Exposure Draft

Financial Reporting Council

December 2015

FRED 64
Draft amendments to FRS 103 *Insurance Contracts*

Solvency II

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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Contents

Summary

(i) With effect from 1 January 2015, the Financial Reporting Council (FRC) revised financial reporting standards in the United Kingdom and Republic of Ireland. The revisions fundamentally reformed financial reporting, replacing the extant standards with five Financial Reporting Standards:

(a) FRS 100 *Application of Financial Reporting Requirements*;

(b) FRS 101 *Reduced Disclosure Framework*;

(c) FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*;

(d) FRS 103 *Insurance Contracts*; and

(e) FRS 104 *Interim Financial Reporting*.

The FRC has also issued FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* to support the implementation of the new micro-entities regime.

This FRED proposes limited amendments to FRS 103 as a result of the implementation of Solvency II.

(ii) The FRC's overriding objective in setting accounting standards is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.

(iii) In meeting this objective, the FRC aims to provide succinct financial reporting standards that:

(a) have consistency with international accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;

(b) reflect up-to-date thinking and developments in the way entities operate and the transactions they undertake;

(c) balance consistent principles for accounting by all UK and Republic of Ireland entities with practical solutions, based on size, complexity, public interest and users' information needs;

(d) promote efficiency within groups; and

(e) are cost-effective to apply.

Draft amendments to FRS 103

(iv) This FRED proposes amendments to FRS 103 to update the terminology and definitions used for changes in the regulatory framework. Established accounting policies can continue to be applied if an entity so chooses.

Invitation to comment

1 The FRC is requesting comments on FRED 64 by 28 February 2016. The FRC is committed to developing standards based on evidence from consultation with users, preparers and others. Comments are invited in writing on all aspects of the draft standard. In particular, comments are sought in relation to the questions below.

Question 1

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

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.

2 Information on how to submit comments and the FRC's policy in relation to responses is set out on page 22.

[Draft] Amendments to FRS 103 *Insurance Contracts*

[Draft] Amendments to Section 1 *Scope*

1 The following paragraph sets out the [draft] amendments to Section 1 *Scope* (inserted text is underlined).

2 Paragraph 1.11A in inserted as follows:

<u>1.11A In [month 2016] amendments were made to this FRS, to update it for changes in the regulatory framework. An entity shall apply these amendments for accounting periods ending on or after 1 January 2016.</u>

[Draft] Amendments to Section 3
Recognition and Measurement: Requirements for entities with long-term insurance business

3 The following paragraphs set out the [draft] amendments to Section 3 *Recognition and Measurement: Requirements for entities with long-term insurance business* (deleted text is struck through, inserted text is underlined).

4 Paragraph 3.1 is amended as follows:

3.1 This section sets out requirements for entities applying this FRS that are carrying out **long-term insurance business**:

(a) Paragraphs 3.3 to 3.10 and 3.16 to 3.18 apply to all long-term insurance business.

(b) Paragraphs 3.11 to 3.15 apply to **with-profits business** and with-profits funds~~, to which the~~ ~~**Prudential Regulatory Authority (PRA) realistic capital regime**~~ ~~is being applied, either voluntarily or compulsorily~~ <u>of an entity that has, or had at any time since 31 December 2004, with-profits liabilities greater than £500 million</u>.

5 Paragraph 3.7 is amended as follows:

3.7 **Acquisition costs** shall not be deferred for with-profits funds ~~to which the PRA realistic capital regime is being applied, either voluntarily or compulsorily~~ <u>within the scope of paragraph 3.1(b)</u>.

6 Paragraph 3.11 is amended as follows:

3.11 The established accounting treatment for long-term insurance business is to measure liabilities for policyholder benefits under the ~~**modified statutory solvency**~~ <u>**established long-term insurance business liability**</u> **basis** ~~**(MSSB)**~~. This FRS requires ~~those~~ with-profits funds ~~within the scope of the PRA realistic capital regime~~ to use the **realistic value of liabilities** as the basis for the estimated value of the liabilities to be included in the **financial statements**.

