unit-linked contracts sold in some countries as there is not a legal requirement to hold assets.

Unit-linked contracts are currently decomposed in many regulatory and accounting frameworks, with the unit-linked account balance viewed as one contract component and any options and guarantees viewed consistently with their treatment in the IASB ED. Any additional features would be valued under the building block model. For unit-linked contracts, the industry and proposed ED accounting views do not differ.

We have asked the IASB to indicate clearly that changes in asset management charges (which are prevalent in unit-linked contracts and usually based on the value of the underlying assets) should be recognised against the contractual service margin ('CSM'), since the asset management activity is a future service. However, just as in the building block model, changes attributable to discount rates should be recognised in

OCI unless a company chooses to recognise such changes in profit or loss in the alternative approach that we proposed (see below). Our approach is illustrated in the following table.



### Discretionary participating contracts

We believe an alternative approach that is based on the building block model in the revised ED is needed for discretionary participating contracts. These contracts often include a number of interrelated guarantees and management actions that can be taken to reduce the effect of these guarantees in certain scenarios. We believe that this alternative approach should not involve splitting the different cash flows. This requires a key decision to be made of what rates should be used to project and discount the cash flows if they are not separated. This is described further below, together with a number of our concerns in the accounting for the CSM.

**'... we believe the accounting for contracts with discretionary participation in underlying items requires an alternative solution ...'**

From PwC's response to IASB exposure draft

## Discount rate

In our discussions on the most appropriate accounting for discretionary participating contracts it was clear that both the choice of discount rates and the interaction with investment return cash flows are important drivers of the measurement of the liability for these contracts, particularly for the options and guarantees. We believe that the measurement of options and guarantees should start with current market values at the balance sheet date and consider a range of scenarios.

If the top-down or bottom-up liability based discount rates based on the revised ED are used for all cash flows in discretionary participating contracts, any options and guarantees embedded in the contracts would be measured on a 'risk-neutral market-consistent'<sup>1</sup> basis. This means that the asset-related cash flows in the liability are measured using observable information at the balance sheet date, which is consistent with the concept of a replicating portfolio and derivative pricing techniques. However, some argue that the measurement of these options and guarantees in this way does not reflect the nature of the contract, which stipulates a certain linkage between liabilities and assets.

In contrast, if an asset based discount rate that reflects historic asset returns is used in the building block measurement model, options and guarantees would typically be measured on what is often referred to as a 'real world' basis. The multiple possible economic scenarios considered under this approach are based on the historic performance of the applicable asset class. The calculations involve significant subjectivity (particularly for equity instruments and real estate), which could reduce comparability between companies.

The difference between a real world and risk-neutral market-consistent valuation of options and guarantees is one of the differences between traditional and market-consistent embedded values used in some countries for supplementary reporting purposes.

***“The final standard should be clear whether options and guarantees are valued on a ‘risk neutral’ or ‘real world’ basis.”***

From PwC's response to IASB exposure draft

## Contractual Service Margin

Regardless of how options and guarantees are valued, another area of significant debate has been how changes in their measurement should affect the income statements. The revised ED requires that changes in indirectly varying cash flows, such as options and guarantees, are recognised directly in the income statement. We believe that these changes should be treated consistent with all other cash flows that fulfil insurance contracts by following the building block model. To the extent that these relate to future services and coverage, we believe that changes in the value of options and guarantees should be recognised in each reporting period against the CSM in line with our views on adjusting the CSM as discussed further below. If a contract becomes onerous, the changes in options and guarantees would immediately be recognised in the income statement, similar to other changes related to future coverage or other services.

We acknowledge in our response that where companies economically hedge their options and guarantees, an accounting mismatch could arise if changes in options and guarantees are recognised against the CSM, whereas changes in the value of the associated hedging instruments will be recognised in the income statement. We have urged the IASB to develop a solution that will avoid introducing an accounting mismatch for these companies.

