Institute and Faculty of Actuaries

# FRS 103: Insurance Contracts

## Financial Reporting Council

Consultative Document

31 October 2013

**About the Institute and Faculty of Actuaries**

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Institute
and Faculty
of Actuaries

31 October 2013

Jenny Carter
Financial Reporting Council
5th floor, Aldwych House
71-91 Aldwych
London
WC2B 4HN

Dear Ms Carter

**FRC Exposure Draft: Draft FRS 103 Insurance Contracts**

The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to comment on the Exposure Draft (ED) for FRS 103 Insurance Contracts, published by the Financial Reporting Council (FRC). As the UK's chartered professional body for actuaries, the proposals contained within this ED will affect our members working in the Life and Non-life Insurance industries operating under UK GAAP.

This response has been prepared by members of the Financial Reporting Group (FRG) of the IFoA, a cross-practice working group of members with Life and Non-life expertise in insurance accounting. We set out below our comments on this ED.

**Background**

Draft FRS 103 uses IFRS 4 (Phase I) as a basis and includes existing requirements and accounting practices from FRS 27 'Life Assurance' and the ABI SORP. We recognise the intention of FRC in withdrawing FRS 27, alongside the expected withdrawal of ABI SORP, once draft FRS 103 is effective. This approach enables UK insurers to continue with their existing accounting practices for insurance contracts (including all with-profits contracts) whilst permitting them to make changes, if such changes offer a minimum level of demonstrable improvement over existing UK GAAP accounting policies.

In January 2012, the FRC published a discussion paper titled, "Insurance Accounting – Mind the UK GAAP", setting out four potential options for UK GAAP in the period following the effective date of Solvency II and before IFRS 4 (Phase II) is available as a potential long-term solution. We responded to that discussion paper on 30 April 2012 and noted that Option 1 – current IFRS 4 (Phase I) and Option 2 – current UK GAAP were viewed as the more favourable short-term solutions. We refer the FRC to our previous response for a fuller discussion of our reasoning regarding the various options open to the FRC.

**Comments on the development of the ED**

We welcome the FRC's decision to publish the ED and their commitment to fill the gap in the consistency of accounting standards that would exist for insurance contracts from the effective date of Solvency II (now expected to be in place from 1 January 2016, at the earliest).

Following on from our April 2012 response:

a) We are broadly supportive of the approach that the FRC has adopted in proposing that draft FRS 103 is based on IFRS 4 (Phase I). We are also positive that the current comprehensive requirements of FRS 27 and the ABI SORP have been incorporated to fill in the gaps of IFRS 4 (Phase I) regarding the underlying recognition, measurement and presentation of insurance contacts as they have been applied to date under UK GAAP.

b) We currently hold mixed views on the 'improvement' options from IFRS 4 (Phase I) in the draft FRS 103.
    - There are concerns that the inclusion of the options may introduce inconsistency in the measurement of liabilities across UK GAAP reporters where no such inconsistency exists today. This is due to the requirement under IFRS 4 that a change in accounting policy for the measurement of insurance contract liabilities only needs to be either more relevant and no less reliable or, more reliable and no less relevant than the policy being replaced. However, in current UK GAAP, an entity is permitted to change their accounting policy if all the conditions to retain the true and fair view of the financial statements in FRS 102, section 10 are met. It is this reduction in tolerance that could lead to divergence in measurement approaches for insurance contract accounting.
    - Further, we recognise that the inclusion of the options prevent the constraints imposed by UK GAAP from being more stringent than those imposed on IFRS reporters. This consistency with full IFRS reporting is welcomed.

c) We previously raised the concern that additional work was required for companies who had not adopted FRS 26 in relation to contract classification. We note that this is now required under the FRS 102 standard, which has been finalised, hence this is now no longer a concern.

We note that the Memorandum of Understanding entered into by the ASB, ABI and certain Life insurers in December 2004 deals with the implications of any amendments to FRS 27, but not with the implications of its withdrawal, which paragraph 1.13 of draft FRS 103 confirms will occur. We request that the FRC clarifies the implications of the withdrawal of FRS 27 on the Memorandum of Understanding.

Our responses to the specific consultation questions follow below. If you have questions on any of the points raised in this response, or wish to discuss it further, please contact IFoA Policy Manager, Helena Dumycz, in the first instance (Helena.Dumycz@actuaries.org.uk; +44 (0) 20 7632 118).

Yours Sincerely

David Hare

David Hare
President
Institute and Faculty of Actuaries

**Question 1**

**Do you support the introduction of draft FRS 103, based on IFRS 4 and incorporating many of the requirements of FRS 27 Life Assurance and elements of the ABI SORP?**

**Does it achieve its aim of allowing entities, generally, to continue with their existing accounting policies for insurance contracts? If not, why not?**

We believe that the main requirement for the short term solution to UK GAAP for insurers and reinsurers is that it should require the minimum amount of change.

We also believe that the short term solution for UK GAAP should be a basis which is well understood and for which there is an established understanding of both the preparation and auditing of the financial statements.

