International Accounting Standards Board  
30 Cannon Street  
London  
EC4M 6XH  

Paris, November 8, 2013  

RE: Exposure Draft ED/2013/7 - Insurance contracts  

Dear Madam/Sir,  

Mazars is pleased to comment on the above mentioned Exposure Draft (ED) on accounting for insurance contracts and welcomes the objectives of the International Accounting Standard Board (IASB) to develop and finalize the global standard for insurance contracts.  

As commented in our 2010 comment letter on the ED/2010/8 we acknowledge that the proposed measurement model –the present value of fulfilment cash flows built on the Building Block Approach– is appropriate for insurance contracts and we welcome the significant improvements compared to the previous Exposure Draft in the following areas:  

- The principle of unlocking the Contractual Service Margin which allows offsetting the changes from re-measurement of the present value of fulfilment cash flows which will affect future periods. As already mentioned in our response to the previous Exposure Draft, we believe that this adjustment mechanism makes the subsequent measurement of the Contractual Service Margin more consistent with its initial measurement and with the fact that the Contractual Service Margin represents the expected future profitability of the portfolio at each reporting date;  

- The use of Other Comprehensive Income (OCI) to book the effect of discount rate changes on the insurance liability, as one of the potential alternatives to avoid the impact of short term market volatility on profitability measurement;  

- The possibility to use a top-down approach to determine the discount rate at each reporting period;  

- The non-mandatory nature of the application of the Premium-Allocation Approach for short duration contracts;  

- The absence of prescription on the methodology to be used to determine the risk adjustment margin with a possibility for the issuer to benefit from a diversification effect in the calculation of the Risk Adjustment;  

- The changes applied to the transition process which lead to a retrospective application if practicable and permit simplifications if it is not the case.  

However we believe the proposed standard still needs to be improved in order to be applied consistently and to be decision-useful to the users of the financial statements.
In this respect we strongly believe that the Board should address the following topics that in our opinion could lead to inappropriate and unfaithful representation of the entity’s activity, and we believe that resolving these concerns in the final standard could be a major improvement to the accounting model:

**Mirroring approach**

We support in principle the idea that the accounting treatment of insurance contracts must take into account the relationship between insurance liabilities and the underlying assets, especially for participating insurance contracts in order to minimize the accounting mismatch.

But the exception to the Building Block Approach proposed by the Board for participating contracts lacks coherence both conceptually and in terms of practical application:
- The scope of contracts defined by the Exposure Draft refers only to the contracts that explicitly mention a requirement to hold assets and a contractual link between the payment to the policyholders and the returns on the underlying assets. We believe that the proposed scope is too restrictive and will not allow comparing contracts which have the same economic characteristics (such as contracts embedding a legal rather than contractual link or contracts creating a link with the general portfolio of assets of the insurance company);
- The bifurcation of cash flows is too complex and does not correspond to the substance of participating contracts and the way these are managed on an operational point of view.

We also disagree on the way options and guarantees are accounted according to this approach and more particularly on the changes in the time value of options and guarantees.

Options and guarantees are fully embedded in the insurance contracts. Recognising their value changes in profit or loss is not consistent with the treatment of other cash flows. These changes do not reflect the services rendered by the insurer on the past period. Such a treatment will alter the interpretation of the income statement by introducing short term market volatility in the analysis of the performance of a long term business.

We recommend sticking to the Building Block Approach for participating contracts, and expanding the unlocking of Contractual Service Margin and potentially the Other Comprehensive Income to deal with the short term market volatility of some items of the Building Block Approach. We encourage the Board to analyse the alternative approaches developed by the industry which are based on a single measurement method for all insurance contracts taking into account:

- The link with the underlying assets when determining the discount rate, and
- A shock absorption mechanism combining the use of Other Comprehensive Income (permitted but not mandatory) and/or the Contractual Service Margin to offset all changes on future cash-flows including changes in the risk adjustment and changes in the time value of options and guarantees so that the profit on insurance contracts is released as services are provided and short term market volatility is not reflected in Profit and Loss.
We also consider that dealing with the accounting mismatch imposes that the insurers’ business model is taken into account when classifying and measuring the financial assets. In particular, as commented in our comment letter on the IFRS 9 Exposure Draft, we believe the scope of assets allowed in the Other Comprehensive Income category is too restrictive to appropriately reflect the asset liability management of the entities.

