asian-oceanian standard-setters group

30 November 2010

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Re: AOSSG comments on IASB Exposure Draft ED/2010/8: Insurance Contracts

Dear Sir David:

The Asian-Oceanian Standard-Setters (AOSSG) appreciates the opportunity to provide comments to the IASB on the Exposure Draft(ED) of IFRS 4.

The AOSSG currently has 24 member standard-setters from the Asian-Oceanian region: Australia, Brunei, Cambodia, China, Dubai, Hong Kong, India, Indonesia, Iraq, Japan, Kazakhstan, Korea, Macao, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Philippines, Saudi Arabia, Singapore, Sri Lanka, Thailand, and Uzbekistan.

To the extent feasible, this submission to the IASB reflects in broad terms the collective views of AOSSG members. Individual member standard setters may also choose to make separate submissions that agree or disagree with aspects of this submission.

The objective of AOSSG is to enhance the input to the IASB from the Asian-Oceanian region and not to prevent the IASB from receiving the variety of views that individual member standard setters may hold. We attach the separate comments on certain Islamic finance impacts of the proposals in the ED from the Islamic Finance Working Group of AOSSG (see Appendix B).

This submission has been reviewed by members of the AOSSG after having been initially developed through the AOSSG's Insurance Contract Working Group. The AOSSG has not received any substantive contrary views from our constituents.

The AOSSG acknowledges that the proposed measurement model in this ED simplifies the various measurement methods applied in insurance accounting and it will enhance the comparability of the financial statements.

However, the following aspects need to be considered:
- Maintaining consistency among standards
- Fluctuation in profit and loss
- Supplementary guidance for Comparability

Maintaining consistency among standards

The development of discount rate application principle which can be applied consistently for all IFRSs is necessary. Currently, the IASB does not provide consistent standards for individual standard's discount rate application.

For example, there are differences between the IAS 19 (defined benefit obligations) and the ED (insurance contract). Even though the defined benefit obligations and insurance contract liability have similar characteristics, but the applied discount rates that are applied to these two standards have differences.

Therefore, it is necessary for the IASB to clearly provide the rationale for the differences between standards on discount rate application. For long-term purposes, developing discount rate application principle such as US GAAP's SFAC 7 (Statement of Financial Accounting Concept No.7) and including it in the conceptual framework are needed.

Fluctuation in profit and loss

According to the proposal of this ED, recognizing all the gains and losses from subsequent measurement in current profit and loss, may increase the volatility of profit and loss, thus we express our concern on this matter. Moreover, we suggest the method to recognise the change in insurance contract liability due to the assumed change in discount rate, not directly related with the insurer's performances, in OCI to be considered as an alternative.

Supplementary guidance for Comparability

Although IFRS lays emphasis on principle based approach, and prefers not to suggest a specific guidance. This may lead insurers to choose various methods to value their insurance contract liabilities, which may in turn result in a variation in the level of presentation and estimation.

Hence, this could contradict with the ED's original objective of unifying the various accounting practices applied by different insurers for the comparability of a financial statement.

The components that require specific guidelines in ED are followed below:

- **Illiquidity risk assessment** for determining the discount rate reflecting the characteristics of an insurance contract liability.

- **The range of the specific assets** of which performance affects the cash flows of an insurance contract.

- **The proximity of the components of a contract** to the insurance coverage that allows them to be unbundled since there is no close relevance.

- **The confidence level** on measuring risk adjustment.

- **The level of possible scenarios** that can take place in estimating the expected probability-weighted present value of contingent cash flows of an insurance contract.

If the individual insurers assess the aforementioned components and recognise insurance contract liability and related profit and loss, the comparability of financial information between insurers may deteriorate. Therefore, we request more detailed guidance to improve the comparability.

In addition, in order to enhance understanding of the corresponding standards, we suggest adding basic examples or presenting education material similar to the fair value measurement. These kinds of examples or education materials will increase the understandability of the insurance accounting standards.