7 Paragraph 3.12 is amended as follows:

3.12 For with-profits funds ~~to which the PRA realistic capital regime is being applied, either voluntarily or compulsorily~~:

(a) liabilities to policyholders arising from with-profits business shall be stated at the amount of the realistic value of liabilities adjusted to exclude the shareholders' share of projected future **bonuses**;

(b) **reinsurance recoveries** that are recognised shall be measured on a basis that is consistent with the value of the policyholder liabilities to which the reinsurance applies;

(c) an amount may be recognised for the **present value** of future profits on **non-participating business** written in a with-profits fund if~~:~~

~~(i) the non-participating business is measured on a realistic basis for the purposes of the regulatory returns made under the PRA realistic capital regime;~~

~~(ii) the value is determined in accordance with the PRA regulations; and~~

~~(iii)~~ the determination of the realistic value of liabilities in that with-profits fund takes account, directly or indirectly, of this value;

(d) where a with-profits life fund has an interest in a subsidiary or associate and the determination of the realistic value of liabilities to with-profits policyholders takes account of a value of that interest at an amount in excess of the net amounts included in the entity's consolidated accounts, an amount may be recognised representing this excess; and

(e) adjustments to reflect the consequential tax effects of (a) to (d) above shall be made.

Adjustments from the ~~MSSB~~ established long-term insurance business liability basis necessary to meet the above requirements, including the recognition of an amount in accordance with paragraph 3.12(c) or 3.12(d), shall be included in **profit or loss**. An amount equal and opposite to the net amount of these adjustments shall be transferred to or from the **fund for future appropriations (FFA)** and also included in profit or loss.

[Draft] Amendments to Appendix I: Glossary

8 The following glossary terms and definitions, and footnote 8 (subsequent footnotes will be renumbered sequentially), are deleted:

~~**INSPRU**~~	~~See **Prudential sourcebook for insurers (INSPRU)**.~~
~~**Prudential sourcebook for insurers (INSPRU)**~~	~~The section of the **PRA** Handbook detailing the prudential rules for **insurers**, including capital requirements, credit, market and **liquidity risk**.~~
~~**realistic capital regime**~~	~~As set out in section 1.3 of INSPRU[8].~~
~~**statutory solvency basis**~~	~~The basis of determination of **insurance liabilities** in accordance with rule 1 of **INSPRU**.~~

~~8 References to the PRA's Prudential sourcebook for insurers, and to individual rules therein, are to the rules made on 1 April 2013 by the FCA and PRA Handbook Designation (General Modifications) Instrument 2013.~~

9 The following glossary terms and definitions are amended as follows (deleted text is struck through, inserted text is underlined):

equalisation provisions	As defined in the relevant regulatory framework ~~(eg **INSPRU**)~~.
gross premium method	A form of actuarial valuation of **liabilities** arising under long-term insurance contracts where the premiums brought into account are the full amounts receivable under the contract. The method includes explicit estimates of cash flows for: (a) premiums, adjusted for renewals and lapses; (b) expected claims and for **with-profits business** future regular but not occasional or terminal **bonuses**; (c) costs of maintaining contracts; and (d) future renewal expenses. Cash flows are discounted at the valuation interest rate. The methodology may be set out in the relevant regulatory framework. ~~For UK companies this is included in the **PRA** Handbook.~~ The discount rate is based on the expected return on the assets deemed to back the **liabilities** ~~as prescribed by the PRA Handbook. This may be further constrained by a maximum rate set by the PRA~~. This will be adjusted to reflect any further risks although, under this method, most of the key risks will be reflected in the modelling of the cash flows. For **linked business**, allowance may be made for the purchase of future units required by the contract terms and credit is taken for future charges permitted under those terms.
long-term fund	The fund or funds maintained by an undertaking in respect of its **long-term insurance business** ~~in accordance with the **PRA** rules~~.