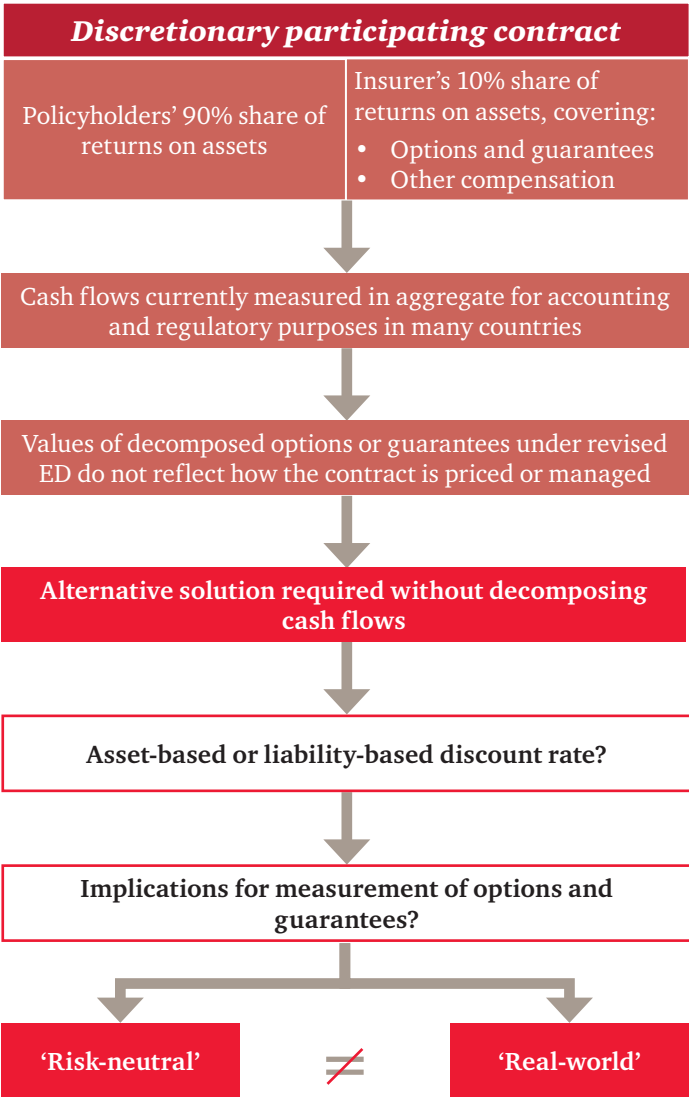
Another key issue in the accounting for discretionary participating contracts in some countries is the accounting for future cash flows attributable to shareholders. In our response we express the view that these changes should be recognised against the CSM. We recognise that there are arguments for and against this treatment, but we believe that this is one of the compromises that will be necessary to obtain support for the standard in some key territories.

As we describe further below, we are also concerned about the lack of guidance on the amortisation of the CSM. In particular for participating contracts the IASB in its discussions concluded that bonus declarations or realisation of gains and losses do not reflect the services provided under an insurance contract. We believe that the final standard should clarify the services provided under these contracts.

<sup>1</sup> By the term 'risk neutral market-consistent' model we include other actuarial techniques that provide an equivalent market consistent assessment, for example, a 'real world/deflator' method. We note that a 'real world/deflator' method is not the same as the 'real world basis' discussed above.



Our approach for an example discretionary participating contract and the complications for measurement are summarised as follows:



- Summary**
- The accounting for participating contracts is of significant interest to many life insurers because, in some countries, these contracts represent the majority of their business. After lengthy discussions on the accounting for contracts with a link to the returns on underlying items, our key conclusions are that:
- We largely agree with the mirroring approach for unit-linked contracts.
  - We believe that an alternative approach to mirroring for discretionary participating contracts should be developed based on the principles of the building block model, without requiring decomposition of cash flows.
  - We believe that changes in options and guarantees should be accounted for consistently, regardless of whether they are included in participating contracts, in line with the building block model.
  - The IASB's final standard should make it clear how the choice of discount rates affects how options and guarantees are measured.