**Contractual Service Margin**

As commented earlier, we strongly support the idea of an unlocked Contractual Service Margin which aims at representing the future unearned profits of an insurance portfolio. We also agree that changes in estimates relating to past coverage should be accounted through Profit and Loss. Nevertheless, we strongly disagree with the Board on the proposed scope of items that are taken into account to adjust the Contractual Service Margin.

We recommend including the changes in the risk adjustment related to future coverage as these changes relate by nature to future cash flows. We also recommend the Board to reconsider the scope of the items impacting the Contractual Service Margin to ensure that the specificities of the participating contracts are correctly addressed in order to reflect the economics of the contracts, to always represent the unearned profits of the contract on its maturity perspective (long term) and to exclude the impact of short term volatility on the profit recognition.

We also encourage the Board to reconsider the treatment it proposes on reinsurance ceded as the economics of the reinsurance transactions might not be reflected appropriately, at inception or during the life of the contract, in case of unfavourable changes in the underlying direct business resulting in an asymmetric accounting treatment between the insurance onerous portfolio and the gain coming from the reinsurance contract. We favour a consistent accounting treatment between pattern profitability on the liability side and on the asset side for such transactions.

**Revenue presentation**

We disagree that the proposed new presentation of the revenue and expenses better reflects the Life insurance business than the previous Exposure Draft proposal so called “Summarized Margin Approach”. This approach was well accepted by the industry, as it was in line with their profitability indicators and consistent with the Building Block Approach used to measure liabilities.

Besides, the construction of this presentation, implying disaggregating the premium between insurance and investment components that are highly interrelated, could introduce an additional layer of complexity and some arbitrary allocation of premium which would not improve comparability between insurers.
As a general conclusion to this letter we consider that extensive field tests should be conducted before the standard is finalized and implemented in order to identify best practices before its first application. As mentioned in our previous comment letter, the Exposure Draft proposes an ambitious measurement model, which adds complexity in a number of areas. For instance, the use of stochastic modelling is likely to increase complexity due to the use of non-observable data and judgemental assumptions. We think that field tests should be conducted specifically in this area to ensure the robustness of the model, highlight the main information to be disclosed and ensure adequate comparability between insurers. Such a field test should also have the aim to ensure that the model proposed meets the users’ needs especially in terms of understandability and predictive information on future cash-flows.

Regarding the effective date, we believe that an insurer should be permitted, but not required, to adopt IFRS 9 before the mandatory effective date of IFRS 4.

Our answers to the questions raised in the ED are detailed in the Appendix attached to this letter.

We would be pleased to discuss our comments with you and are at your disposal should you require further clarification or additional information.

Yours sincerely

Michel Barbet-Massin

*Head of Financial Reporting Technical Support*
Question 1

Do you agree that financial statements would provide relevant information that faithfully represents the entity’s financial position and performance if:

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

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

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

We welcome the proposal that the Contractual Service Margin can be adjusted to reflect changes between current and previous estimates of the present value of future cash flows related to future coverage and other future services. As already mentioned in our response to the previous Exposure Draft, we believe that this adjustment mechanism makes the subsequent measurement of the Contractual Service Margin more consistent with the initial measurement and with the fact that the Contractual Service Margin represents the expected future profitability of the portfolio at each reporting date, in line with a current estimate of unearned profits.

Board
Conceptually, we disagree with the Board’s proposal to exclude changes in the measurement of the risk adjustment from the scope of items that can impact the Contractual Service Margin. Changes in the measurement of the risk adjustments should be eligible to the absorption mechanism. These changes are interconnected with changes on future cash flows. For that reason, changes linked to re-measurement of the risk adjustments relating to future coverage should enter into the Exposure Draft definition of what should go through the Contractual Service Margin. Recognising immediately as a profit or a loss a change in an estimation that relates to future periods is thus in our view not appropriate. The Board’s proposal will add artificial volatility in the profitability of insurance companies and the Contractual Service Margin would not represent a current estimate of future profits. Additionally, booking changes on the risk adjustment directly through P&L would permit monitoring an entity’s annual result through the entity’s assessment of the risk adjustment.

