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Insurance Accounting Standards Board
30 Canon Street
London, EC4M 6XH
United Kingdom

Comments on the Discussion Paper - *Preliminary Views on Insurance Contracts*

IAK(The Institute of Actuaries of Korea) is pleased to comment on the Discussion Paper- *Preliminary Views on Insurance Contracts*.

IAK has a significant interest in the development of these standards. We would be happy to further discuss any of our comments with you.

Yours sincerely

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RESPONSE TO THE DISCUSSION PAPER

Q1. Should the recognition and derecognition requirements for insurance contracts be consistent with those in IAS 39 for financial instruments? Why or why not?

A1. The recognition and derecognition requirements for insurance contracts should be consistent with those in IAS 39 for financial instruments. But peculiar characteristics of insurance contracts should be considered.

Q2. Should an insurer measure all its insurance liabilities using the following three building blocks:

(a) explicit, unbiased, market-consistent, probability-weighted and current estimates of the contractual cash flows,

(b) current market discount rates that adjust the estimated future cash flows for the time value of money, and

(c) an explicit and unbiased estimate of the margin that market participants require for bearing risk (a risk margin) and for providing other services, if any (a service margin)?

If not, what approach do you propose, and why?

A2. We agree that an insurer should measure all its insurance liabilities using the three building blocks.

Q3. Is the draft guidance on cash flows (appendix E) and risk margins (appendix F) at the right level of detail? Should any of that guidance be modified, deleted or extended? Why or why not?

A3. We think that the draft guidance on cash flows and risk margins in the Discussion Paper is at the appropriate level of detail.

However, if practical examples are provided, it will help us to apply the guidance.

Q4. What role should the actual premium charged by the insurer play in the calibration of margins, and why? Please say which of the following alternatives you support.

(a) The insurer should calibrate the margin directly to the actual premium (less relevant acquisition costs), subject to a liability adequacy test. As a result, an insurer should never recognise a profit at the inception of an insurance contract.

(b) There should be a rebuttable presumption that the margin implied by the actual premium (less relevant acquisition costs) is consistent with the margin that market participants require. If you prefer this approach, what evidence should be needed to rebut the presumption?

(c) The premium (less relevant acquisition costs) may provide evidence of the margin that market participants would require, but has no higher status than other possible evidence. In most cases, insurance contracts are expected to provide a margin consistent with the requirements of market participants. Therefore, if a significant profit or loss appears to arise at inception, further investigation is needed. Nevertheless, if the insurer concludes, after further investigation, that the estimated market price for risk and service differs from the price implied by the premiums that it charges, the insurer would recognise a profit or loss at inception.

(d) Other (please specify).

A4. We support alternative (c).

From the point of view that all insurance liabilities should be measured the amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity, we think that it is relevant to apply same approach for both new and existing insurance contract.

Therefore it would be appropriate and consistent that the insurer would recognise a profit or loss at inception if there is sufficient evidence that the estimated market price for risk and service differs from the price implied by the premiums that it charges,

Q5. This paper proposes that the measurement attribute for insurance liabilities should be the amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity. The paper labels that measurement attribute 'current exit value'.
(a) Is that measurement attribute appropriate for insurance liabilities? Why or why not? If not, which measurement attribute do you favour, and why?
(b) Is 'current exit value' the best label for that measurement attribute? Why or why not?

A5.

(a) We agree that the measurement attribute for insurance liabilities should be the amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity.

(b) We think that there should be more prudence to use the label of current exit value. Defining fair value more clearly should be preceded through Fair Value Measurements (FVM) project. The definition of fair value (in the FVM project) must be compared with current exit value (in the project on insurance contracts). If there are differences between them, the differences should be identified and clarified. After that, a proper label for the measurement attribute for insurance liabilities is to be decided.

