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Dear Sirs

FRED 49: Draft FRS 103 Insurance Contracts

We write in response to your invitation to comment on FRED 49: Draft FRS 103 Insurance Contracts ("FRED 49"). In summary:

- We welcome the Financial Reporting Council's ("the FRC's") development of a Financial Reporting Standard (FRS) for insurance contracts. Whilst we continue to support the FRC's longer-term solution of incorporating the first comprehensive International Financial Reporting Standard (IFRS) on insurance contracts into UK GAAP, an accounting standard such as FRS 103 is a useful intermediate step. It would consolidate the difference sources of UK GAAP accounting guidance for insurance contracts, making them easier to access and apply.
- We do not support the introduction of paragraphs 2.2-2.11. In line with IFRS 4, these paragraphs provide a more flexible regime for voluntary changes of accounting policy relating to insurance contracts. Whilst this flexibility is helpful in jurisdictions without a comprehensive basis of accounting for insurance contracts, this is not the case in the UK where the law, the ABI SORP and FRS 27 provide such a comprehensive basis. Furthermore, allowing greater latitude in the selection of insurance contract accounting policies would reduce comparability between UK entities. Given that there are already constraints on this flexibility arising from UK law, we believe that the benefits of comparability to both shareholders and regulators outweigh the limited benefits this change would bring.

Our answers to the questions raised in the Invitation to Comment section of FRED 49 are set out in the appendix to this letter.

If you have any questions concerning our comments, please contact Veronica Poole on 0207 007 0884 or Francesco Nagari on 0207 303 8375.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'V. Poole', is positioned above the typed name.

Veronica Poole
National Head of Accounting and Corporate Reporting
Deloitte LLP

Appendix – responses to questions raised in the Invitation to Comment section of FRED 49

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 FRS 103 as a single standard for accounting for insurance contracts under UK GAAP. The incorporation of many of the requirements of FRS 27 *Life Assurance* and elements from the existing Association of British Insurers *Statement of Recommended Practice on Accounting for Insurance Business* (ABI SORP) will help to ensure that existing practices are largely preserved under the new regime pending the completion of the IASB's project on insurance accounting.

In general, we welcome the fact that this standard is based on IFRS 4, subject to our comments in our response to Question 2

We note that FRS 102 contains the requirement for all UK reporting entities to apply the IFRS 4 definition of an insurance contract, which will require those entities that have not previously adopted FRS 26 *Financial Instruments: Recognition and Measurement* to perform a contract classification exercise in order to identify:

- which contracts meet the definition of an insurance contract and will be accounted for under FRS 103; and
- which contracts do not meet the definition of an insurance contract and will be accounted for under sections 11 and 12 of FRS 102 (or, as permitted by those sections, IAS 39 or IFRS 9).

We agree with this position and note that for affected entities there will be a change from existing UK accounting, as acknowledged by the FRC within the Consultation Stage Impact Assessment.

We believe that the new standard will allow existing entities that are not insurance companies to preserve their accounting for warranties, as set out in paragraph 28 of the Accounting Council's Advice to the FRC:

- For manufacturers, dealers and reailers, the scope exemption in paragraph 1.7(a) of the draft FRS clearly achieves this.
- For other non-insurance companies this would be possible under the grandfathering provisions of paragraph 2.12, although this is (a) less clear to a reader and (b) they would need to apply the provisions of paragraph 2.13. We suggest that the FRC should clarify the drafting to make this explicit, including whether or not they intend such entities to apply paragraph 2.13.

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?

We do not support the introduction of paragraphs 2.2-2.11. In line with IFRS 4, these paragraphs provide a more flexible regime for voluntary changes of accounting policy relating to insurance contracts. Whilst this flexibility is helpful in jurisdictions without a comprehensive basis of accounting for insurance contracts, this is not the case in the UK where the law, the ABI SORP and FRS 27 provide such a comprehensive basis. Furthermore, allowing greater latitude in the selection of insurance contract accounting policies would reduce comparability between UK entities. Given that there are already

constraints on this flexibility arising from UK law, we believe that the benefits of comparability to both shareholders and regulators outweigh the limited benefits this change would bring.

In addition:

- Given the legal constraints, as well as the fact that entities reporting under existing UK GAAP are likely to be in the midst of other projects relating to the IASB's proposed changes and the introduction of Solvency II, we expect that there will be little or no demand for this flexibility.
- Setting a lower hurdle for improvements to accounting policies than that in FRS 102 paragraphs 10.8 to 10.12 could lead to more diversity in accounting policies. This could make completion of regulatory returns by preparers, and their interpretation by the Prudential Regulation Authority, significantly more complex and time-consuming.
- The 'improvement' options within IFRS 4 were originally designed to accommodate different accounting practices around the world, including its use in jurisdictions where there is no consistent accounting guidance for insurance contracts. This rationale does not apply in the UK, where there is already a comprehensive basis of accounting for insurance contracts.

We believe that changes of accounting policy for insurance contracts should be subject to the same conditions in FRS 102 paragraphs 10.8 to 10.12 as any other accounting policy change. In addition, entities seeking to use the proposed flexibility in order to align with an IFRS reporting parent entity will, of course, be able to apply IFRS as adopted in the EU, including IFRS 4.

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 agree with the requirement for new entrants to apply the same requirements as existing preparers as set out in paragraph 1.5. However, we do not believe that the 'improvement' options should be available to either existing preparers or to new entrants for the reasons set out above in our response to Question 2.

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 margin, 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?

Our response to Question 2 explains why we believe the improvement options from IFRS 4, including proposed paragraph 2.8, should not form part of the final FRS 103. However, if these flexibility options are retained, we agree with paragraphs 2.8 and 2.9 as drafted.

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 disclosure readily available to preparers?

We do not believe that the incremental disclosures required by draft FRS 103 paragraph 4.7(c)(iii) would be unduly burdensome for the majority of affected entities for the reasons set out in paragraph 36 of the Accounting Council's advice to the Financial Reporting Council.

We agree with the proposed transitional provision in paragraph 6.3 of draft FRS 103 and believe this will be relevant to entities that have insurance contracts accounted for under FRS 103 but that are not regulated entities.

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?

Yes, we believe this approach is appropriate. We agree that the retention of this guidance, brought forward from FRS 27, is a useful reference material which will be welcomed by UK GAAP preparers. We do not believe that the change in status from 'standard' to 'guidance' will impact the usefulness of the disclosures to users of financial statements.

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 agree that it may be helpful to provide similar guidance to other regulated financial institutions that are required to provide FRS 102 capital disclosures in areas where the capital regime is complex. We recommend that the FRC considers a targeted consultation with relevant user groups and preparers in the event that it does decide to introduce such guidance.

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 not identified any requirements of the draft FRS or accompanying draft Implementation Guidance for which we believe an amendment would be required in order to be applied by insurers other than companies.

Question 9: Do you agree with the proposed effective date? If not, what alternative date would you propose, and why?

We agree with the proposed effective date.