FK | Finanssialan Keskusliitto
FC | Finansbranschens Centralförbund
FFI | Federation of Finnish Financial Services

25.10.2013

Kahola Marja-Liisa

Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London
EC4M6XH

25 October 2013

Dear Mr Hoogervorst,

The Federation of Finnish Financial Services would like to thank the IASB for the revised Exposure Draft: Insurance Contracts ("ED") and the opportunity to comment on the ED. We highly appreciate the efforts the IASB has done to finalise the principle-based standard.

REVISED EXPOSURE DRAFT: INSURANCE CONTRACTS

The revised proposals in the ED and in the related IFRS 9 are important because they should address the linkage between assets and liabilities in reporting performance. Progress has been made in the ED e.g. by introducing Other Comprehensive Income ("OCI") for changes in market interest rates, the unlocking of contractual service margin, adopting the "earned premium approach" and the revised transition principles. However, we think some important changes are still needed.

We support the Board's objective to provide transparent current measurement of insurance liabilities in the balance sheet. However, we are concerned about the following significant issues:

- There is a mandatory requirement to reflect all changes in discount rates for liabilities in OCI, whereas IFRS 9 restricts OCI to simple debt instruments. To avoid accounting mismatches OCI must not be mandatory. We propose that the IASB develops a comprehensive and appropriate approach to fair value through P&L ("FVPL") and to fair value through OCI ("FVOCI") measurement for both assets and insurance liabilities.
- The "mirroring approach" is quite complex and should therefore be improved to make sure it applies to all participating contracts and contracts with discretionary participating features.

We provide our detailed comments to questions 2, 3 and 4 of Appendix 1 below.

Appendix 1

Question 2 - CONTRACTS THAT REQUIRE THE ENTITY TO HOLD UNDERLYING ITEMS AND SPECIFY A LINK TO RETURNS ON THOSE UNDERLYING ITEMS

The purpose of the proposed "mirroring approach" is to remove accounting mismatches, and is as such supportable. The proposal is quite complex, which is why we appreciate the efforts to develop an alternative approach. However, if an alternative approach is developed, it is important that it applies to all participating contracts and contracts with

Finanssialan Keskusliitto
Bulevardi 28, 00120 Helsinki
Puh: 020 793 4200
Faksi: 020 793 4202
etunimi.sukunimi@fkl.fi
www.fkl.fi

Finansbranschens Centralförbund
Bulevarden 28, 00120 Helsingfors, Finland
Tel: +358 20 793 4200
Fax: +358 20 793 4202
fornamn.efternamn@fkl.fi

Federation of Finnish Financial Services
Bulevardi 28, 00120 Helsinki, Finland
Tel: +358 20 793 4200
Fax: +358 20 793 4202
firstname.lastname@fkl.fi

discretionary participation features. For example insurance contracts of Finnish insurance companies differ from insurance contracts in Germany or UK in that policyholder benefits do not directly vary or at most vary weakly with the returns of investments.

Question 3 - PRESENTATION OF INSURANCE CONTRACT REVENUE AND EXPENSES

We agree with the ED proposal that financial statements would provide relevant information that faithfully represents the entity's financial performance, if an entity presents for all insurance contracts, in profit or loss, insurance contract revenue and expenses. We support the earned premium revenue approach in the ED for the presentation because it is consistent with the commonly understood measurements of revenue and expense and the premium revenue number is an important metric for users. The Finnish insurance companies are able to compute the revenue with reasonable effort. We do not think additional application guidance will be necessary.

Question 4 - INTEREST EXPENSE IN PROFIT OR LOSS

We welcome the Board's decision to introduce an OCI model in IFRS 4 and to reintroduce FVOCI in IFRS 9, as we consider OCI a vital element to adequately reflect the performance of certain insurance products in a current measurement environment. However, we think that **FVOCI should not be mandatory and FVPL application should also be available in order to present the changes in the insurance liability that arise from changes in the discount rate in P&L.**

Because of this starting point the following response addresses only the need for FVPL, and should not be understood in any way to oppose FVOCI presentation. In Finland insurance companies need both presentations.