## 2. Interest expense and the use of other comprehensive income

The use of OCI for changes in discount rates is probably the second largest area of debate in the revised ED. The reason is that today insurers worldwide are used to different accounting and regulatory regimes and utilise different investment strategies and product types. Insurers in some countries apply a model where changes in discount rates flow through the income statement, whereas in other countries they take a cost view in the income statement. Additionally, insurers hold different assets to support their liabilities to policyholders: some insurers mainly invest in debt instruments held at fair value through OCI, while others also invest in equity instruments, investment properties or derivatives that are usually measured at fair value through profit or loss. The longstanding diverse accounting practice and investment strategy make it difficult to reach a 'one size fits all' solution.

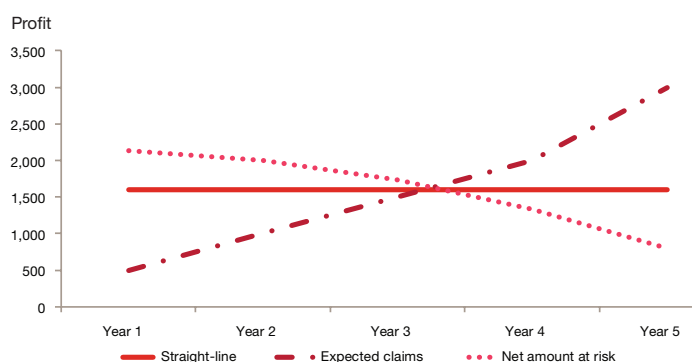
In our response we recognise that IFRS is a mixed measurement model today. IFRS 9: 'Financial Instruments' envisages that debt instruments could be measured at fair value through profit or loss, fair value through OCI or amortised cost. In the latter two cases interest income and expense in the income statement would be based on the original yield or discount rates. In contrast, under the measurement model for provisions in IAS 37, changes in discount rates on provisions are recognised in the income statement using a current rate.

Given the mixed measurement models used and despite the fact that we are aware that users and standard setters are not fond of optionality, we see no other solution than providing companies with an irrevocable choice at transition or on inception of a portfolio of contracts to recognise changes in discount rates in measuring insurance contract liabilities in the income statement or in OCI.

## 3. Adjusting the contractual service margin

Since the CSM represents the unearned profit in an insurance contract, for many companies (particularly in the life insurance sector) the CSM will be the primary factor determining the profit profile. Consistent with our response to the previous ED, we agree with adjusting the CSM at each reporting period for changes in estimated cash flows related to future coverage and other future services. We also believe that changes in the risk adjustment should be recognised in a similar way against the CSM to maintain consistency with changes in cash flows. We are aware that this approach is complex to apply, and therefore recommend that the IASB reaches out to territories with less sophisticated systems to understand the implications of such an approach.

Our most significant concern in this area of the revised ED is the amortisation of the CSM according to the services provided under the insurance contract. Significant diversity has arisen in the amortisation patterns for the CSM in territories where similar principles to the revised ED have been used. The following graph shows the potentially different amortisation patterns for a simple term life insurance contract reflecting three possible patterns of services.



***“... entities should be able to make an irrevocable choice at transition or on inception of a portfolio whether changes in discount rates in measuring insurance contract liabilities are recognised within the interest margin in profit of loss or in OCI.”***

From PwC's response to IASB exposure draft



***“... we are concerned that without further guidance there will be significant diversity in the patterns used to amortise the contractual service margin, even for similar contracts.”***

From PwC’s response to IASB exposure draft

We believe that this diversity in profit recognition will undermine the comparability of financial statements, which is one of the key objectives of the standard. As a result, additional guidance is needed in the final standard. We have suggested introducing a rebuttable presumption to amortise the CSM using a straight-line pattern after reflecting contract terminations, subject to guidance being provided on when rebutting the straight-line pattern would be appropriate. A straight-line pattern represents the stand ready obligation to incur claims throughout the coverage period. Rebutting the straight-line pattern could, for example, be allowed for products where the amount of maximum coverage varies throughout the product life, such as decreasing term insurance.