The AOSSG views, as summarised above, are explained in more detail in Appendix A. If you have any queries regarding any matters in this submission, please contact us.

Sincerely,

Ikuo Nishikawa	Dr. Chungwoo Suh
Chairman of the AOSSG	Leader of the AOSSG Insurance Contract Working Group

Appendix A

Question 1- Relevant information for users
Do you think that the proposed measurement model will produce relevant information that will help users of an insurer's financial statement to make economic decisions? Why or why not? If not, what changes do you recommend and why?

AOSSG members appreciate the IASB's effort to replace the existing interim standard IFRS 4 insurance contracts which allows different local liability measurement practices across jurisdictions, with a single standard for the measurement of insurance contracts to be applied across all jurisdictions adopting the IFRS.

In addition, AOSSG members believe that the proposed measurement model will produce relevant information that will help users of an insurer's financial statement to make economic decision, because it can faithfully reflect the facts an insurer fulfils its insurance obligations, providing relevant information about the amount, timing and uncertainty of future cash flows, so that it will increase information transparency and enhance information decision-usefulness.

Question 2 - Fulfilment cash flows
(a) Do you agree that the measurement of an insurance contract should include the expected present value of the future cash outflows less future cash inflows that will arise as the insurer fulfils the insurance contract? Why or why not? If not, what do you recommend and why?
(b) Is the draft application guidance in Appendix B on estimates of future cash flows at the right level of detail? Do you have any comments on the guidance?

Q2-a) AOSSG members agree that the measurement of an insurance contract should include the expected present value of the future cash outflows less future cash inflows that will arise as the insurer fulfils the insurance contract.

Generally, the insurance contract liability is not transacted in market. Measuring with fulfilment value is appropriate considering the economic substance of insurance contract.

From theoretical perspective, measuring the insurance contract liability with the current price of future cash flow enables to fully present the fulfilment values and to increase the understandability.

The rules stated above are also consistent with the proposed method of 'measuring current value of the expected cash flow' of 'Measurement of Liabilities in the IAS 37's ED and 'Financial Instruments: Amortised Cost and Impairment's ED.

Q2-b) AOSSG members note that the draft guidance in Appendix B on estimates of future cash flows is at the right level of detail.

Question 3 - Discount rate
(a) Do you agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability and not those of

(b)	Do you agree with the proposal to consider the effects of liquidity and with the guidance on liquidity? Why or why not?
(c)	Some have expressed concerns that the proposed discount rate may misrepresent the economic substance of some long duration insurance contracts. Are those concerns valid? Why or why not? If they are valid, what approach do you suggest and why?

Q3-a) AOSSG members believe that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability because:

The cash flows occurred from the non-participating contract are not directly related with the cash flows occurred from the backing asset which are managed to fulfill the insurance contract liability. Thus, only applying the liability's intrinsic characteristics is logically consistent with the fulfillment value which is measurement purpose of the insurance contract.

As mentioned in the IAS 19.BC27, if the return rate of this kind of backing assets is used as the discount rate of insurance contract liability, there could be problem that the amount of liability is recognised lesser as invested in the high-risk assets with high expected return.

Q3-b) AOSSG members agree with the proposal of adding the liquidity premium to the discount rate of insurance contract liability.

However, AOSSG members have some concerns about how this might be done, particularly as paragraph BC 110 states that "…there is not yet a consensus on how best to measure those effects, for example how to separate liquidity effects from credit effects."

In addition, AOSSG members note that there will be great operational confusion occurred if the detailed definition and the application guidelines are not provided on the liquidity premium. When considering the fact that the measurement result may greatly change due to the differences of discount rate that are applied in insurance contract liability, if the detailed definition and application guidelines do not exist, there is risk of deteriorating the reliability of financial statements' comparability between companies.

Considering the measurement purpose of 'fulfillment value,' the liquidity premium does not measure assuming transfer of the insurance contract liability to the third party. It is measured assuming early fulfillment of insurance contract on insurers' insurance contractor. However, the IASB's clarification on this matter is not provided on the ED.