Q6. In this paper, beneficial policyholder behaviour refers to a policyholder's exercise of a contractual option in a way that generates net economic benefits for the insurer. For expected future cash flows resulting from beneficial policyholder behaviour, should an insurer:
(a) incorporate them in the current exit value of a separately recognised customer relationship asset? Why or why not?
(b) incorporate them, as a reduction, in the current exit value of insurance liabilities? Why or why not?
(c) not recognise them? Why or why not?

A6. We support alternative (b).

It is consistent and appropriate to incorporate future cash flows which are expected from beneficial policyholder behavior in current exit value. It may cause unnecessary cost as well as no practical profit to measure future cash flows which are expected from beneficial policyholder behavior separately as customer relationship asset.

Q7. A list follows of possible criteria to determine which cash flows an insurer should recognise relating to beneficial policyholder behaviour. Which criterion should the Board adopt, and why?

(a) Cash flows resulting from payments that policy holders must make to retain a right to guaranteed insurability (less additional benefit payments that result from those premiums). The Board favours this criterion, and defines guaranteed insurability as a right that permits continued coverage without reconfirmation of the policyholder's risk profile and at a price that is contractually constrained.

(b) All cash flows that arise from existing contracts, regardless of whether the insurer can enforce those cash flows. If you favour this criterion, how would you distinguish existing contracts from new contracts?

(c) All cash flows that arise from those terms of existing contracts that have commercial substance (ie have a discernible effect on the economics of the contract by significantly modifying the risk, amount or timing of the cash flows).

(d) Cash flows resulting from payments that policyholders must make to retain a right to any guarantee that compels the insurer to stand ready, at a price that is contractually constrained, (i) to bear insurance risk or financial risk, or (ii) to provide other services. This criterion relates to all contractual guarantees, whereas the criterion described in (a) relates only to insurance risk.

(e) No cash flows that result from beneficial policy holder behaviour.

(f) Other (please specify).

A7. We agree with alternative (c).

We argue that it is appropriate to consider all cash flows with commercial substance to measure insurance liabilities as current exit value. It could distort consequences or be impossible in practice to reflect cash flows related only with insurance risk.

Q8. Should an insurer recognise acquisition costs as an expense when incurred? Why or why not?

A8. We think that an insurer should recognise acquisition costs as an expense when incurred. We believe that it would be appropriate and consistent that we should consider economically significant all future cash flows in measuring the insurance liabilities as current exit value. It would be unnecessary to dispute the definition of acquisition costs.

Q9. Do you have any comments on the treatment of insurance contracts acquired in a business combination or portfolio transfer?

A9. Since the principle of measuring the insurance liabilities as the current exit value, it is not appropriate that deducted current exit value from the fair value of company, which acquired insurance contract, is regarded as intangible asset. That is, it is proper that the difference is recognized as the profit or loss.

This is not necessary to treat differently from existing insurance contracts, which is the same logic as the answer for Q4, and is important to keep consistency.

Q10. Do you have any comments on the measurement of assets held to back insurance liabilities?

A10. In order to eliminate the accounting mismatches, the assets held to back insurance liabilities assets should be measured on the base of the same principle that the insurance liabilities is measured as the current exit value.

Q11. Should risk margins:

(a) be determined for a portfolio of insurance contracts? Why or why not? if yes, should the portfolio be defined as in IFRS 4 (a portfolio of contracts that are subject to broadly similar risks and managed together as a single portfolio)? Why or why not?

(b) reflect the benefits of diversification between (and negative correlation between) portfolios? Why or why not?

A11.

(a) It is appropriate and consistent to measure risk margin with aggregate for a portfolio rather than individual contracts in aspects of adverse selection and random fluctuation risk and so on. It is also appropriate in regard to definition of portfolio.

(b) It is not appropriate to reflect the benefits of diversification and negative correlation between portfolios to risk margin. In aspects of principles to measure insurance liabilities as current exit value, the benefits of diversification and negative correlation between portfolios do not have an effect on risk property of insurance contracts because it is regarded as Entity-specific.