~~**modified statutory solvency**~~ **established long-term insurance business liability basis** ~~**(MSSB)**~~	~~The~~ A basis for determining insurance liabilities which ~~is~~: (a) is appropriate to the entity; (b) is consistent from year to year without arbitrary changes; (c) is consistent with the method of valuing assets; (d) includes appropriate margins for adverse deviation of relevant factors; (e) recognises the distribution of profits in an appropriate way over the duration of each **insurance contract**; and (f) is in accordance with generally accepted actuarial practice. ~~the **statutory solvency basis**~~ The established long-term insurance liability basis shall include adjustments~~ed for the following items~~: (a) to defer new business **acquisition costs** incurred where the benefit of such costs will be obtained in subsequent **reporting periods**; and (b) to treat investment, resilience and similar reserves, or reserves held in respect of general contingencies or the specific contingency that the fund will be closed to new business, where such items are held in respect of **long-term insurance business** ~~within the **long-term fund**~~, as reserves rather than provisions. These are included, as appropriate, within shareholders' capital and reserves or the **fund for future appropriations (FFA)**. The basis applied by an entity shall be consistent with accounting policies applied in periods ending before 1 January 2016.
mutual	As defined in the **PRA** ~~Handbook~~ Rulebook.
net premium method	An actuarial valuation of **liabilities** arising under long-term **insurance contracts** where the premium brought into account at any valuation date is that which, on the valuation assumptions regarding interest, mortality and disability, will exactly provide for the benefits guaranteed. A variation of the net premium method involves **zillmerisation**. The detailed methodology for UK companies is included in regulations contained in the **PRA** ~~Handbook~~ Rulebook.
non-participating business	**Long-term insurance business** where **policyholders** are not entitled to share in the surplus of the relevant ~~**long-term fund**~~ long-term business.
principles and practices of financial management (PPFM)	The statement that the ~~**PRA**~~ Financial Conduct Authority requires each **with-profits** life fund to make available to its **policyholders** containing, inter alia, a description of the fund's investment management and bonus distribution policies.

realistic value of liabilities	~~That element~~ The sum of: (a) the with-profits benefits reserve; (b) the future policy-related **liabilities**; and (c) the realistic current **liabilities** of the fund, ~~amount defined by rule 1.3.40 in **INSPRU**~~, excluding current **liabilities** ~~falling within the definition in rule 1.3.190~~ that are recognised separately in the **statement of financial position**. The method for determining the realistic value of liabilities shall be consistent with that applied in periods ending before 1 January 2016.
regulatory capital resources	An entity's capital resources as calculated in accordance with the ~~capital resources table in **INSPRU**~~ regulatory framework.

[Draft] Amendments to Appendix IV: Note on legal requirements

10 The following paragraphs set out the [draft] amendments to Appendix IV: *Note on legal requirements* (deleted text is struck through, inserted text is underlined).

11 The table in paragraph A4.3 is amended as follows (only the line that is amended is shown here):

Legislation	**Overview of requirements**
~~Industrial and Provident Societies Act 1965~~ <u>Co-operative and Community Benefit Societies Act 2014</u>	The Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008 require every society that is an insurance undertaking to prepare its financial statements substantially as though it were a company registered under the Companies Act 2006.

[Draft] Amendments to Implementation Guidance to accompany FRS 103 *Insurance Contracts*

[Draft] Amendments to Implementation Guidance – Section 1 *Guidance for entities with long-term insurance business*

12 The following paragraphs set out the [draft] amendments to Implementation Guidance – Section 1 *Guidance for entities with long-term insurance business* (deleted text is struck through, inserted text is underlined).

13 Paragraph IG1.1 is amended as follows (footnote 1 is not amended and is not repeated here):

IG1.1 An entity may, but is not required to, adopt the requirements of paragraph 3.12 of **FRS 103** *Insurance Contracts* for UK[1] **with-profits business** that does not fall within the scope of ~~the~~ ~~**PRA realistic capital regime**~~ ~~or for which the PRA has granted a full waiver from compliance with this regime~~ paragraph 3.1(b) of FRS 103. If an entity changes its **accounting policy** for such with-profits business it shall only do so in accordance with paragraph 2.3 of FRS 103.

14 Paragraph IG1.2 is amended as follows:

IG1.2 The shareholders' share of projected future **bonuses** deducted in accordance with paragraph 3.12(a) of FRS 103 should be calculated as the value of future transfers to shareholders calculated using market consistent financial assumptions, and assuming that transfers take place at a level consistent with those assumptions ~~within the PRA realistic balance sheet~~. Where an explicit assumption is not required in order to calculate the **liabilities** ~~under the PRA's approach~~ then continuation of the current profit sharing arrangements should be assumed unless the firm has plans to change this approach. Non-economic projection assumptions should be consistent with those used elsewhere ~~in the realistic balance sheet~~. The amount deducted in accordance with this paragraph should be taken to the **fund for future appropriations (FFA)**. If shareholders transfers have been included as part of the ~~PRA~~ **realistic value of liabilities~~y~~** (or otherwise included in liabilities) then the amount of such transfers should be taken out of liabilities and included in the FFA, together with any related tax liability. If shareholders transfers have not been set up as part of the ~~PRA~~ realistic value of liabilities~~y~~ or elsewhere, no adjustment is required.