Q3-c) AOSSG members consider that those concerns are not valid.

AOSSG members believe that using the discount rate that applies to insurance contract liability as rate of return on asset management does not appropriately apply the economic substance of non-participating insurance contract. In other words, since cash flows of non-participating insurance contract is not directly influenced by the cash flows of backing assets, there will be distortion of economic substances if cash flows occurred on these contracts are discounted with the rate of return on managed assets.

If credit risk, insurers' non-performance risk, is applied to discount rate, the discount rate will increase if insurers' credit risk increases. Thus, if insurers' insurance contract liability decreases, there will be recognition of profit. This is opposed in intuition and this may cause confusion to the users of financial statements.

On the other hand, there are some views that the concern is valid particularly in an environment where there are no (or lack of) observable rates on financial instruments with similar maturity periods to use as a benchmark to discount long-term duration insurance contracts.

Consequently, a mismatch of assets and liabilities may arise. For example, insurers would face difficulties in determining reliable discount rates as they typically have long duration insurance contracts exceeding 20 years, as there is a lack of long dated assets in certain markets.

Additional review comments on the discount rate

AOSSG members also consider that there is need to develop the discount rate application rule that can be consistently applied to all the IFRSs. The current IASB does not provide consistent standards regarding the discount rate application on individual standards.

For example, there are differences between the IAS 19 Employee benefits and the IFRS4 ED Insurance contracts. The defined benefit obligation and the insurance liability have similar characteristics but there are differences in discount rates that are applied on these two standards. Therefore, the IASB needs to clarify the reasoning behind these differences between the standards relating to the discount rate application. In addition, developing the discount rate application principle such as the US GAAP's SFAC 7(Statement of Financial Accounting Concept No.7) and including this in the conceptual framework are needed.

Question 4 – Risk adjustment versus composite margin
Do you support using a risk adjustment and a residual margin (as the IASB proposes), or do you prefer a single composite margin (as the FASB favours)? Please explain the reasons for your view.

AOSSG members support using a risk adjustment and a residual margin approach as it reflects the change in the risk underlying the contract over the coverage period because the IASB's proposals:

(a) would provide more useful information to users about the insurer's perceptions of the effects of uncertainty on the amount and timing of future claims liability fulfillment cash flows; and
(b) could reduce the amount of residual margin, which need to be released by rather subjective methods, so that it will provide users of financial statements with more reliable information.

However, some AOSSG members support the composite margin method for the reasons explained below.

Easier management and comparability

For the composite margin approach, the operational burden will be relatively small since risk adjustment is not measured separately, even though the future cash flow occurring in insurance contract is forecasted and this cash flow is discounted. Also, it is expected that the comparability between companies is not to be deteriorated since avoiding the subjectivity when measuring risk adjustment is possible.

Moreover, for the composite margin approach, since the risk adjustment does not influence remeasurement of the insurance contract liability, it is expected that the insurers can easily disclose remeasurement of insurance contract liability or its related information. Moreover, the users of financial information can easily understand the related information and external auditors' audit will be relatively easy.

Possibility of a loss at the point of the first time adoption of the standard

It is likely to have little difference in actuarial estimates between the point of insurance products pricing and the point of measuring a liability after selling the insurance. However, there may be a large fluctuation of the change of economical assumptions. According to the two margin approach which distinguishes between risk adjustment and residual margin, the change in assumptions influence the insurance contract liability relatively big, thus, when economic assumptions greatly change, the possibility of a loss at the point of the first adoption of the standard is greater than the situations of applying the composite margin approach. In addition, since the required risk adjustments for smaller insurers may be big, the possibility of a loss at the point of the first time adoption may be high. This may cause the problem that the accounting value may differ depending on the size of an insurer or ability to assess.