We argue that the measurement of insurance liabilities(eg term life insurance and annuities) should be measured on the base of the objective standard regardless of Entity-specific.

Q12.

(a) Should a cedant measure reinsurance assets at current exit value? Why or why not?

(b) Do you agree that the consequences of measuring reinsurance assets at current exit value include the following? Why or why not?

(i) A risk margin typically increases the measurement of the reinsurance asset, and equals the risk margin for the corresponding part of the underlying insurance contract.

(ii) An expected loss model would be used for defaults and disputes, not the incurred loss model required by IFRS 4 and IAS 39.

(iii) If the cedant has a contractual right to obtain reinsurance for contracts that it has not yet issued, the current exit value of the cedant's reinsurance asset includes the current exit value of that right. However, the current exit value of that contractual right is not likely to be material if it relates to insurance contracts that will be priced at current exit value.

A12.

(a) It is thought that the current exit value is appropriate in the measurement of reinsurance contracts in the same as the measurement of original contracts. There is one thing to be considered that there could be no consistency between assets of insurance contracts of non-insurer and assets of reinsurance.

Therefore, it is appropriate that the cash flows of reinsurance contracts are to be considered in measuring that of the original contracts.

That is, when you measure an insurance liability with estimating future cash flows of the original contracts rather than separately recognize current exit value as a reinsurance asset, it is appropriate to reflect future cash flows of reinsurance, which can be negative.

(b-i) We agree that a risk margin typically increases the value of the reinsurance asset, and equals the risk margin for the corresponding part of the underlying insurance contract.

(b-ii) We agree that an expected loss model is appropriate for the test for impairment of reinsurance assets. In other words, the current exit value of the

reinsurance asset should incorporates a reduction for the expected(probability-weighted) present value of losses from default or disputes, with a further reduction for the margin that market participants would require for bearing the risk that defaults or disputes exceed expected value.

(b-iii) We agree with the IASB's preliminary view.

If the cedant has a contractual right to obtain reinsurance for contracts that it has not yet issued, it is reasonable that the current exit value of the cedant's reinsurance asset includes the current exit value of that right. Of course there are some doubts of the possibility if the value of contractual right can be measured in a practice.

We think that the current exit value of that contractual right is not likely to be material if it relates to insurance contracts that will be priced at current exit value.

Q13. If an insurance contract contains deposit or service components, should an insurer unbundle them? Why or why not?

A13. It is very complex to separately unbundle insurance component and deposit component of insurance contract and the cost of unbundling may exceed its benefits. Unbundling may introduce excessive discretions to determine deposit components out of an insurance contract. Also unbundling may not be applicable to some contracts. Therefore it would be reasonable to apply Phase II to all components of insurance contracts.

Q14.

(a) Is the current exit value of a liability the price for a transfer that neither improves nor impairs its credit characteristics? Why or why not?

(b) Should the measurement of an insurance liability reflect (i) its credit characteristics at inception and (ii) subsequent changes in their effect? Why or why not?

A14.

(a) No opinion.

(b) If financial liabilities within the scope of IAS 39 should be measured by reflecting credit characteristics, we may reflect credit characteristics on insurance liabilities because there is no reason to measure insurance liabilities differently from financial liabilities.

However, we support the argument that there is no need to consider the credit characteristics in measurement of insurance liabilities.

Q15. Appendix B identifies some inconsistencies between the proposed treatment of insurance liabilities and the existing treatment under IAS 39 of financial liabilities. Should the Board consider changing the treatment of some or all financial liabilities to avoid those inconsistencies? If so, what changes should the Board consider, and why?

A15. There could be some differences due to peculiar characteristics of insurance contract. To eliminate the inconsistencies between accounting treatment of insurance liabilities and that of financial liabilities, any adjustment is not required.

Q16.