The future Board’s analysis on the scope of changes impacting the Contractual Service Margin should take into account the issues raised in question 2 on participating contracts, more particularly the way to deal with the short term market volatility of some items of the Building Block Approach, as we are supporting a single Building Block model for all the contracts.

The Exposure Draft proposes that the Contractual Service Margin is accreted for interests using the locked-in interest rate at inception. We believe that measuring the Contractual Service Margin using the locked-in interest rate at inception would add layers of cost and complexity compared to a method based on the current interest rate. In addition such a method would be consistent with the measurement attributes of the Best Estimate.
We agree with the proposal that the Contractual Service Margin cannot be negative at inception and over the amortization period. We understand that it will be possible to impact positively the Contractual Service Margin if a contract becomes profitable after being onerous. Nevertheless, it is not clear whether the recovery of the profitability corresponding to the losses booked through Profit and Loss will be reversed through Profit and Loss before reinstating the Contractual Service Margin. According to us, the reinstatement of the Contractual Service Margin after having first recognized the reversal of past losses in Profit and Loss would give more faithful information. We recommend the Board to clarify this topic in the final standard.

Finally, we have some concerns with regard to the treatment of the Contractual Service Margin for reinsurance contracts. For the cedant company, according to our understanding, the proposal of the Exposure Draft would not in all cases permit to reflect in Profit or Loss the economics of the reinsurance transaction because of an asymmetric treatment between the underlying insurance contract and the reinsurance contract. When a reinsured portfolio becomes onerous, a loss is booked in the Profit and Loss on the direct business whereas the gain on the reinsurance contract is spread over the remaining service period of the reinsurance as a negative CSM would be booked. We recommend reviewing the reinsurance topic, aiming to ensure a consistency between pattern profitability on the liability side and on the asset side.
Question 2

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

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

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

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

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

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

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

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

We support in principle that the accounting treatment of insurance contracts must take into account the relationship between insurance liabilities and the underlying assets, especially for participating insurance contracts in order to minimize accounting mismatches.

Nevertheless, we disagree with the Board’s proposal of an exception to the Building Block Approach for participating contracts both conceptually and in terms of practical application. We have summarized below our main concerns on this approach:

Overall comment

We believe that the approach proposed by the Board introduces a high level of complexity for the measurement of participating contracts without solving all the issues relating to the specificities of such contracts and the way they are managed (direct and indirect varying cash flows are managed and considered as a whole). The guidance given in the Exposure Draft is difficult to implement from a practical point of view and might lead to results difficult to explain and to compare between insurance companies.
Scope of contracts

The Exposure draft is prescriptive in the definition of the scope of contracts covered by the mirroring approach. The Exposure Draft requires that the insurance contract specifies both an obligation for the entity to hold the underlying assets and a link between the payments to the policyholder and the returns on those underlying assets. We believe that the measurement of insurance liabilities should rather be defined by the economic substance of the insurance contract and the business model of the entity.

Separation of cash flows

Conceptually we believe that the principle of bifurcation of the cash flows arising from insurance contracts is not consistent with the way insurers manage their contracts. Furthermore, the proposed approach to bifurcate cash flows is structurally complex and its implementation remains unclear from a practical point of view.

Treatment of changes in the value of options & guarantees

In the mirroring approach proposed, we strongly disagree with the specific treatment of options and guarantees embedded in the insurance contract. Despite the fact that these elements are closely related to the host contract and thus are not bifurcated, the Exposure Draft proposes to isolate them and to book the impact related to their changes of fair value differently from the other changes.

We disagree on the way options and guarantees are accounted according to this approach and more particularly on the changes in the time value of options and guarantees. The recognition of these changes in Profit or Loss is not consistent with the treatment of other cash flows and does not reflect the services rendered by the insurer on the past period.

Furthermore this treatment introduces:
- further volatility in the Profit or Loss linked to short term changes of market conditions which are not reflecting the pattern of the services provided;
- a lack of comparability of the Profit or Loss between insurance competitors due to the fact that the changes of the time value of options and guarantees is highly dependent on assumptions which are not observable and are entity specific such as Policyholders’ behavior.