Question 5 - Risk adjustments

(a) Do you agree that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected? Why or why not? If not, what alternatives do you suggest and why?
(b) Paragraph B73 limits the choice of techniques for estimating risk adjustments to the confidence level, conditional tail expectation (CTE) and cost of capital techniques. Do you agree that these three techniques should be allowed, and no others? Why or why not? If not, what do you suggest and why?
(c) Do you agree that if either the CTE or the cost of capital method is used, the insurer should disclose the confidence level to which the risk adjustment corresponds (see paragraph 90b(i))? Why or why not?
(d) Do you agree that an insurer should measure the risk adjustment at a portfolio level of aggregation (i.e. a group of contracts that are subject to similar risks and managed together as a pool)? Why or why not? If not, what alternative do you recommend and why?
(e) Is the application guidance in Appendix B on risk adjustments at the right level of detail? Do you have any comments on the guidance?

Q5-a) AOSSG members generally agree that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected.

However, Some AOSSG members also note that the proposed definition of risk adjustment does seem to contain ‘fair value measurement’ elements. The measurement objective (fulfilment value) of insurance contract liability in the ED does not presume the transfer of insurance liability to the third party. Nonetheless, the definition of risk adjustment seems to assume the transfer of insurance contract liability, thus, it does not align with the measurement objective.

Q5-b) AOSSG members basically agree with the three types of techniques allowed on estimating risk adjustments in the ED. Including too many techniques in the accounting standards may deteriorate the understanding of the users and the comparability of financial statements. Moreover, the three types of techniques proposed are currently used in real operations so that there will not be difficulty in operational application.

However, considering the possibility of developing more elaborate measuring method in future, it is proper for the IASB to provide comprehensive principles which cover the three types of techniques and include three types of techniques as examples.

Q5-c) AOSSG members agree to the proposal of disclosing the confidence level used in the CTE approach and the cost of capital approach. Confidence level plays an important role in estimating the risk adjustment to the all three techniques proposed in the exposure draft.

Therefore, disclosing the different method of confidence level applied by insurers with similar risks will increase the comparability between companies, and will increase the understandability of the users of financial statements.

Q5-d) AOSSG members assent to the proposal of measuring the risk adjustment at a portfolio level. According to the definition of portfolio, if the objects of risk adjustments to be measured have similar risks, and managed together, measurements at an individual level as well as a portfolio level may share similarities. Also, portfolio’s diversification effect may be applied which is projected to reduce the operational burden and maintain accuracy.

However, some insurance companies in certain AOSSG member countries measure the risk adjustment at an individual level, with the effect basically similar to at a portfolio level. So we suggest providing an option for insurance companies to measure the risk adjustment at an individual level.

Q5-e) Considering the principle based accounting standards preferred by the IASB, the level of guidance seems appropriate.

However, additional information of determination method of individual components (e.g. various risk premiums) required to estimate the capital ratio for the cost of capital technique needs to be provided.

Additionally, when determining the risk adjustment, (The maximum amount that the insurers can pay reasonably in order to be free from the risk of the real fulfilment cash flow exceeding the expected fulfilment cash flow) there is possibility of inputting the insurers’ arbitrary opinion and this may deteriorate the comparability of the financial statements. Hence, a more explicit guidance needs to be provided.

Question 6 – Residual/Composite Margin

(a) Do you agree that an insurer should not recognise any gain at initial recognition of an insurance contract(such a gain arises when the expected present value of the future cash outflows plus the risk adjustment is less than the expected present value of the future cash inflows)? Why or why not?

(b) Do you agree that the residual margin should not be less than zero, so that a loss at initial recognition of an insurance contract would be recognised immediately in profit or loss (such a loss arises when the expected present value of the future cash outflows plus the risk adjustment is more than the expected present value of future cash inflows)? Why or why not?

(c) Do you agree that an insurer should estimate the residual or composite margin at a level that aggregates insurance contracts into a portfolio of insurance contracts and, within a portfolio, by similar date of inception of the contract and by similar coverage period? Why or why not? If not, what do you recommend and why?

(d) Do you agree with the proposed method(s) of releasing the residual margin? Why or why not? If not, what do you suggest and why?