We believe the IFRS 4 standard should reflect the business model a company has chosen. It would therefore be important for the insurance liability accounting model to be suitable for both FVOCI and FVPL environments. The ability to recognise changes at FVOCI is important for insurance companies that have business models where insurance contracts are typically managed at a more aggregate level together with associated assets. However, there is also a wide range of other business and asset liability models which the rejection of the option in BC142-BC145 has not taken into account. Finnish insurance companies do not associate insurance liabilities and assets; there is not even allocation of assets between liabilities and equity. Therefore, the complexity the IASB assumes about the association between the assets and the liabilities does not exist. On the contrary, in many Finnish insurance companies the mandatory FVOCI would lead to unduly complex presentation with accounting mismatches in both P&L and OCI, and moreover, economic mismatches would be suppressed or distorted. This presentation would neither be useful nor faithful, and would cause costs which cannot be justified.

In the ED of IFRS 9 Classification and Measurement and IAS 39 standard, the IASB has aimed at finding a proper presentation for financial assets and financial liabilities that would take into account the purposes for which they are held.

> If a company uses bonds to manage cash flows of the insurance liability and assets, the duration mismatch is reported in OCI. But if a company manages

duration mismatch with derivatives, the duration mismatch is scattered between P&L and OCI. If the standard has a mandatory requirement to use OCI for the liabilities, it would penalize the use of derivatives and could discourage their use even though it would be good risk management.

Finnish insurance companies have a lot of equity holdings in their balance sheet (39% of investments of life-insurers and 33% of investments of non-life insurers were equity holdings at the end of 2012). Some companies actively trade their assets. It is not possible for these companies to get good accounting matching in P&L and OCI even though they classify their assets to be measured at FVOCI.

When sales and purchases of assets occur, the difference between holding and realized value is recycled from OCI to P&L, while there is no equivalent recycling for liabilities, as recycling occurs only when liabilities are derecognised. Also the fact that many long-term contracts have regular premiums would cause accounting mismatch to the mandatory OCI, because the effect of the premiums is recognised with the discount rate at inception but the assets purchased by the received premium – if measured by FVOCI – are recognised with the discount rate at the date of the purchase.

We are concerned about the comparability and transparency of the accounts if the proposed IFRS 4 standard is not changed. If the IFRS 4 and IFRS 9 are applied consistently, the presentation will be useful. If they are applied inconsistently or FVOCI is mandatory, total liability changes are comparable between companies but the disaggregated results in P&L and OCI will be useless.

We share the Board's objective of reporting the underwriting performance. However, there are different views on what the underwriting performance is. For some entities the investment result is an integral part of the result. The presentation of the ED is not the only possible one. The performance can be reported also in the notes as currently done by some companies.

In summary, even though we understand the Board's reluctance to adopt options, we believe the mandatory presentation does not give useful, relevant and faithful presentation. The most useful, relevant and faithful presentation is achieved if companies can choose to present changes in insurance contract liabilities on a basis consistent with that applied to the corresponding asset values, and that the choice should be based on the business model that underpins a company's asset/liability management.

The Finnish non-life insurers are deeply concerned about the requirement that in P/L a calculation of interest expense of the claim reserves should be recognised using the interest rate at contract inception. The insurers manage and monitor their business by claim year, and do not have contract date or discount rates related to contract date in claim systems. They believe that using contract inception date rates does not create valuable, increased information on their financial performance. Furthermore, using discount rates at inception would require extensive changes in the IT systems.

Thank you very much for the opportunity to comment on the ED. If you have any questions on our response, we will be happy to answer them.

FEDERATION OF FINNISH FINANCIAL SERVICES

Esko Kivisaari

Deputy Managing Director