Besides, we notice an inconsistent treatment of option and guarantees under the mirroring approach and the Building Block Approach with regard to the impact of interest rates on the future cash flows coming from these options and guarantees. The impact of interest rate changes on options and guarantees are presented in Other Comprehensive Income under the Building Block Approach whereas it would go through Profit or Loss under the mirroring approach.
Understandability of the outcome

As a consequence of the complexity of this model, we identify serious difficulties for auditors to ensure that the output of this approach is giving faithful information and for entities themselves to explain their profitability. We also believe that this model would impair the comparability of financial statements.

We support the concept of a single model to assess the fulfillment cash flows of the insurance contracts. We believe that the coexistence of several measurement approaches will conduct to additional complexity in understanding the financial statements both for preparers and users. We would recommend sticking to the Building Block Approach for participating contracts, and expanding the unlocking of the Contractual Services Margin and/or the Other Comprehensive Income in order to ensure consistency on the geography of the impact of change in future cash flows.

We recommend that all the components which are closely related to the insurance contracts benefit from the same accounting treatment in order to avoid an overly complex framework. All changes to these elements relating to future periods should be considered either in the Other Comprehensive Income or in the measurement at each reporting period of the Contractual Service Margin.

We believe that the Board should consider the alternative approaches developed by the industry which are based on the principle that the measurement of the insurance liability should reflect the link with the underlying assets for all cases of participating contracts.

Dealing with the accounting mismatches imposes in our view that business model of insurers is more taken into account in the IFRS 9 standard when classifying and measuring financial assets with less restrictive rules to classify financial assets in the category Fair Value through Other Comprehensive Income.
Question 3 – Presentation of insurance contract revenue and expenses

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

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

The ED proposals relating to the presentation of insurance contracts revenue and expenses may appear theoretically sound, as they aim to present revenue corresponding to the level of services rendered by the company during the financial period.

Nevertheless we do not believe that the proposals are suitable for all insurers’ business models. Whereas presenting the gross premium amount as revenue seems consistent for non-life insurers, for which a premium revenue number is an important metric, we doubt that this model would be relevant for life-insurers. We would prefer that life-insurers apply the Summarised Margin Approach proposed in the 2010-ED which is more consistent with the way they manage their activity.

Moreover, the pattern of revenue recognition implied by the Earned Premium Revenue model proposed by the Board may create an inconsistency with the overall model as it uses expected claims as the main driver of premium revenue. Since claims are not always the main service provided by the insurer, this driver may not be in line with the transfer of services by the insurer.

We have concerns regarding the disaggregation of the premium between insurance and investment components of the contract, as required by paragraph 58. We believe that this disaggregation:

- is not consistent with paragraph 10 (b) that requires that only distinct investment components are separated from the host contract. The disaggregation of the premium would apply to components of the contract that are “highly interrelated”;
- would be very complex to implement in practice, and would imply costs that outweigh the benefits of this requirement, by creating the need to collect new data that are not always available and not in line with the way insurers manage their contracts;
- would introduce a certain level of arbitrary when disaggregating the premium, that would not facilitate comparison between insurance companies.
Question 4 – Interest expense in profit or loss

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

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

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

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

Consistently with our response to the 2010 Exposure Draft, we think Other Comprehensive Income is a way to deal with accounting mismatch between assets and liabilities, when assets backing the underlying contracts are accounted in Other Comprehensive Income category, consistently with the business model of the entity.

We have several comments on the assets and liabilities management topics:

- Life insurers are managing their portfolios based on assets and liabilities. The insurance accounting treatments should deal with the consistency between assets and liabilities, and so IFRS 4 should not be seen in isolation to IFRS 9.

- We think that accounting for assets and liabilities should be consistent with the insurers’ business model: where assets backing the liabilities portfolio are classified in the category fair value through Profit or Loss, an entity should be permitted to account impacts related to changes in the discount rate of the liability in Profit or Loss, consistently with its business model. This approach should be based on the liability unit of account – on a portfolio basis – as it is the practical way insurer deal with their liabilities.