15 Paragraph IG1.3 is amended as follows and 'realistic value of liabilities' is no longer shown in bold type:

IG1.3 ~~Under the PRA realistic capital regime, a~~ In determining the realistic value of liabilities, a with-profits life fund may take account of ~~includes within assets~~ the value of future profits expected to arise from any **non-participating business** that forms part of the with-profits fund—sometimes referred to as the **value of in-force life assurance business (VIF)**. Excluding the VIF from the **statement of financial position** whilst recognising the realistic value of liabilities in full, and valuing the non-participating liabilities in the with-profits fund on a statutory basis, would give rise to an inconsistency in the fund's net assets. An entity is therefore permitted to recognise the VIF if that business has been taken into account in measuring the liability, in the circumstances of paragraph 3.12(c) of FRS 103, even though there is not a direct link between the value of the asset and the amount of the liabilities. Where there is not a direct link between the value of the business and the amount of realistic liabilities, but the value is taken into account in determining those liabilities, it is appropriate to recognise the total value of the business. Although not separately identifiable, any excess value over that included in realistic liabilities will be taken to the FFA.

16 Paragraph IG1.4 is amended as follows:

IG1.4 Paragraph 3.12(c) of FRS 103 permits an amount to be recognised for VIF on non-participating business written in a with-profits fund when~~: (i) the non-~~

~~participating business is measured on this basis for the purposes of the regulatory returns made under the PRA realistic capital regime; (ii) the VIF is calculated on the basis used in the PRA realistic capital regime; and (iii)~~ the determination of the realistic value of liabilities takes account of this value either directly or indirectly. Where with-profits **policyholders** are entitled to a share of the profits on non-participating business it would generally be expected that the determination of the realistic liabilities would take account, directly or indirectly, of the value of future profits on this business.

17 Paragraph IG1.6 is amended as follows:

IG1.6 The VIF recognised within assets ~~for regulatory purposes~~ as described in paragraph IG1.3~~2~~ is determined as the discounted value of future profits expected to arise from the policies, taking into account liabilities relating to the policies measured on the ~~a **statutory solvency**~~ **established long-term insurance business liability basis**. ~~When~~ This includes adjustments ~~are made onto a **modified statutory solvency basis (MSSB)**~~ for the purposes of the **financial statements** (for example, to adjust liabilities to exclude certain additional reserves included in the liabilities for regulatory purposes, or where future income included in the VIF covers **deferred acquisition costs** included in the ~~MSSB~~ statement of financial position).~~,~~ A~~a~~ corresponding adjustment to the value of in-force policies will need to be made in order to ensure a consistent valuation.

18 Paragraph IG1.7 is amended as follows:

IG1.7 Paragraph 3.12 of FRS 103 requires that the VIF asset ~~recognised~~ should be taken account of in determin~~ed~~ing ~~in accordance with~~ the realistic value of liabilities ~~capital regime requirements~~. Paragraph IG1.4 explains that the value calculated ~~under the realistic capital regime requirements~~ must be adjusted to ensure consistency where adjustments have been made onto the ~~MSSB~~ established long-term insurance business liability ~~measurement~~ basis in relation to non-participating contracts. The measurement of the VIF asset ~~recognised in accordance with the realistic capital regime~~ may take into account the release of capital requirements for non-participating business. It would not be appropriate to recognise this release of capital requirements within the VIF asset presented in the accounts because the ~~MSSB~~ established long-term insurance business liability basis liabilities do not include an allowance for capital. Therefore the amount of the VIF asset ~~determined for the purposes of the PRA realistic capital regime~~ should be adjusted accordingly.

19 Paragraph IG1.8 is amended as follows:

IG1.8 The profit recognition profile for non-participating contracts which do not satisfy FRS 103's definition of an insurance contract or contain a **discretionary participation feature** will be determined by the requirements of Sections 11, 12 and 23 of **FRS 102**. Where these contracts are written in a with-profits fund, paragraph IG1.4 will apply but the VIF recognised for such contracts ~~for the purposes of the PRA's realistic capital regime~~ should be adjusted to reflect the difference in the profit recognition bases between the basis used to determine the VIF ~~used in~~ taken into account in determining the realistic value of liabilities ~~capital regime~~ and the profit recognition profile determined by FRS 102.