(e) Do you agree with the proposed method(s) of releasing the composite margin, if the Board were to adopt the approach that includes such a margin? Why or not?

(f) Do you agree that interest should be accreted on the residual margin? Why or why not? Would you reach the same conclusion for the composite margin? Why or why not?

(Q6-a) AOSSG members agree that an insurer should not recognise any gain at initial recognition of an insurance contract. Expected profits for an insurance contract arise as the insurer fulfils the insurance contract, which means that profits should be recognised based on this process.

(Q6-b) AOSSG members agree that a loss at initial recognition of an insurance contract should be immediately recognised in profit or loss. Reasons are followed below:

(a) Consistent with the ED of ‘Revenue from Contracts with Customers’ which proposes to recognise the loss of onerous contracts

(b) Able to provide the useful information to the users of financial statement on timely manner

- As a reason for the residual margin is negative, (1) When measuring the insurance contract liability, differences between the expected cash flows and expected cash flows at the point of developing the insurance contract (2) When developing the new insurance product, the aggressive manner (manner that bears loss and not based on the practical assumption) may be the cause.

- In case of the first reason, if the changes in assumptions are caused by an observation of the current market or from an entity’s past experience, the entity will need to account for an additional fulfilment obligation due to the increase of cash outflows as a liability at the point of recognition. Also, the insurer will need to recognise the loss at initial measurement in order to inform the financial

- In case of the second reason, the entity needs to reflect the loss determined at the point of developing the insurance contract in its financial statements for an accurate financial information disclosure.

(Q6-c) AOSSG members generally agree with the proposal. In order to maintain consistency of the proposed definition, method of recognition and release of residual margin or composite margin, it is proper to measure the residual margin or composite margin on portfolio level.

However, some insurance companies in certain AOSSG member countries measure the residual margin at an individual level, with the effect basically similar to at a portfolio level. So, AOSSG members suggest providing an option for insurance companies to measure the residual margin at an individual level.

(Q6-d) AOSSG members agree with the proposed principles of recognition method in this ED. However, when considering the insurance contracts' wide range of coverage period, date of inception of an insurance contract, as well as an age of a policyholder, it is projected that the number of portfolios for measuring residual margin will not greatly differ with the number of insurance contracts.

In order to estimate large number of portfolios, there will be additional time or system required which will result increase in operational burden. In order to improve these kinds of problems, adding simplified operational method which requires recognizing the residual margin from insurance contracts with similar coverage period within the portfolio level or small portfolio level is necessary.

(Q6-e) AOSSG members agree with the proposal. Composite margin is not included in the future cash flow (building block 1) related to the insurance contract. But, it includes many components of many insurance prices that were considered when calculating the price (e.g. non-incremental acquisition cost and overhead).

According to the ED's proposal, these components are all included in the composite margin, which in turn will be released over the remaining coverage period. AOSSG members believe this method is reasonable.

(Q6-f) AOSSG members believe that at insurance contracts' initial recognition, the residual or composite margin are calculated by deducting the present value of future fulfilment cash outflows from the present value of future fulfilment cash inflows.

Therefore, the time value of money is applied. Considering this fact, in the event of subsequent measurement, it is proper to recognise the interest expense with applying discount rate to the residual and composite margin that was used at the initial measurement.

However, some AOSSG members argue that accreting interest on margin is cumbersome to apply in practice and fixed interest rate at inception may result in the estimates being artificially stated and being not representative of the observable market interest rates over the duration of the insurance contracts.

Also, some AOSSG members mention that residual margin is only a credit, a difference by calculating certain items, which has in itself not much economical substance. Therefore, accrediting interest on the margin does provide reliable and useful information to users of financial statements.

Question 7 - Acquisition costs
(a) Do you agree that incremental acquisition costs for contracts issued should be included in the initial measurement of the insurance contract as contract cash outflows and that all other acquisition costs should be recognised as expenses when incurred? Why or why not? If not, what do you recommend and why?

