

Jenny Carter
Financial Reporting Council
Aldwych House
71-91 Aldwych
London
WC2B 4HN

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Direct line: 020 7951 2025

Email: aclifford@uk.ey.com

Dear Ms Carter

FRED 49 Draft FRS 103 - Insurance Contracts

Introduction

Ernst & Young LLP welcomes the opportunity to comment on FRED 49 Draft FRS 103 – Insurance Contracts ('the exposure draft') issued by the Financial Reporting Council ('the FRC').

Overall comments

We support the FRC's objective in improving financial reporting in the UK, in a manner that will enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs. We also support the view that UK accounting standards should not be more restrictive than EU-adopted IFRS, unless this is necessary for compliance with company law.

Overall, we agree with the proposals to allow entities writing insurance contracts to continue with their current accounting practices for insurance contracts, but permitting entities the same flexibility to make improvements (subject to legal and regulatory requirements) as have entities in the UK and Republic of Ireland applying IFRS 4 – *Insurance Contracts* (IFRS 4).

We recognise that the exposure draft is an interim solution to insurance contract accounting pending the completion by the IASB of its updated standard for insurance contracts. We also recognise that the standard needs to be revised once changes to the regulatory regime for insurers have been finalised (Solvency II).

We have some reservations and comments over the detail in the exposure draft. We disagree with the principle of Question 7 of the Invitation to Comment as we do not believe it is appropriate that a proposed standard on insurance contracts is the place to ask a question about disclosures required by banking entities. Any such proposed disclosures should be the subject of a separate consultation. We also consider that the language used in the detailed Implementation Guidance (IG) of the exposure draft is unhelpful as it implies that the guidance is mandatory (eg. by consistent use of word 'shall'). This is not consistent with the wording of the IG in either FRS 102 or IFRS 4 and should be modified. Additionally, we do not understand the rationale for the inclusion of various paragraphs derived from the ABI SORP in respect of life insurance accounting into Section 3 of the exposure draft. The equivalent ABI SORP paragraphs in respect of non-life insurance are not part of the standard but have been only as IG.

If you have any matters arising concerning the content of our response, please do not hesitate to contact me.

Kind Regards

Yours sincerely



Tony Clifford
Partner, Financial Reporting Group

Responses to FRC questions

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 support the introduction of draft FRS 103, based on IFRS 4 and incorporating elements of FRS 27 and the ABI SORP both within the draft standard and as non-mandatory implementation guidance (IG).

We agree that it achieves its aim of allowing entities, generally, to continue with their existing accounting policies for insurance contracts. In addition, consistent with IFRS 4, it permits entities to change those accounting policies if the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs.

However, we do not agree with the inclusion of various elements of the ABI SORP dealing with life insurance accounting into Section 3 of the exposure draft (paragraphs 3.3 to 3.6 and 3.8 to 3.10). We do not understand the rationale for including these paragraphs within the standard when the equivalent paragraphs for non-life insurance are included only as part of the IG. In our view, paragraphs 3.3 to 3.6 and 3.8 to 3.10 should also be IG.

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 the options in the draft FRS? If not, why not?

We agree with the inclusion of the 'improvement options' in paragraph 2.3 of FRS 103 which provides a similar degree of flexibility for insurers applying FRS 103 as those applying FRS 101 – *Reduced Disclosure Framework* or IFRS 4.

We do not consider that insurers applying FRS 103 should be subject to more onerous requirements than those applying FRS 101 or IFRS 4.

Question 3

Draft FRS 103 paragraph 1.5 requires new entrants to apply the same accounting 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 IFRS by new entrants? If not, how should this be improved?

We believe that new insurers (ie insurers who have to set accounting policies for insurance contracts for the first time) should have the same flexibility to set accounting policies as existing insurers. As such, we believe paragraph 1.5 provides sufficient guidance and clarity.

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 agree with the rebuttable presumption. Paragraphs 2.8 and 2.9 of FRS 103 (with one important exception – see below) are the same as paragraphs 27 and 28 of IFRS 4. We do not believe that FRS 103 should make changes to IFRS 4 unless absolutely necessary (eg. a conflict with the Regulations) in order to maintain the principle that insurers applying FRS 103 should have the same flexibility as those applying IFRS 4.

The first sentence of paragraph 2.8 states "*Except in respect of long-term insurance business to which Section 3 applies, an insurer need not change its accounting policies for insurance contracts to eliminate future investment margins*" (emphasis added). These added words, which are not in paragraph 27 of IFRS 4, imply that life insurers **MUST** change their accounting policies to eliminate future investment margins. We do not understand the rationale for this restriction which is inconsistent with the objective of allowing insurers the same flexibility under FRS 103 and FRS 101/IFRS 4. Additionally, life insurers can circumvent this restriction by changing their accounting policies in accordance with paragraph 2.3 of FRS 103 so that they are no longer consistent with Section 3 (as stated by paragraph 3.2 of FRS 103). We therefore recommend that these words are deleted.

Question 5

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

Although insurers may not have a full 10 years of claims development data readily available when first applying FRS 103, we believe that the transitional relief on initial application described in paragraph 6.3 of FRS 103 is sufficiently flexible to cater for the fact that some insurers may find full retrospective application of paragraph 4.7(c)(iii) impracticable.

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 the financial statements?

We agree that it is appropriate that these recommended capital disclosures are contained within the implementation guidance as guidance rather than being mandated within draft FRS 103. This is consistent with the FRC's aim of not making FRS 103 more onerous than either IFRS 4 or FRS 101. If the recommended disclosures were mandated, an insurer could still avoid them by simply moving to IFRS or FRS 101.

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 do not believe that an exposure draft on insurance contract accounting is an appropriate place for the FRC to consult on capital disclosures applicable to non-insurers. If the FRC wishes to add additional implementation guidance to FRS 102 in respect of capital disclosures applicable to financial institutions other than insurers, it should do this via a separate consultation or exposure draft. However, we note that IFRS provides no such guidance and we do not believe that FRS 102 should be more onerous for financial institutions to apply than IFRS.

The recommended disclosures in section 3 of the implementation guidance apply only to life insurers. These recommended disclosures are not appropriate for either non-life insurers or any other type of financial institution without substantial modification.

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 no comments to make on this matter.

Question 9

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

We believe that the proposed effective date must be aligned with FRS 102 and agree with the proposal to apply it for accounting periods beginning on or after 1 January 2015.

Appendix 1 – Other matters

In this appendix we comment on certain other matters.

1. Implementation Guidance wording

The draft implementation guidance accompanies, but is not part of, draft FRS 103. It is not mandatory. However, the wording used throughout the implementation guidance is inconsistent with its non-mandatory status and makes frequent use of phrases such as “shall disclose” and “shall be made”. This style of wording, which misleadingly implies that the guidance is mandatory, is inconsistent with the wording used for implementation guidance in both FRS 102 and IFRS.

We recommend that the wording of the implementation guidance removes phrases which imply that it is mandatory and is aligned to the wording of the implementation guidance in FRS 102.

2. Paragraph 4.1 of draft FRS 103

This paragraph should also refer to the additional disclosures required by section 5.