The basis for conclusions in the ED implies that the calculation of the CSM has to be performed at a level lower than the portfolio of contracts. We have asked the IASB to clarify this in the final standard and to require the CSM to be calculated for contracts within a portfolio by similar date of inception. This would mean that a negative CSM value for newly written loss making contracts would not be netted against previously written profitable business.

#### **4. Presentation of insurance contracts revenue and expenses**

Presentation of insurance contracts revenue and expenses is the area in the revised ED where there seems to be least agreement between commentators. On the one hand, many non-life insurers support the revenue proposals in the ED, because the proposal is the closest to their current practice. It allows them to continue to use the ratios currently applied, although they will have to take into account deposit elements that are excluded from revenue and claims. In contrast, many life insurers believe that revenue as described in the ED is not a useful measure for their products and they largely prefer the summarised margin approach from the previous ED. Observers from other industries find it hard to understand why the insurance industry should be treated differently and they support the notion of revenue excluding deposit components.

We supported the summarised margin approach in the previous ED with optional gross-up of revenue and expenses for contracts where the simplified approach to measurement (the ‘premium allocation approach’) is applied. Although we still see the merits of the summarised margin approach, we also acknowledge that having revenue, consistent with other industries, has merit. We believe that revenue should be reported by insurers, because we now see no compelling reason why the insurance industry should be treated differently from any other industry; in addition we prefer consistency in income statement presentation for life and non-life insurers. Deposit components should be excluded to make reported revenue more meaningful.

Although on balance we support revenue as proposed in the revised ED, we are concerned about the operational complexities in disaggregating deposit components and the difficulty in explaining to users the movements in revenue as a result of multiple drivers, especially for estimated claims and expenses. We have recommended that the IASB should work with preparers and users to determine whether this approach is useful.

***“We support the notion of revenue and expenses being recognised for insurance contracts, which is broadly consistent with the accounting for revenue in other industries.”***

From PwC’s response to IASB exposure draft





***“We suggest a practical solution to allow entities that issue insurance contracts a second opportunity to revisit the decisions in adoption of IFRS 9 when the final insurance standard becomes effective.”***

From PwC’s response to IASB exposure draft

## **5. Effective date and transition**

Transition is an area where most constituents seem to be generally satisfied with the IASB proposals. The previous ED did not allow for a CSM at transition, which led to significant concerns from life insurers. We agree with the concept of retrospective application that has been provided for in the revised ED. The simplifications for transition are not conceptually pure, although they provide a pragmatic solution for transition. However, we appreciate that transition will still be challenging.

The interaction with IFRS 9 is important and insurers are keen to avoid having to explain two significant accounting changes to the market with one relatively soon after the other. In an ideal situation, the effective dates of both standards would be aligned. However, the application of IFRS 9 will cover a much broader set of companies than just the insurance industry and we expect that the IASB is unlikely to be able to postpone the effective date of IFRS 9 only for insurers.

We have suggested that the IASB should provide insurers the opportunity to revisit their accounting for assets under IFRS 9 when they first apply the new insurance contracts standard. This will enable users to have a more holistic view of the performance of the company issuing insurance contracts in the context of how it manages its business and will provide more useful information to users of the financial statements.

## Our comments on the FASB exposure draft

As noted in the first section above, we continue to support the development of a global converged standard for insurance contracts. However, there are a number of differences between the EDs issued by the IASB and the FASB. If the Boards cannot come to a converged view, we believe that the FASB should focus on making targeted changes to US GAAP in the areas of measurement of specified guarantee features, guidance on the level of premium deficiency assessment and enhanced disclosures. Although we have issued separate letters in response to the IASB ED and FASB ED, our views as shown in the right hand column, are substantively aligned:

Topic	FASB ED proposal	IASB ED proposal	PwC response to FASB
<b>Explicit risk adjustment/margin</b>	<ul style="list-style-type: none"> <li>No explicit risk adjustment. Margin represents the expected unearned profit at risk</li> <li>Released over coverage and settlement period.</li> </ul>	<ul style="list-style-type: none"> <li>Explicit risk adjustment represents the compensation that the insurer requires for bearing uncertainty.</li> <li>Remaining difference at contract inception between inflows and outflows is the CSM, which is released as services are provided over coverage period.</li> </ul>	<ul style="list-style-type: none"> <li>Support the IASB's explicit risk adjustment but include a requirement to use a consistent calculation methodology.</li> </ul>
<b>Adjusting the margin</b>	<ul style="list-style-type: none"> <li>All changes in estimates are recognised immediately in the income statement.</li> </ul>	<ul style="list-style-type: none"> <li>Changes in cash flows related to future coverage and other services are adjusted against the CSM.</li> </ul>	<ul style="list-style-type: none"> <li>Changes in cash flows related to future coverage and other services should be adjusted against the CSM.</li> </ul>
<b>Acquisition costs</b>	<ul style="list-style-type: none"> <li>Qualifying acquisition costs are included in margin and are not part of fulfilment cash flows.</li> <li>Qualifying acquisition costs strictly defined (consistent with current US GAAP guidance).</li> <li>Only expenses related to successful acquisition efforts are capitalised.</li> </ul>	<ul style="list-style-type: none"> <li>Qualifying acquisition costs are included in fulfilment cash flows.</li> <li>Includes expenses that arise directly from existing insurance contracts or can be attributed to them on a reasonable and consistent basis.</li> <li>Expenses related to successful as well as unsuccessful acquisition efforts are included in the cash flows.</li> </ul>	<ul style="list-style-type: none"> <li>Given goal of converged standard, would support the IASB definition of qualifying acquisition costs and inclusion in fulfilment cash flows.</li> </ul>
<b>Premium allocation approach</b>	<ul style="list-style-type: none"> <li>Premium allocation approach is a required separate model and should be applied for all contracts meeting specified criteria.</li> </ul>	<ul style="list-style-type: none"> <li>Premium allocation approach is optional for contracts where it would produce similar measurement to the building block model or where the coverage period is one year or less.</li> </ul>	<ul style="list-style-type: none"> <li>Premium allocation approach should be optional for contracts that meet the criteria.</li> </ul>

Topic	FASB ED proposal	IASB ED proposal	PwC response to FASB
Balance sheet and income statement presentation	<ul style="list-style-type: none"> <li>Prescriptive requirements for the presentation in the balance sheet as well as the income statement.</li> </ul>	<ul style="list-style-type: none"> <li>Generally, the requirements in IAS 1 should be followed, with some minimum requirements in the revised ED.</li> </ul>	<ul style="list-style-type: none"> <li>Preparers should have flexibility in income statement and balance sheet presentation.</li> </ul>
Contracts that require a company to hold underlying items and specify a link to returns on items	<ul style="list-style-type: none"> <li>Participating features that are contractually dependent on underlying items are measured on the same basis as underlying items.</li> <li>Participating features that are not contractual (or that allow discretion in the pass-through of performance) should reflect the company's expectations of timing and amount of discretionary payments.</li> </ul>	<ul style="list-style-type: none"> <li>Mirroring approach applies to policyholders' participation where expected cash flows vary directly with underlying items and where a company is required to hold the underlying items.</li> </ul>	<ul style="list-style-type: none"> <li>Support mirroring approach for variable (unit-linked) contracts.</li> <li>Support measurement approach based on building block approach for contracts with other participating features.</li> </ul>
Transition	<ul style="list-style-type: none"> <li>Estimate remaining margin using objective data, including various historical documentation.</li> <li>If impracticable or no objective data, assume zero margin.</li> <li>Use prior definition of portfolio.</li> </ul>	<ul style="list-style-type: none"> <li>Estimate remaining margin using expected cash flows and cash flows known to have occurred.</li> <li>Use definition of portfolio at transition.</li> </ul>	<ul style="list-style-type: none"> <li>Follow IASB transition guidance, in conjunction with explicit risk adjustment and unlocked margin approach.</li> </ul>

## Areas of difference between FASB and IASB response letters

While we have consistent views on the main areas of difference between the two Boards, there are some areas of difference in our response to the FASB, the more significant of which are set out below.

