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Dear Jenny

**FINANCIAL REPORTING FOR INSURANCE CONTRACTS IN THE UK AND REPUBLIC OF IRELAND**

We welcome the opportunity to comment on the proposals in *FRED 49: Draft FRS 103 Insurance Contracts* and the associated *Exposure Draft of Implementation Guidance to accompany draft FRS 103 Insurance Contracts*.

We support the proposals to develop an FRS for insurance contracts based on the current version of IFRS 4. We welcome the fact that the FRC has taken account of comments on the 2012 discussion paper in developing FRS 103. In particular we support:

- Allowing entities, generally, to continue with their existing accounting policies for insurance contracts;
- Permitting improvements to accounting policies in respect of insurance contracts to be made in accordance to the same criteria that apply to insurers applying IFRS 4;
- Retaining elements of the ABI SORP and FRS 27 as implementation guidance to FRS 103; and
- Setting the mandatory effective date to accounting periods beginning on or after 1 January 2015 while allowing early adoption.

The Implementation Guidance is intended to provide guidance on applying elements of FRS 103, FRS 102 and Schedule 3 to the Regulations. It is stated that the guidance 'does not carry the authority of an accounting standard' and so, we assume that compliance with the guidance is not intended to be mandatory. However, its wording has largely been directly copied from the ABI SORP and FRS 27 and makes repeated uses of the word 'shall' which may be read as implying that compliance with the guidance is mandatory. The Implementation Guidance should therefore be redrafted to avoid the use of words such as 'shall' in order to be consistent with its intended status.

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Under current UK GAAP, accounting practice in respect of foreign currency denominated insurance business is to treat some balances arising out of insurance contracts (e.g. deferred acquisition costs or unearned premiums) as non-monetary items and others (e.g. outstanding claims) as monetary items for the purpose of applying FRS 23's requirements in respect of foreign currency translation. This treatment can give rise to accounting mismatches when the foreign currency assets backing the insurance contracts are all retranslated at year end exchange rates. We note that the IASB, in its recent insurance contracts exposure draft (paragraph 20), is proposing that all elements of an insurance contract should be treated as monetary items. We would welcome the FRC providing a similar clarification in FRS 103. Accounting for an insurance contract as a whole (including any associated deferred acquisition costs) as a monetary item would reduce complexity, eliminate certain accounting mismatches and maintain consistency with the approach being proposed under IFRS.

Paragraph 1.13 of draft FRS 103 confirms the withdrawal of FRS 27. The FRC should clarify what the implications of FRS 27's withdrawal are for the existing Memorandum of Understanding concerning FRS 27 'Life Assurance' (the memorandum) dated December 2004 entered into by the Accounting Standards Board, the Association of British Insurers (ABI) and certain members of the life assurance and bancassurance sectors. The memorandum (paragraph 10) deals with the implications of amendments to FRS 27 but does not deal with the implications of its withdrawal.

We agree that the FRC should revisit and revise FRS 103 once the IASB has issued its updated standard on insurance contracts and once the changes in the regulatory regime for insurers (Solvency II) have been finalised.

Our answers to your specific questions are included in the attached Appendix 1. Drafting comments are noted in Appendix 2.

Please contact Mike Vickery if you would like to discuss the contents of this letter.

Yours sincerely

PricewaterhouseCoopers LLP



### 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 previously commented that incorporating the current version of IFRS 4 into UK GAAP provides the most pragmatic and cost effective solution in the short to medium term. We also recommended that elements of the ABI SORP be retained as guidance to limit divergence in accounting for similar transactions.

We therefore support the introduction of FRS 103 on this basis and believe it achieves the stated aim of generally allowing entities to continue with their existing accounting policies for insurance contracts.

The drafting of some of the implementation guidance needs revisiting to ensure it does not imply that it is mandatory (refer to Appendix 2).

### 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?**

We support inclusion of the ‘improvement’ options from IFRS 4 into FRS 103. We do not believe it is appropriate for the constraints imposed by UK GAAP to be more stringent than those imposed on IFRS reporters. We believe it is appropriate to allow entities to make changes in accounting policy if the new policy makes the financial statements either more reliable and no less relevant, or more relevant and no less reliable.

While there might be some concerns of these options leading to diversity in practice, we note that upon adoption of IFRS, insurers in the UK have generally continued with their existing accounting policies. Further, we would not expect insurers to change their accounting policies often and any changes made will demonstrably need to be an improvement in order to meet the required criteria.