The introduction of draft FRS 103, based on IFRS 4 and incorporating many of the requirements of FRS 27 and elements of the ABI SORP, satisfies these requirements. As a result, we are broadly positive about the introduction of the standard on this basis. We also believe it does achieve the stated aim of its introduction.

We agree that the inclusion of implementation guidance based on the ABI SORP and FRS 27 will be useful in seeking to maintain consistency of approach within the new UK GAAP framework.

We note, however, that much of the implementation guidance is taken directly from FRS 27 and the ABI SORP. It may be more beneficial if this guidance is redrafted to better reflect a principles-based approach rather than mandatory requirements.

**Question 2**

**Draft FRS 103 paragraph 2.3 includes the 'improvement' options from IFRS 4 (i.e. permitting entities to change accounting policies for insurance contracts in certain circumstances). Do you agree with the inclusion of these options in the draft FRS? If not, why not?**

Members of the FRG currently hold mixed views on the 'improvement' options from IFRS 4 under draft FRS 103 paragraphs 2.2 – 2.11.

Some members do not believe it is appropriate for the constraints imposed by UK GAAP to be more stringent than those imposed on IFRS reporters and are in favour of keeping the 'improvement' options.

However, other members believe it is undesirable to allow those reporting under UK GAAP to be able to amend their accounting policies and recommend the removal of the 'changes in accounting policy' section containing paragraphs 2.2 – 2.11.

This distribution of views within FRG may well mirror the differences of opinion that will exist within the wider insurance sector. Consequently, it is difficult for the IFoA to express a preference for inclusion of the 'improvement' options or otherwise. We would, however, reiterate that the aim of allowing entities, generally, to continue with their existing UK GAAP-based accounting policies for insurance contracts is highly beneficial to the UK reporting environment applicable to insurance companies. This remains our overriding consideration.

**Question 3**

**Draft FRS 103 paragraph 1.5 requires new entrants to apply the same requirements as existing preparers in setting a benchmark for their accounting policies, but they are also permitted to utilise the improvement option where justified, in finalising their initial accounting policies.**

**Is there sufficient clarity on the application of the draft FRS by new entrants? If not, how should this be improved?**

We believe there is sufficient clarity. If there is any uncertainty, then we would recommend additional narrative in the implementation guidance.

**Question 4**

**Draft FRS 103 includes paragraphs from IFRS 4 on future investment margins. Paragraph 2.8 notes that an insurer need not change its accounting policies to eliminate future investment margins, however there is a rebuttable presumption that an insurer's financial statements will become less relevant and reliable if an accounting policy is introduced that reflects future investment margins in the measurement of insurance contracts (unless those margins affect contractual payments). Paragraph 2.9 describes how an insurer might overcome the rebuttable presumption.**

**Do you agree with the rebuttable presumption? If not, please describe your preferred measurement basis for insurance contracts and whether or not you would permit insurers to continue with their existing accounting policies in this area for the time being?**

We see no reason to deviate from IFRS 4's requirements in this regard.

**Question 5**

**Draft FRS 103 paragraph 4.7(c)(iii) has adopted the IFRS 4 requirement for claims development disclosures. Is the data for these disclosures readily available to preparers?**

For most UK insurers, we expect that this information would generally be available as it is required for regulatory returns. Any non-regulated insurers, where FRS 102's definition of an insurance contract would apply in future, are likely to have sufficient preparation time to generate these disclosures.

**Question 6**

**The requirement to provide capital disclosures is now contained in paragraph 34.31 of FRS 102 and Section 3 of the draft Implementation Guidance provides only guidance on how those disclosures might be made by insurers with long-term insurance business, rather than mandating a particular presentation.**

**Do you believe this approach is appropriate in the context of applying draft FRS 103 with FRS 102? Will it have an impact on the usefulness of the disclosures to users of financial statements?**

The implementation guidance appears to go further than the minimum required under paragraph 34.31 of FRS 102 regarding both quantitative and qualitative disclosures.

However, in practice, we do not anticipate that following the guidance will pose a significant burden for the writers of long term insurance business given it is consistent with what is currently required under FRS 27, nor that they would change their existing practices in the short term.

Therefore, we would not object to this approach being adopted in the short term and believe it will not reduce the usefulness of disclosures. However, this should be reviewed when the FRC next considers the long term solution for FRS 103.

**Question 7**

**Do you think the guidance on providing capital disclosures, set out in Section 3 of the draft Implementation Guidance, should also be applicable to other financial institutions applying FRS 102, such as banking entities?**

We believe others will be better placed to respond to this question and as such, we have not commented here.

**Question 8**

**Draft FRS 103, as with other accounting standards, is written in the context of a company and the relevant legal requirements. Appendix IV recognises that draft FRS 103 applies to other entities, including mutual insurers established under the Friendly Societies Act 1992. Are there any requirements of the draft standard or accompanying draft Implementation Guidance that you consider require amendment in order to be applied by insurers other than companies?**

We have considered the requirements of the ED in their application to 'insurers other than companies' and have not identified any material amendments as being required.

**Question 9**

**Do you agree with the proposed effective date? If not, what alternative date would you propose and why?**

Yes, we agree with the proposed effective date being the same as for FRS 102 (1 January 2015) and with the option for early adoption.