### Scope

Within the US our outreach with preparers has revealed that some commercial and industrial maintenance and other service contracts appear to be in the scope of the insurance standard. This does not seem to be in line with the FASB's intention to provide a fixed-fee service contract exemption. We recommended that the FASB should revise the scope for its fixed-fee service contract exception or defer application to non-financial service companies until further outreach is performed.

### Discount rate

Whilst conceptually we believe that the discount rate should reflect the characteristics of the insurance contract liability, the exclusion of a company's own credit risk from the discount rate could result in the recognition of day one accounting losses. When these losses solely relate to the exclusion of a company's own credit risk in the discount rate, we have recommended to the FASB that the loss be deferred and amortised over the term of the contracts.

**“...we urge the FASB and IASB to resolve their remaining differences on this project and work together to address the concerns raised...”**

From PwC's response to FASB exposure draft

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## ***Our comments on other areas of the IASB exposure draft***

We appreciate that the IASB is not seeking comments outside the five areas for re-exposure. Nevertheless, our response highlights some other areas where we believe changes should be made.

### ***Optional unbundling***

Unbundling should be optional for interdependent account balances that are distinct. This would, for example, enable banks to account for loans with a waiver on death on an amortised cost basis.

### ***Fronting arrangements***

The requirements for combining contracts should be changed to include principal/agent guidance to address likely diversity in accounting for some fronting arrangements.

### ***Confidence level disclosure***

The confidence level disclosures should be deleted from the standard and replaced by disclosures about the method and assumptions used to determine the risk adjustment.

### ***Premium allocation approach***

The unwinding of acquisition costs and pre-coverage cash flows under the premium allocation approach should be addressed as the standard is silent on the treatment.





### ***Reinsurance***

Consistent models (building block model or premium allocation approach) between direct insurance contracts and corresponding reinsurance assets held should be allowed.

### ***Business combinations***

Clarify how the CSM should be recognised if contracts acquired in a business combination qualify for the premium allocation approach as this approach does not identify a CSM.

### ***Portfolio transfers***

We believe contracts acquired in a portfolio transfer are akin to acquiring new insurance contracts and therefore should be re-assessed at the acquisition date to determine whether they transfer significant insurance risk and qualify for the PAA or building block model.

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## Contact us

PwC has a group of IFRS accounting and actuarial specialists who have been monitoring the developments at the IASB over number of years. They have been heavily involved in writing our response letter and are included as contacts below.

If you would like to discuss any of the issues raised in this paper, please call one of the following or speak with your usual contact at PwC.

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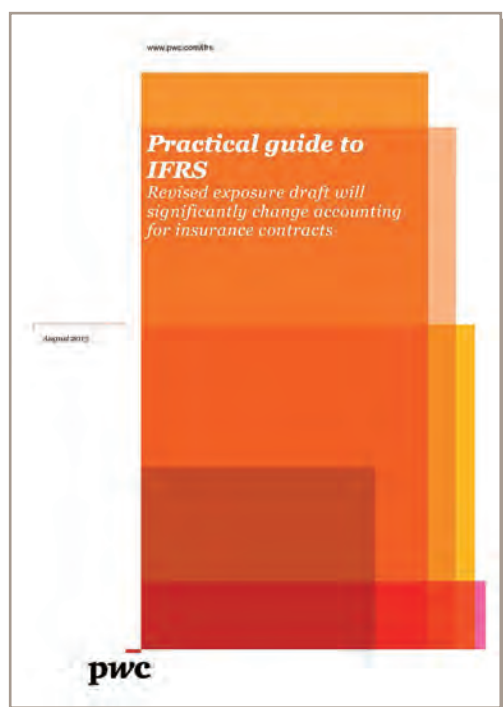
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