20 Paragraph IG1.9 is amended as follows:

IG1.9 Paragraph 3.12(d) of FRS 103 permits that where a with-profits fund has an interest in a subsidiary or associate and the determination of ~~that is valued for PRA regulatory purposes~~ the realistic value of liabilities takes account of a value for that interest at an amount in excess of the net amounts that would be included in the entity's consolidated accounts, an amount may be recognised representing this excess if the determination of the realistic value of liabilities to with-profits policyholders takes account of this value. As explained in paragraph 3.15 of FRS 103 this situation could arise where the subsidiary or associate writes non-participating business and the value of the subsidiary or associate ~~recognised for PRA reporting purposes~~ incorporates the VIF of non-participating business written in the subsidiary or associate. The value of the subsidiary or associate recognised ~~for PRA reporting purposes~~ is reduced by the subsidiary's or associate's capital requirement ~~as noted in rule 1.3.33(3) of~~ ~~**INSPRU**~~. When preparing both consolidated and non-consolidated accounts, the excess value that may be recognised should therefore be taken as the excess before deduction of the subsidiary's or associate's capital requirement.

21 Paragraph IG1.10 is amended as follows:

IG1.10 Where the amounts on a 'realistic' basis determined in accordance with paragraph 3.12 of FRS 103 are different from the amounts on the established long-term insurance business liability basis ~~a MSSB~~, a corresponding amount is transferred to or from the FFA, so that there is no effect on **equity**. The potential shareholders' share corresponding to additional bonuses to policyholders that have been included in the policyholders' liability should be accounted for in the FFA. As a result, there will generally be no change in the profit for the **reporting period** except where the adjustments result in a negative balance on the FFA and the entity determines that this negative balance should result in a deduction from equity through **profit or loss**.

22 Paragraph IG1.11 is amended as follows:

IG1.11 Entities with with-profits business within the scope of paragraph 3.1(b) of FRS 103 ~~the PRA realistic capital regime~~ are required to measure the liability of that business in respect of **options and guarantees** relating to policyholders either at **fair value** or at an amount estimated using a **market-consistent stochastic model** ~~in accordance with PRA regulations~~.

23 Paragraph IG1.12 is amended as follows (footnote 2 is not amended and is not repeated here):

IG1.12 For all entities with **long-term insurance business**, the best basis for measuring policyholders' options and guarantees is one that includes their time value[2]. Any **deterministic approach** to valuation of a policy with a guarantee or optionality feature will generally fail to deal appropriately with the time value of the option. Therefore stochastic modelling techniques to evaluate the range of potential outcomes should be used unless a market value for the option is available. The ~~PRA realistic capital regime~~ regulatory framework includes a requirement to value options and guarantees on this basis. For the liabilities of businesses not falling within the scope of ~~the PRA realistic capital regime~~ paragraph 3.1(b) of FRS 103, entities are encouraged, but not required, to adopt these valuation techniques. Where options are not valued on this basis, additional disclosures are required; these are set out in paragraph IG3.14(c).

24 Paragraph IG1.13 is amended as follows:

IG1.13 In determining the value of guarantees and options under the ~~PRA realistic capital regime~~ regulatory framework, the entity will take into account under each scenario in the market-consistent stochastic modelling management actions it anticipates would be taken in response to variations in market variables (such as changing the balance of the investment portfolio between debt instruments and equity, varying the amount charged to policyholders, or varying its bonus policy) that will affect the amount payable under the guarantee or option. Such actions must be realistically capable of being implemented within the timescale assumed in the scenario analysis, and be consistent with the entity's published **principles and practices of financial management~~s~~ (PPFM)**.

[Draft] Amendments to Implementation Guidance – Section 2 *Guidance for entities with general insurance business or long-term insurance business*

25 The following paragraph sets out the [draft] amendments to Implementation Guidance – Section 2 *Guidance for entities with general insurance business or long-term insurance business* (deleted text is struck through, inserted text is underlined).

26 Paragraph IG2.28 is amended as follows:

IG2.28 Disclosure should be made where an equalisation reserve has been established in accordance with the **PRA** ~~Handbook~~ Rulebook. Where equalisation reserves are established, an entity should disclose the following in the notes to the financial statements:

(a) that the amounts provided are not liabilities because they are in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the reporting date;

(b) notwithstanding this, they are required by Schedule 3 to the Regulations to be included within technical provisions; and

(c) the impact of the equalisation reserves on **equity** and the effect of movements in the reserves on the profit or loss for the reporting period.