AOSSG members agree with the ED's proposal that only applying the incremental cost to the current value of fulfilled cash flows at initial measurement of insurance contract.

However, we suggest changing the assessment of the incremental cost on portfolio level, not the individual contract level. On the ED's paragraph B61, it states projection of all cash flows of insurance contracts are to be assessed from portfolio level.

As cash flow projection items, it states the direct cost and systematically allocated indirect cost. However, according to the paragraph (f), it suggests that the acquisition costs should contain the incremental costs only at the level of an individual insurance contract rather than at the level of a portfolio of insurance contracts.

In addition, the interpretation of what falls under incremental and non-incremental acquisition costs may differ from one insurer to another dependent on the type of distribution channels applied. To facilitate consistency in treatment of acquisition costs by insurers, the Board should consider further elaboration in the proposed standard.

Question 8 – Premium allocation approach
(a) Should the Board (i) require, (ii) permit but not require, or (iii) not introduce a modified measurement approach for the pre-claims liabilities of some short-duration insurance contracts? Why or why not?
(b) Do you agree with the proposed criteria for requiring that approach and with how to apply that approach? Why or why not? If not, what do you suggest and why?

(Q8-a) AOSSG members believe it is appropriate to permit but not require the modified measurement approach. Our reasons are followed below:

- AOSSG members believe that it is not reasonable to regulate applying different models for contracts covering the same risks just because its duration is less than one year from logical consistency perspective.

- Therefore, in principle, AOSSG members think that it is appropriate to apply the measurement method using the building block. Therefore, from cost-benefit perspective, it is proper to allow the use of unearned premium approach when the insurers decide the pre-claims liability do not have material differences with the measurement method using building block.

(Q8-b) AOSSG members agree with the proposal because the proposed judgment criteria and application approaches are easy to understand, convenient to implement and will not damage the accounting information relevance and decision usefulness.

However, some AOSSG members also note that the IASB should introduce the concept of life insurance contracts and non-life insurance contracts as the criteria of adopting the modified measurement approach, rather than introduce the time criteria.

Generally, non-life insurance contracts that use an unearned premium approach have the coverage period of one year or less in general, but there are other insurance contracts that have a coverage period of more than one year such as builders risk insurance and worker's compensation insurance. When the insurers are measuring pre-claims liability using unearned premium approach, due to the fact that requisite of applying unearned premium approach requires the insurance coverage to be less than one year, it is inappropriate to apply different measurement methods on contracts with same risks and this will confuse the information users.

Therefore, it is appropriate that the unearned premium approach to be applied depending on the characteristics of a contract rather than on the coverage period.

Question 9 – Contract boundary principle
Do you agree with the proposed boundary principle and do you think insurers would be able to apply it consistently in practice? Why or why not? If not, what would you recommend and why?

AOSSG members agree with the IFRS 4 ED's proposal. When measuring an insurance contract liability, all the cash flows expected to arise as the insurer fulfils the obligation have to be reflected. This means that unless an insurer can avoid the cash flows for the contract, cash flows within the range of an insurance contract which can be viewed as one contract, should be considered.

In this point of view, AOSSG members believe the proposal in this exposure draft, suggesting the boundary of an insurance contract would be the point at which an insurer is either no longer required to provide coverage or has the right or the practical ability to reassess the risk of the policyholder and, as a result, can set a price that fully reflects that risk, is reasonable.

Question 10 – Participating features
(a) Do you agree that the measurement of insurance contracts should include participating benefits on an expected present value basis? Why or why not? If not, what do you recommend and why?
(b) Should financial instruments with discretionary participation features be within the scope of the IFRS on insurance contracts, or within the scope of the IASB's financial instruments standards? Why?
(c) Do you agree with the proposed definition of a discretionary participation feature, including the proposed new condition that the investment contracts must participate with insurance contracts in the same pool of assets, company, fund or other entity? Why or why not? If not, what do you recommend and why?

