



KPMG LLP
Financial Services
15 Canada Square
London E14 5GL
United Kingdom

Tel +44 (0) 20 7311 1000
Fax +44 (0) 20 7311 3311

The Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

Your ref FRED 64

Our ref dc/dh

Contact Danny Clark
020 7311 5684

For the attention of Jenny Carter

26 February 2016

Dear Jenny

FRED 64: Draft amendments to FRS 103 Insurance Contracts – Solvency II

We welcome this opportunity to comment on FRED 64: Draft amendments to FRS 103 *Insurance Contracts – Solvency II*.

FRS 103 is based on the International Accounting Standards Board's IFRS 4 *Insurance Contracts*. However, unlike IFRS 4, it seeks to include the requirements for a reporting entity that had previously prepared its accounts under UK GAAP immediately before the date on which FRS 103 became effective ('old' UK GAAP), either in the main body of the standard, or in the accompanying non-mandatory Implementation Guidance.

Under 'old' UK GAAP the basis for accounting for life assurance business was derived from the statutory solvency basis and the realistic capital regime, as set out in the Prudential sourcebook for insurers (INSPRU). FRS 103 (and the accompanying non-mandatory guidance) therefore contains references to INSPRU.

With effect from 1 January 2016, for most UK insurers, the existing regulatory framework, Solvency I, which included the statutory solvency basis and the realistic capital regime, were replaced by a different regulatory framework, Solvency II, and INSPRU, in its current format, was effectively withdrawn.

The purpose of FRED 64 is to propose amendments to FRS 103 to update the terminology and definitions for these changes in the regulatory framework, without making any other changes to the accounting and reporting requirements set out in FRS 103.

We appreciate there is a need to update the terminology in FRS 103 for the changes in the regulatory framework. However, we consider that there may be alternative approaches that would better achieve the FRC's objective.



Therefore, in responding to the FRC's proposals, we have considered the following questions:

- (i) Do the FRC's proposals achieve its objective; and
- (ii) Could the FRC's proposals be achieved by adopting a different approach?

Our responses to the specific questions included in FRED 64 are included in the Appendix to this letter.

If you wish to discuss any of the points we have raised, please contact David Holliday on 0297 311 5663, or me on 020 7311 5684.

Yours sincerely

Danny Clark
Partner, KPMG LLP

Appendix 1

Responses to specific questions raised in the FRED

Question 1:

Do you agree with the amendments proposed to FRS 103 and the related Implementation Guidance? If not, why not?

Do the FRC’s proposals achieve its objective?

Paragraph 3.1 (b) of the extant FRS 103 states that paragraphs 3.11 to 3.15 apply to with-profits business and with-profits funds to which the Prudential Regulatory Authority’s (PRA) realistic capital regime is being applied either voluntarily or compulsorily. Paragraphs 3.7 and 3.12 also include requirements for with-profits funds to which the PRA’s realistic capital regime is being applied either voluntarily or compulsorily.

The proposed amendments to paragraph 3.1 (b) do not appear to make allowance for entities that have, or had at any time since 31 December 2004, with-profits liabilities of less than £500 million, but choose to voluntarily apply the PRA realistic capital regime. It would also appear that paragraphs 3.7 and 3.12 would no longer directly apply to these entities. We are unsure if this consequence of the amendment to paragraph 3.1 was intended.

As part of the proposed amendment to paragraph 3.7, the words ‘within the scope of paragraph 3.1(b)’ have been added. We would have expected similar words to be added to paragraphs 3.11 and 3.12.

The revised definitions of the ‘established long-term insurance business liability basis’, and the ‘realistic value of liabilities’ include the statement that ‘The method for determining the realistic value of liabilities shall be consistent with that applied in periods ending before 1 January 2016’. Given that there would have been no changes to the methods applied during 2016, unless a reporting entity had chosen to voluntarily ‘improve’ its accounting policies, it might be preferable to refer to the methods that applied in periods ending before 1 January 2015, which was the date on which the ABI SORP and FRS 27 were effectively withdrawn. If an entity had chosen to ‘improve’ its accounting policies on the adoption of FRS 103, then it might no longer be applying the modified statutory solvency basis and the realistic value of liabilities at 31 December 2015. However, an entity that had chosen to ‘improve’ its accounting policies would no longer be applying section 3 (or at least not in full).