27 Paragraph IG2.42 is amended as follows:

IG2.42 The long-term business provision may be calculated on the **established long-term insurance liability basis** ~~used for reporting under PRA rules~~ subject to~~:~~

~~(a) reassessment of the provisions and reserves included in the statutory liabilities for solvency purposes to consider the extent to which they should be included in the long-term business provision. This will require the exclusion of the appropriate proportion of reserves (such as investment reserves, reserves to cover general contingencies and reserves to cover the specific contingency of the fund being closed to new business). Any amount in excess of the necessary provision should be disclosed in the financial statements as a reserve or in the **fund for future appropriations (FFA)** as appropriate; and~~

~~(b)~~ the reversal of any reduction in policyholder liabilities ~~in the regulatory returns~~ where these liabilities already implicitly take account of a pension fund surplus through future expense assumptions which reflect lower expected contributions.

28 Paragraph IG2.48 is amended as follows:

IG2.48 The net assets held to cover linked liabilities at the reporting date may differ from the technical provisions for linked liabilities. The reasons for any significant mismatching should be disclosed. ~~In practice this should apply only to overseas companies included in consolidated financial statements because of the requirements of rule 3.1.57 of **INSPRU**.~~

29 In paragraph IG2.50 the first occurrence of 'FFA' is replaced by 'fund for future appropriations (FFA)' in bold type.

30 Paragraph IG2.53 is amended as follows:

IG2.53 The investment return (which includes movements in realised and **unrealised investment gains and losses**) and related tax charges on assets representing reserves which are held within the **long-term fund** for solvency purposes under the PRA rules should be credited to the technical account for long-term business. Allocations may then be made as appropriate to the **non-technical account** in accordance with paragraphs IG2.65 and IG2.66 or to the FFA. When the regulatory framework does not require the entity to set up a long-term fund for its **long-term insurance business**, the entity shall make the allocations as appropriate between the technical and non-technical account and disclose the basis of its allocation in the notes to the financial statements.

31 The rubric before paragraph IG2.56 is amended as follows:

Paragraphs IG2.56 to IG2.58 ~~provide guidance for applying the requirements of paragraphs 2 and 3 of the instructions for completing Form 47 in the PRA rules. They~~ are only relevant to long-term insurance business.

32 Paragraph IG2.60 is amended as follows:

IG2.60 On consolidation, the profit or loss of any non-insurance entity belonging to the long-term ~~fund~~ business may be included directly in the technical account for long-term business. Where material, more detailed disclosure should be provided in the notes to the financial statements. Where an entity carrying on general insurance business is ~~owned by~~ an asset of the long-term ~~fund~~ business, the profit or loss of this business should be transferred from the non-technical account to the technical account for long-term business using new lines for this purpose.

The Accounting Council's Advice to the FRC to issue FRED 64 *Draft amendments to FRS 103 – Solvency II*

Introduction

1 This report provides an overview of the main issues that have been considered by the Accounting Council in advising the Financial Reporting Council (FRC) to issue FRED 64 *Draft amendments to FRS 103 Insurance Contracts – Solvency II*.

2 The FRC, in accordance with the *Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012* (SI 2012/1741), is a prescribed body for issuing accounting standards in the UK. The *Foreword to Accounting Standards* sets out the application of accounting standards in the Republic of Ireland.

3 In accordance with the *FRC Codes and Standards: procedures*, any proposal to issue, amend or withdraw a code or standard is put to the FRC Board with the full advice of the relevant Councils and/or the Codes & Standards Committee. Ordinarily, the FRC Board will only reject the advice put to it where:

(a) it is apparent that a significant group of stakeholders has not been adequately consulted;

(b) the necessary assessment of the impact of the proposal has not been completed, including an analysis of costs and benefits;

(c) insufficient consideration has been given to the timing or cost of implementation; or

(d) the cumulative impact of a number of proposals would make the adoption of an otherwise satisfactory proposal inappropriate.

4 The FRC has established the Accounting Council as the relevant Council to assist it in the setting of accounting standards.

Advice

5 The Accounting Council is advising the FRC to issue FRED 64 *Draft amendments to FRS 103 Insurance Contracts – Solvency II.*

6 The Accounting Council advises that these proposals will update FRS 103 *Insurance Contracts* for changes in the regulatory framework and ensure that established accounting policies can continue to be applied if an entity so chooses.

