



May 2016

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# Impact Assessment and Feedback Statement

## Amendments to FRS 103 *Insurance Contracts*

### Solvency II

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## Amendments to FRS 103 *Insurance Contracts*

### Solvency II



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# 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.

## Amendments to FRS 103 – Solvency II

- 2 The amendments 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 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 amendments to FRS 103 are necessary given the changes in the regulatory framework.

## Feedback Statement

- 5 The purpose of this Feedback Statement is to summarise the comments received to FRED 64 *Draft amendments to FRS 103 – Solvency II*. FRED 64 was issued in December 2015 and the comment period closed on 28 February 2016.
- 6 The Corporate Reporting Council’s Advice to the FRC included with the amendments to FRS 103 *Insurance Contracts* sets out how the key comments have been taken into account in finalising those amendments.
- 7 The table below shows the number of respondents to the consultation and analyses the respondents by category.

**Table 1: Respondents by category**

	<b>No. of respondents</b>
Accountancy firms	6
Accounting bodies	1
	<hr/>
	7
	<hr/> <hr/>



## FRED 64 Draft amendments to FRS 103 – Solvency II

- 8 FRED 64 posed two questions, and the feedback and FRC response to it is summarised below.

### Question 1

Do you agree with amendments proposed to FRS 103 and the related Implementation Guidance? If not, why not?
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**Table 2: Respondents' views on Question 1**

	<b>No. of respondents</b>
Agreed	2
Agreed with reservations	5
Disagreed	–
	<hr/> <hr/> 7

- 9 Although respondents agreed that amendments to FRS 103 are required, and supported the intention that entities should generally be permitted to continue with their established accounting policies, two particular issues were raised in relation to the proposals. These issues are:
- (a) how the requirements should be applied by new entrants; and
  - (b) the proposed principles-based definitions of 'established long-term insurance business liability basis' and 'realistic value of liabilities'.

### ***New entrants***

- 10 Paragraph 1.5 of FRS 103 includes the requirement that a new entrant, setting accounting policies in relation to insurance contracts, or other financial instruments with discretionary participation features, for the first time, shall first consider the requirements of Section 3 *Recognition and Measurement: Requirements for entities with long-term insurance business*, the Regulations and any relevant parts of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, as a means of establishing current practice as a benchmark before assessing whether to set accounting policies that differ from those benchmark policies (in accordance with paragraph 2.3).
- 11 Three respondents suggested that, as Section 3 is based on the old regulatory regime, this requirement no longer operates effectively as new entrants will effectively have to familiarise themselves with, and assess, a regulatory regime that no longer applies, and will never have applied to them, before deciding which accounting policies to apply. It was also noted that the requirements of Section 3 may no longer be 'current practice' as some entities are likely to 'improve' their accounting policies to reflect Solvency II. A suggested solution was the deletion of Section 3, which would not impact on existing insurers because their accounting policies have already been established.

### *FRC response*

- 12 The FRC considered the framework that should apply to new entrants, and noted that current practice is likely to be evolving. The FRC considers that a benchmark should apply to new entrants, in order to maintain a consistent starting point for insurers selecting their accounting policies for insurance contracts for the first time and therefore has not deleted Section 3 of FRS 103. However, recognising the concerns raised by the respondents, the FRC has amended paragraph 1.5 of FRS 103 in order to provide two alternative

benchmarks for new entrants. One benchmark is the requirements of Section 3 of FRS 102, and the other is to establish policies that are consistent with the relevant requirements of the Solvency II Directive, subject to any appropriate adjustments.

### ***Revised definitions***

- 13 Five respondents commented on the proposed principles-based definitions of 'established long-term insurance business liability basis' and 'realistic value of liabilities'. They noted that the definitions were drafted broadly and used undefined terms, therefore more guidance would be needed to ensure that entities applied the definitions consistently, and that new entrants may apply the definitions differently from established insurers. Some respondents suggested that retaining the current definitions, but clarifying that the references to INSPRU were to INSPRU as at 31 December 2015, would be a preferable solution.

### ***FRC response***

- 14 The FRC did not intend the changes to FRS 103 to result in changes in accounting practice and therefore in practical terms entities would need to refer to INSPRU as at 31 December 2015 in order to continue with their existing accounting policies. Therefore the FRC has retained the existing definitions of the 'modified statutory solvency basis' and the 'realistic value of liabilities', and amended them to refer to INSPRU as at 31 December 2015. The PRA Rulebook can be accessed 'as at' a certain date, and therefore this is a practical solution.

### ***Other issues raised***

- 15 Respondents raised a number of additional issues, mainly relating to drafting. In addition, clarity was requested in relation to references to the regulatory framework.

### ***FRC response***

- 16 A number of amendments have been made to the proposals to reflect the comments received. In addition, the FRC notes that the Corporate Reporting Council's advice clarifies that when FRS 103 refers to a requirement of the regulatory framework, an entity shall apply the requirements of the regulatory framework that applies to it. This may result in differences in accounting between some entities.

## 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.

- 17 Respondents raised a number of additional issues. These included a suggestion that FRS 103 specifically recognise that insurers might consider ‘improving’ their accounting policies by reference to Solvency II, and that the term ‘long-term fund’ should no longer be defined as Solvency II does not require them to be maintained.

### *FRC response*

- 18 A number of amendments have been made to the proposals to reflect the comments received. In particular:
- (a) paragraph 2.3A has been inserted to note that one basis for changing accounting policies might be to enable them to be more consistent with the relevant rules under the Solvency II Directive, subject to any appropriate adjustments; and
  - (b) the definition of long-term fund has been deleted.



**Financial Reporting Council**

8th Floor  
125 London Wall  
London  
EC2Y 5AS

+44 (0)20 7492 2300

[www.frc.org.uk](http://www.frc.org.uk)