Report

Financial Reporting Council

March 2014

Impact assessment and Feedback statement

FRS 103 *Insurance Contracts*

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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Impact assessment

Introduction

1 As published in its Regulatory Strategy[1], the Financial Reporting Council (FRC) is committed to a proportionate approach to the use of its powers, making effective use of impact assessments and having regard to the impact of regulation on small enterprises. The FRC issued an Impact Assessment with FRS 100 *Application of Financial Reporting Requirements*, FRS 101 *Reduced Disclosure Framework* and FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* which included 12 example case studies to illustrate the impact of the new accounting standards on a wide range of UK entities.

2 As FRS 103 is applicable to entities applying FRS 102, this impact assessment has been prepared as additional case study scenarios to supplement those previously published. It focuses upon the impact of FRS 103 on entities with insurance contracts and does not seek to repeat all possible impacts of FRS 102, many of which affect insurance companies in the same way as any other entity.

3 In many cases FRS 103 permits entities to continue to apply their existing accounting policies and therefore the costs of implementing FRS 103 will be minimised. In addition, FRS 102 introduced a definition of an insurance contract, with a consequential need to analyse the contracts in place and determine the accounting accordingly. Although any resulting changes in accounting are an impact of FRS 102, not FRS 103, the following case study scenarios do refer to this impact on an insurance company.

4 The FRC believes that the introduction of FRS 103 will have a positive impact on financial reporting, and that the benefits of more consistent, transparent information for decision-making outweigh the transition costs of implementing the new standards.

Scenario	
Company K	Insurance company that has previously applied FRS 26
Company L	Insurance company that has not previously applied FRS 26
Company M	An entity that has insurance contracts as defined in FRS 102 and FRS 103, but is not legally an insurance company

1 www.frc.org.uk/FRC-Documents/FRC/Regulatory-Strategy-Our-Role-and-Approach-%28Version.aspx

Company K – Insurance company that has previously applied FRS 26

Scenario

Company K is a medium-sized group with both general insurance business and long-term insurance business within the group. It has voluntarily applied FRS 26 (IAS 39) *Financial instruments: Recognition and Measurement*, and has therefore already made the distinction between its investment contracts and its insurance contracts. Its life assurance contracts are within a subsidiary. It provides disclosures about risks, sensitivities and capital in accordance with FRS 27 *Life Assurance* (at a group level) and Appendix E of FRS 29 (IFRS 7) *Financial Instruments Disclosures*.

Applicable accounting standards

Company K will apply FRS 102 and FRS 103.

Costs of implementing the applicable accounting standards

As FRS 103 has sought to replicate the requirements of IFRS 4 and FRS 27, and is consistent with UK company law, there will be few additional requirements upon Company K regarding recognition and measurement of insurance contracts.

Company K's life assurance subsidiary will need to make full disclosure of its capital policy, capital management strategy, and capital position including a reconciliation between its statement of financial position and the regulatory capital requirement. This is information that is already available for inclusion in the group financial statements.

Company K will need to make additional disclosures, for example in relation to its objectives, policies and processes for managing risks arising from insurance contracts and the methods used to manage those risks, as well as in relation to loss development.

In addition, other aspects of accounting by Company K may change on application of FRS 102.

Company L – Insurance company that has not previously applied FRS 26

Scenario

Company L is a medium-sized life assurer that has not previously applied FRS 26 (IAS 39) *Financial instruments: Recognition and Measurement*. It provides disclosures about risks, sensitivities and capital in accordance with FRS 27 *Life Assurance*.

Applicable accounting standards

Company L will apply FRS 102 and FRS 103. As a financial institution it will provide additional disclosures as set out in Section 34 *Specialised Activities* of FRS 102.

Company L will need to review its accounting and reporting for its financial instruments and insurance contracts. Financial instruments will need to be measured at either fair value, or at amortised cost. It must analyse its 'insurance' contracts and determine whether they meet the detailed definition of insurance contract set out in FRS 103. This analysis may need to be done on a contract by contract basis. It will also need to determine whether any contracts contain separable embedded derivatives that will need to be accounted for separately.

Contracts that do not meet the definition of an insurance contract shall be accounted for in accordance with FRS 102, either as financial instruments, or under another section as applicable. The income recognition profile may change.

Costs are likely to be incurred in maintaining fair value and amortised cost accounting records for financial instruments that may currently be measured on another basis and training staff on the new financial reporting requirements.

Company L will need to make additional disclosures, for example in relation to its objectives, policies and processes for managing risks arising from insurance contracts and the methods used to manage those risks.