(a) For participating contracts, should the cash flows for each scenario incorporate an unbiased estimate of the policyholder dividends payable in that scenario to satisfy a legal or constructive obligation that exists at the reporting date? Why or why not?

(b) An exposure draft of June 2005 proposed amendments to IAS 37 (see paragraphs 247–53 of this paper). Do those proposals give enough guidance for an insurer to determine when a participating contract gives rise to a legal or constructive obligation to pay policyholder dividends?

A16.

(a) For participating contracts, we think that the cash flows for each scenario should incorporate an unbiased estimate of the policyholder dividends payable in that scenario to satisfy a legal or constructive obligation that exists at the reporting date.

But we think it would be proper that 'established pattern of past practice' among practices of constructive obligation stated in Paragraph 248 of Discussion Paper should be excluded because of the arbitrary which insurers divide differently from 'established pattern of past practice'. That is, practices of constructive obligation should be only applied to the case that the 'insurer has indicated to other parties that it will accept certain responsibilities'.

(b) We think that the guidance is appropriate.

Q17. Should the Board do some or all of the following to eliminate accounting mismatches that could arise for unit-linked contracts? Why or why not? **(a) Permit or require insurers to recognise treasury shares as an asset if they are held to back a unit-linked liability (even though they do not meet the Framework's definition of an asset).** **(b) Permit or require insurers to recognise internally generated goodwill of a subsidiary if the investment in that subsidiary is held to back a unit-linked liability (even though IFRSs prohibit the recognition of internally generated goodwill in all other cases).** **(c) Permit or require insurers to measure assets at fair value through profit or loss if they are held to back a unit-linked liability (even if IFRSs do not permit that treatment for identical assets held for another purpose).** **(d) Exclude from the current exit value of a unit-linked liability any differences between the carrying amount of the assets held to back that liability and their fair value (even though some view this as conflicting with the definition of current exit value).**

A17.

(a) If insurers acquire treasury shares in order to back a unit-linked liability, in case it's not forbidden by the law or regulation, it would be reasonable to recognize the treasury shares as an asset and measure them at fair value to eliminate accounting mismatch.

(b) It is appropriate that insurers should recognise internally generated goodwill of a subsidiary as an asset with its fair value if the investment in that subsidiary is held to back a unit-linked liability to eliminate accounting mismatch.

(c) Insurers should measure assets at fair value through profit or loss on the income statement if they are held to back a unit-linked liability to eliminate accounting mismatch.

(d) If the requirements of other IFRSs can't be changed, it would be meaningful alternative to exclude from the current exit value of a unit-linked liability any differences between the carrying amount of the assets held to back that liability and their fair value.

But as we mentioned at (c), we think that insurers should measure assets at fair value through profit or loss on the income statement if they are held to back a unit-linked liability to eliminate accounting mismatch.

Q18. Should an insurer present premiums as revenue or as deposits? Why?

A18. Answered in Q13, unbundling of the insurance component and deposit component may be very complex and costly. Unbundling may introduce excessive discretions to determine deposit component out of an insurance contract. Also unbundling may not be applicable to some contracts. Because of the all reasons above, the total premium would be better to express as the revenue.

Q19. Which items of income and expense should an insurer present separately on the face of its income statement? Why?

A19. The expression by each driver of all changes in carrying amounts of the insurance liabilities may cause confusion to users. Thus IASB should provide practical guidance considering information comparability, materiality, quantitative and qualitative improvement of disclose and so on.

Q20. Should the income statement include all income and expense arising from changes in insurance liabilities? Why or why not?

A20. If the volatility from measurement of insurance liabilities is presented on the income statement as the profit or loss, it may confuse users and reduce the reliability of financial statements generated in insurance industry.

Therefore, we can consider following alternatives;

① Profit or loss from measurement of the insurance liabilities can be presented as capital adjustments(other comprehensive incomes or losses) with detail disclosure in footnotes.

② Measure the insurance liabilities only to disclose details through the footnotes to users without reflection to the financial statements.