### 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 think that, by reference to the requirements in Section 3 and the Implementation Guidance, paragraph 1.5 makes it sufficiently clear that new entrants would apply the same requirements as existing preparers in setting a benchmark for their accounting policies while permitting the improvement option. We do not propose any changes.



#### 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 see no reason to deviate from IFRS 4's requirements in this regard. Including the paragraphs on future investment margins from IFRS 4 will allow entities to continue with their existing accounting policies on future investment margins. This is consistent with the objective of FRS 103 to allow entities to generally continue with their existing accounting policies.

We also agree with the rebuttable presumption as this is consistent with the improvement option in IFRS 4. Refer to our response to Question 2 above.

#### 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?**

For most UK insurers, we expect that this information would generally be available as it is required for regulatory returns. It is possible that the availability of data may vary in overseas subsidiaries depending on the local accounting and regulatory reporting requirements.

#### 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?**

The proposed implementation guidance goes significantly further than the minimum disclosures required by paragraph 34.31 of FRS 102 in respect of the extent of both quantitative and qualitative disclosures. The guidance is based on current FRS 27 requirements for insurers with long-term insurance business.

Conceptually we question whether it is appropriate for the Implementation Guidance to FRS 103 to set out, as guidance on the application of FRS 102, something that goes significantly further than the



minimum that FRS 102 requires. In general it would be more appropriate for guidance on applying FRS 102's requirements to be included as implementation guidance to FRS 102 and for such guidance to be aligned with the requirements of that standard.

However, we note that, in practice life insurers will currently be preparing disclosures based on FRS 27 and so compliance with the guidance is unlikely to impose a significant additional burden.

#### **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?**

If the FRC wishes to provide additional guidance on capital disclosures to entities other than those issuing insurance contracts then this should be done via a consultation on an amendment to FRS 102. We do not think that FRED 49 is the appropriate place to consult on such changes.

Further, we do not support the extension of guidance based on FRS 27 to other entities as:

- FRS 27 was drafted specifically in the context of life insurance business and its content may not be appropriate for other financial institutions; and
- FRS 27 goes significantly further than what FRS 102 requires and it would not be appropriate to imply, by way of guidance, that institutions that have not previously been required to give such disclosures, should go further than what is required in the main body of FRS 102.

Also, making disclosures that comply with FRS 27 would go further than what is currently required under full IFRS. In general we do not think that it is appropriate for new UK GAAP guidance to imply that disclosures over and above those required by full IFRS should be given, particularly where such disclosures were not required under 'old UK GAAP'.

#### **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 a need for such amendments.

#### **Question 9**

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

We concur that the effective date should be the same as for FRS 102 and that early application should be permitted.



Paragraph no.	Drafting comment
1.7	There is an inconsistency between this paragraph (which scopes some insurance contracts out of FRS 103) and paragraph 1.6 of FRS 102 (which states all insurance contracts are within FRS 103's scope). Para 1.6 of FRS 102 should be amended to be consistent with paragraph 1.7 of draft FRS 103.
A2.22 – A2.24	These paragraphs set out requirements in respect of investment contracts which do not fall within the scope of FRS 103. It is inappropriate for an Appendix to FRS 103 to set out requirements for contracts not within its scope. If these requirements are to be maintained they should be incorporated into the relevant section of FRS 102.
Implementation Guidance (throughout)	<p>The IG is stated to provide guidance only and does not carry the authority of an accounting standard. However, many of the paragraphs therein appear to mandate recognition or measurement and disclosure requirements in respect of insurance contracts (using words such as 'shall'). If it is intended that these paragraphs represent requirements then they should be included in the main body of FRS 103.</p> <p>Conversely, if it is not intended that these paragraphs represent requirements, then the wording of the paragraphs should be changed (for example by replacing 'shall' with 'may') to make it clear that it is not necessary to follow the guidance in order to comply with FRS 103.</p>
IG2.1 – IG2.8, IG2.9 – IG2.13, IG2.21 – IG2.27, IG 2.54 – IG 2.55	<p>The rubric to these paragraphs states that they provide guidance for applying the requirements of Sections 18, 21 and 23 of FRS 102:</p> <p>However, these sections of FRS 102 do not generally apply to contracts accounted for under FRS 103.</p> <p>If this guidance is to be included we believe it should be badged as providing guidance on the application of FRS 103's requirements as opposed to providing guidance on sections of FRS 102 that are not applicable.</p>