In addition, other aspects of accounting by Company L may change on application of FRS 102.

Costs of implementing the applicable accounting standards

The costs of applying FRS 102 and FRS 103 for the first time are likely to be more than minimal for an insurance company that has not previously applied FRS 26.

There may also be additional costs in terms of accountancy advice and audit effort and in ensuring effective communication with members and other users about the new financial information.

Company M – An entity that has insurance contracts as defined in FRS 102 and FRS 103, but is not legally an insurance company

Scenario

Company M is not a legally constituted insurance company. It is not a financial institution as defined in FRS 102. Company M issues contracts that have previously been accounted for under FRS 12 *Provisions, contingent liabilities and contingent assets.*

Applicable accounting standards

Company M will apply FRS 102 and FRS 103. It determines that the contracts it issues are insurance contracts as defined in FRS 103. However in accordance with FRS 103 Company M can continue to apply its existing accounting policies to the contracts (provided they are in compliance with FRS 102) or it can choose to change to an insurance contracts basis of accounting. Company M chooses to continue to apply its existing accounting policies.

Company M must make the disclosures required by Section 4 of FRS 103. Company M is not required to make the disclosures under Section 34 *Specialised Activities* of FRS 102 as it is not a financial institution.

Costs of implementing the applicable accounting standards

The costs of applying FRS 102 and FRS 103 will include assessing whether or not the contracts it issues are insurance contracts and, if they are, determining the accounting principles to apply and making the required disclosures in the financial statements.

There may also be additional costs in terms of accountancy advice and audit effort and in ensuring effective communication with members and other users about the new financial information.

Feedback statement

1 In July 2013 the FRC issued FRED 49: Draft FRS 103 *Insurance Contracts* and the accompanying draft Implementation Guidance. The comment deadline was 31 October 2013, giving respondents three months to provide their feedback. The purpose of this feedback statement is to summarise the comments received. The Accounting Council's Advice to the FRC sets out how the comments received have been taken into account in finalising FRS 103.

2 The FRC received 13 comment letters, which were from the following stakeholder groups:

Table 1: Respondents by category

	No. of respondents
Preparers	1
Accountancy firms	4
Accounting bodies	4
Actuarial bodies	1
Representative bodies of preparers	3
Total	**13**

3 FRED 49 posed nine questions, and in addition respondents were invited to comment on any other aspect of the draft standard. The more significant comments made, that were not in response to a specific question, related to:

(a) insurance contracts denominated in foreign currencies (see paragraphs 36 and 37 of the Accounting Council's Advice);

(b) disclosure by captive insurers (see paragraphs 44 and 45 of the Accounting Council's Advice); and

(c) the Memorandum of Understanding concerning FRS 27 *Life Assurance* (see paragraphs 52 and 53 of the Accounting Council's Advice).

4 The responses to the questions asked in FRED 49 are summarised below.

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?

Table 2: Respondents views on question 1

	No. of respondents
Agreed	11
Disagreed	1
Other	1
Total respondents	13
Did not comment	–
	13

5 Overall there is very significant support for the introduction of a standard for insurance contracts (FRS 103) based on FRED 49. This, of course, does not necessarily mean that those respondents agreeing with its introduction and aims did not raise issues that they felt should be considered in its finalisation, but they were not significant enough to qualify the overall support.

Question 2

Draft FRS 103 paragraph 2.3 includes the 'improvement' options from IFRS 4 (ie 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?

Table 3: Respondents views on question 2

	No. of respondents
Agreed	7
Disagreed	2
Other	2
Total respondents	11
Did not comment	2
	13

6 Those supporting the inclusion of the 'improvement' option agree with the Accounting Council that UK accounting standards should not be more constraining than EU-adopted IFRS, nor FRS 101 *Reduced Disclosure Framework*. Some note the possibility of greater diversity in practice, but they also note that amongst those applying EU-adopted IFRS, the option has not been widely used in the UK, and that any changes in accounting policy must be demonstrably improvements.

7 Those disagreeing or providing other views were concerned with, amongst other things, the potential impact on consistency between reporting entities and that there is a lower hurdle for changing accounting policies for insurance contracts than would otherwise be permitted by FRS 102. Even those disagreeing noted that their concerns over consistency may not arise in practice.

8 The Accounting Council reconsidered this issue taking into account the feedback received, as set out in paragraphs 29 and 30 of the Accounting Council's Advice, and advises that this option is included in FRS 103 to ensure that entities applying FRS 103 will have the same flexibility as those entities in the UK and Republic of Ireland that are applying EU-adopted IFRS and FRS 101.