- We recommend on the other hand allowing the use of Other Comprehensive Income on the asset side for a wider range of assets types. Restricting the use of Other Comprehensive Income to equities and to vanilla debt instruments could prevent insurers to deal with accounting mismatch and to reflect their business model. IFRS 9 discussions on hedging and derivatives should take into account Insurers Business model.
We welcome the IASB proposal regarding transition rules. In our comment letter in response to the 2010 Exposure Draft, we have supported a retrospective application (full or simplified) so that the balance of the Contractual Service margin (previously residual margin) on contracts in force at the date of the transition is subsequently amortized in Profit or Loss. We also believe it is consistent to book as part of the Other Comprehensive Income the impact of the difference between the current discount rate at the date of the transition and the discount rate at inception.

We support the simplifications introduced by the Board in the transitional approach.

On the effective date, we support the alignment of the effective date of the future IFRS on insurance contracts and of IFRS 9 as it is necessary for insurers to take into consideration the interaction between the measurement of both their financial assets and their insurance liabilities. We believe that insurers should be permitted, but not required, to adopt IFRS 9 before the mandatory effective date of IFRS 4.

In this respect, entities may need to modify their classification of assets under IFRS 9 and as such, would benefit from not having to do it twice (once in the context of IFRS 9 and then again in the context of the future standard on insurance contracts).
Question 6 - The likely effect of a Standard for insurance contracts

Considering the proposed Standard as a whole, do you think that the costs of complying with the proposed requirements are justified by the benefits that the information will provide? How are those costs and benefits affected by the proposals in Questions 1-5?

How do the costs and benefits compare with any alternative approach that you propose and with the proposals in the 2010 Exposure Draft? Please describe the likely effect of the proposed Standard as a whole on:
- the transparency in the financial statements of the effects of insurance contracts and the comparability between financial statements of different entities that issue insurance contracts; and
- the compliance costs for preparers and the costs for users of financial statements to understand the information produced, both on initial application and on an ongoing basis.

As auditors we are not directly concerned by the cost for complying with the proposed standard and we have difficulties in assessing that cost. Nevertheless our discussions with the industry lead us to believe that current proposal would be costly to implement and that the benefits in terms of financial reporting would not reach the level expected, in particular for participating contracts.

Notwithstanding the comment above, we believe that the measurement model proposed by the Board could benefit from the investments recently realized by the European industry to comply with future Solvency 2 regulation, even if the level of synergies is still uncertain.

The proposals made in the Exposure Draft 2013 introduce complexity in the accounting for insurance contracts. This complexity is inherent to the objective of the Board to develop a principle-based insurance standard applicable to the diversity of insurance businesses. Understandability of insurers' financial statements resulting from the future standard is a key issue for users. Accounting complexity appears to be unavoidable for such a complex and diverse industry. Nevertheless we believe it is key for the Board to monitor the level of complexity of its accounting model to avoid any downgrade in the understandability of insurers' financial statements. We believe that users need an improved understanding of insurers' financial performance and position that would not be achieved under a too complex approach.

In this context, we believe that field tests should be conducted before the Standard is finalized and first applied. They will be a crucial step in the process of finalizing the standard in order to ensure that the objectives of clarity and transparency of the financial statements and comparability between insurance companies are achieved and that disclosures include the appropriate information. They should permit to avoid huge costs if they happen to conclude that some proposals are either not practicable or not understandable for users.
Question 7 – Clarity of drafting

Do you agree that the proposals are drafted clearly and reflect the decisions made by the IASB? If not, please describe any proposal that is not clear. How would you clarify it?

When preparing this comment letter we have focused on the proposed model and on our opinion regarding its relevance and suitability for the insurance industry. Our main concerns are presented in the cover letter and the detailed answers to the other specific questions raised by the Board in this ED.

We have not made any comparison between the decisions made by the Board in the course of the project and the way these decisions are reflected in the ED. We have not performed an in-depth reading of the ED and its accompanying documents with the purpose of identifying sources of unclarity either.

In this matter we will be pleased to help you by participating in the fatal flaw review of the Standard.