Could the FRC’s proposals be achieved by adopting a different approach?

We have concerns with the proposed definitions of the ‘established long-term insurance business liability basis’ that would replace the definition of the modified statutory solvency basis and the new definition of the ‘realistic value of liabilities’. Although we appreciate that the definition of the ‘established long-term insurance business liability basis’ is drawn from the ‘methods and

assumptions' for an actuarial valuation set out in INSPRU, it could apply to virtually any recognised basis of accounting for insurance contracts, and the new definition of the 'realistic value of liabilities' uses terms that do not appear to be defined.

We appreciate that the statement included in both definitions that we refer to above is intended to clarify that the descriptions of the 'established long-term insurance business' and the 'realistic value of liabilities' are intended to refer to the modified statutory solvency basis and the realistic value of liabilities as defined in INSPRU. Nevertheless, this effectively requires knowledge of the basis that previously applied. Any entity currently applying FRS 103 that wished to remind itself how to apply its existing accounting policies and any entity newly adopting FRS 103 would need to refer to the old rules in INSPRU in order to understand how to apply paragraph 1.5 of FRS 103.

As an entity applying FRS 103 would effectively have to refer to INSPRU to understand the new definitions, replacing the references to INSPRU, the realistic capital regimes, the statutory solvency basis, and the modified statutory solvency basis with other loosely drawn definitions might not necessarily be the best way to achieve the FRC's objective.

An alternative approach would be to make no changes to FRS 103, other than to make clear that the definitions of INSPRU, the realistic capital regimes, and the statutory solvency basis refer to the version of INSPRU that was in force on 31 December 2014. A slight modification to this approach would be to include the relevant sections from this version of INSPRU in the non-mandatory Implementation Guidance. We appreciate that it would not be ideal to require users of FRS 103 to have to refer to regulatory requirements that are no longer applied, but FRS 103 is intended to be a temporary standard, so this approach would be acceptable in the short to medium term.

We note that the section of the current PRA Rulebook that contains the insurance rules for non-Solvency II firms includes the measurement approach for a contract under the 'old' Solvency I rules (i.e. the statutory solvency basis). Another alternative approach would be to leave the definition of the modified statutory solvency basis unchanged, and to change the definition of the statutory solvency basis to refer to the appropriate section of the current PRA Rulebook. If the revised definition of the realistic value of liabilities was expanded to explain some of the term used (e.g. using explanations derived from FRS 27), then there would be no need to refer to regulatory requirements that are no longer applied.

Question 2:

Have you identified any other amendments that you consider should be made to FRS 103 or the related Implementation guidance as a result of the changes in the regulatory framework? If so, please provide details of your proposed amendments and the rationale for them.

One of the consequences of the Solvency II framework is that insurance entities will no longer be required to maintain equalisation provisions as a regulatory requirement, and as such they will no longer be recognised in accounts prepared in accordance with FRS 103, unless they are required by another regulatory framework.

Another consequence of Solvency II is that life insurance companies will no longer be required to maintain a 'long-term fund'. We note that the glossary of terms contains a definition of a 'long-term fund'. We have not undertaken a comprehensive search to determine where (and how many times) this term is used in FRS 103 (and the accompanying non-mandatory guidance), but we suggest that the FRC should consider whether it is necessary to continue to include this (now) obsolete term.

We appreciate that the FRC might have chosen not to take this opportunity to simplify FRS 103 by removing all references to equalisation provisions and to a long-term funds to allow for the fact that not all insurers applying FRS 103 would necessarily be operating within the Solvency II framework. However, many of the other proposed changes would appear to be made on this basis.