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?

Table 4: Respondents views on question 3

	No. of respondents
Agreed	9
Disagreed	–
Other	2
Total respondents	11
Did not comment	2
	13

9 Respondents generally agree with the requirements for new entrants, noting that this is an area that was not addressed by IFRS 4. Those providing other views suggested that the reference to the implementation guidance should be strengthened, as in practice this might actually be where the most relevant information for new entrants is. However, the reference needs to reflect the non-mandatory nature of the Implementation Guidance and therefore only minimal changes have been made.

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?

Table 5: Respondents views on question 4

	No. of respondents
Agreed	9
Disagreed	–
Other	1
Total respondents	10
Did not comment	3
	13

10 All of those respondents agreeing with paragraphs 2.8 and 2.9 as included in draft FRS 103 saw no reason to deviate from IFRS 4 in this regard. The respondent providing a different comment felt the paragraphs are slightly convoluted, but did not disagree with them in principle. As a result the requirements have been retained in FRS 103.

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?

Table 6: Respondents views on question 5

	No. of respondents
Agreed	10
Disagreed	–
Other	2
Total respondents	12
Did not comment	1
	13

11 It is expected by respondents that the information for these disclosures is generally available as it is required for regulatory returns, although some respondents noted that the availability of data in overseas subsidiaries may vary. Two respondents raised the possibility of disclosure exemptions for captive insurers.

12 As a result the disclosure requirements have been retained in FRS 103. The Accounting Council's consideration of disclosure exemptions for captive insurers is set out in paragraphs 44 and 45 of the Accounting Council's Advice.

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?

Table 7: Respondents views on question 6

	No. of respondents
Agreed	10
Disagreed	1
Other	1
Total respondents	12
Did not comment	1
	13

13 There is broad support for this proposal, however, a number of respondents commented that the draft Implementation Guidance appears to go further than the requirements of FRS 102, but noted that in practice this is unlikely to pose a significant burden on preparers because it is consistent with current practice. As a result the disclosure requirements have been retained as proposed.

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?

Table 8: Respondents views on question 7

	No. of respondents
Agreed	2
Disagreed	4
Other	–
Total respondents	6
Did not comment	7
	13

14 Most respondents did not comment on this question, perhaps because their interest in the consultation was specific to insurance entities rather than possible read across to other financial institutions.

15 Only two respondents agreed with the suggestion that the guidance on capital disclosures might have relevance for other financial institutions, and even they noted that further work would need to be done to make the guidance relevant to others and that further consultation would be required.

16 However, a number of respondents disagreed. They felt that this should not have been addressed in a consultation on draft FRS 103 as any such guidance should be included in FRS 102. Further they consider the guidance is not applicable to other financial institutions in its current form and that it goes significantly further than FRS 102 and full IFRS. In general they do not agree that UK guidance should imply disclosures over and above those required by EU-adopted IFRS.

17 The Accounting Council does not advise taking forward the possibility of issuing guidance on capital disclosures for financial institutions more generally at the present time. However, this may be considered further in the future, for example as part of the three-yearly review of FRS 102.

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?

Table 9: Respondents views on question 8

	No. of respondents
Agreed	2
Disagreed	6
Other	–
Total respondents	8
Did not comment	5
	13

18 One respondent noted that part of the draft Implementation Guidance might recognise that allocating certain funds between working capital and policyholders' liabilities is not clear-cut for mutual insurers. Another respondent identified some smaller 'non-directive' friendly societies that comply with a format that differs from the Companies Act 2006.

19 Otherwise respondents either did not comment or had not noted any amendments required as a result of differing legal requirements. Drafting improvements have been made to FRS 103 and the Implementation Guidance to reflect the comments made.

Question 9

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

Table 10: Respondents views on question 9

	No. of respondents
Agreed	13
Disagreed	–
Other	–
Total respondents	13
Did not comment	–
	13

20 No objections were received in relation to the proposed effective date, which is aligned with that of FRS 102. Indeed at least one respondent noted that it is necessary, not simply advisable, for the two to be aligned.

21 The effective date of FRS 103 is confirmed as aligned with that of FRS 102, being accounting periods beginning on or after 1 January 2015.

Appendix to Feedback Statement: Republic of Ireland (RoI) Legal References

The table below should be read in conjunction with Appendix V of FRS 103.

Paragraph	UK Reference	RoI Reference
Question 8	Friendly Societies Act 1992	Friendly Societies Acts 1896 to 1977

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