7 When these draft amendments are finalised the Accounting Council's Advice to the FRC in respect of these amendments will be added into FRS 103.

Background

8 When FRS 103 *Insurance Contracts* was issued in March 2014 the Accounting Council advised the FRC to review, in due course, whether or not consequential changes to FRS 103 would be required for the commencement of Solvency II.

9 As Solvency II is effective from 1 January 2016 this review is now being carried out and the Accounting Council advises that limited amendments are proposed to FRS 103 to reflect the changes in the regulatory regime. The Accounting Council does not advise making changes to FRS 103, other than those that are necessary as a result of the changes in the regulatory framework.

Draft amendments to FRS 103

10 FRS 103 makes a number of references to the PRA realistic capital regime, which will be replaced by Solvency II from 1 January 2016. In addition, it refers to the Prudential sourcebook for Insurers (INSPRU), which will be replaced from the same date. As these references will be out of date, amendments will be required to FRS 103.

11 In considering the amendments that are required, the Accounting Council advises that entities should be permitted to continue to apply established accounting practice in their financial statements, if they choose to do so. It notes that FRS 103 already includes the ability for an insurer to change its accounting policies for insurance contracts if it judges certain criteria are met, and therefore there is no need to introduce specific new accounting policies relating to Solvency II.

12 The Accounting Council notes that paragraph 3.1(b) of FRS 103 describes the circumstances in which the requirements for with-profits liabilities and related assets apply, which was based on those to which the PRA realistic capital regime applied. The Accounting Council considered the following two options for revising the description of the scope of these requirements:

(a) describe more fully the current scope; or

(b) describe the scope by reference to Solvency II.

13 The Accounting Council noted that describing the scope by reference to Solvency II may extend the application of the relevant requirements of FRS 103 to entities not previously within their scope. As the Accounting Council's aim was to limit the amount of change in accounting policies that would be required, the Accounting Council advises describing the current scope in paragraph 3.1(b) more fully, in order to avoid unintended consequences.

14 In developing a revised description for the established method of accounting for long-term insurance business (to replace the modified statutory solvency basis), the Accounting Council advises taking a principles-based approach to the definition. However, in order to make it clear that entities are not expected to change accounting policies unless they take advantage of the provisions of paragraph 2.3, the definitions of both the 'established long-term insurance liability basis' and the 'realistic value of liabilities' make it clear that these should be consistent with accounting policies applied in periods ending before 1 January 2016.

Effective date

15 The Accounting Council advises that the amendments to FRS 102 set out in this FRED should be effective for accounting periods ending after 1 January 2016. Early adoption should not be permitted because this is consistent with the effective date of the new regulatory framework.

Consultation stage impact assessment

Introduction

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.

Draft amendments to FRS 103

2 The draft amendments are intended to update FRS 103 *Insurance Contracts* for changes in the regulatory framework and ensure that established accounting policies can continue to be applied if an entity so chooses. As such, an entity can apply its judgement and choice over the extent to which the changes in the regulatory framework impact on its financial reporting. These draft amendments should not result in additional costs for entities.

3 The FRC notes that some changes in the regulatory framework may, nevertheless, have a direct impact on financial reporting, for example in relation to equalisation provisions. HM Treasury has carried out an impact assessment on the transposition of the Solvency II Directive into UK law and regulation and the FRC has not carried out any further impact assessment in relation to this.

Conclusion

4 The FRC believes that the draft amendments to FRS 103 are necessary given the changes in the regulatory framework.

This draft is issued by the Financial Reporting Council for comment. It should be noted that the draft may be modified in the light of comments received before being issued in final form.

For ease of handling, we prefer comments to be sent by e-mail to:

ukfrs@frc.org.uk

Comments may also be sent in hard copy to:

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

Comments should be despatched so as to be received no later than 28 February 2016.

The FRC's policy is to publish on its website all responses to formal consultations issued by the FRC unless the respondent explicitly requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. The FRC does not edit personal information (such as telephone numbers or postal or e-mail addresses) from submissions; therefore, only information that you wish to be published should be submitted.

The FRC aims to publish responses within 10 working days of receipt.

The FRC will publish a summary of the consultation responses, either as part of, or alongside, its final decision.

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