(d) Paragraphs 64 and 65 modify some measurement proposals to make them suitable for financial instruments with discretionary participation features. Do you agree with those modifications? Why or why not? If not, what would you propose and why? Are any other modifications needed for these contracts?

(Q10-a) AOSSG members agree that payments arising from the participating features should be included in the measurement of insurance contracts, because it corresponds with the principle that all the cash flows expected to arise as the insurer fulfils the obligation should be included.

Reflecting distributions on the measurement of the liability arising from participating contracts would bring consistency in measurement of an insurance contract liability. In some countries, future distributions from unrealised gains and losses of an underlying asset are accounted as a separate liability by the shadow accounting.

However, if the future distributions are included in the cash flows, the possible liability arising from the participating contracts will automatically be included in an insurance contract liability and the shadow accounting will not be necessary.

According to this ED's paragraph 32, it suggests that if the amount, timing or uncertainty of the cash flows arising from an insurance contract depends wholly or partly on the performance of specific assets, the discount rate's calculation of the insurance contract shall reflect that dependence.

Especially for participating insurance contracts, applying the cash flow caused by future distributions decided by the performances of operating assets in forecasting cash flow can maintain consistency with the rules of paragraph 32.

Thus, future distributions to a policyholder should be included in the cash flows to measure an insurance contract liability.

(Q10-b) AOSSG members believe that in order to be indentified as insurance contract, financial instruments with discretionary participation features should be tested for whether the insurance risk transferred is significant. If the insurance risk is significant, financial instruments with discretionary participation should be within insurance contract standards. Otherwise, financial instruments with discretionary participation features should be within financial instrument standards.

In principle, as participating investment contracts that have discretionary participating features do not transfer significant insurance risk, it will be more appropriate to be excluded from the scope of the IFRS on insurance contracts but included within the scope of the IASB's financial instruments standards. There is a possibility of deterioration in comparability of financial statements if different standards are applied on the participating investment contracts issued by an insurance company and by other financial institutions.

However, there were some views that using the same accounting standards for both types of contract will produce more relevant information for users and simplify the accounting for those contracts. That's because participating investment contracts and participating insurance contracts are sometimes linked to the same underlying pool of assets and sometimes participating investment contracts even share in the performance of insurance contracts.

(Q10-c) AOSSG members disagree due to the review opinion of (b).
If financial instruments with discretionary participation features want to be regarded as insurance contract, the insurance risk transferred must be significant. If the insurance risk transferred is not significant, financial instruments with discretionary participation should not be regarded as insurance contract.

That is, whether financial instruments with discretionary participation should be regarded as insurance contract should be determined according to the definition of insurance contract.

(Q10-d) AOSSG members agree with the proposal.
Despite of review opinions of (B), if the participating investment contracts that have discretionary participating features are necessary for scope of the insurance related IFRS, we believe this ED's proposal that applies characteristics of participating investment contracts is appropriate.

Question 11 – Definition and scope

(a) Do you agree with the definition of an insurance contract and related guidance, including the two changes summarised in paragraph BC191? If not, why not?
(b) Do you agree with the scope exclusions in paragraph 4? Why or why not? If not, what do you propose and why?
(c) Do you agree that the contracts currently defined in IFRSs as financial guarantee contracts should be brought within the scope of the IFRS on insurance contracts? Why or why not?

(Q11-a) AOSSG members agree with the proposal. In this ED, when deciding whether to transfer the significant insurance risk, following two are considered additionally.

Therefore, it could prevent classifying the contracts that do not transfer the significant insurance risk as insurance contracts and appropriately apply economic substance of insurance contract.

- A contract does not transfer insurance risk if there is no scenario that has commercial substance in which the present value of the net cash outflows paid by the insurer can exceed the present value of the premiums. (B25)

- In determining whether it will pay significant additional benefits in a particular scenario, the insurer takes into account the effect of the time value of money. (B26)

(Q11-b) AOSSG members agree with the scope exclusions in paragraph 4 in the proposed standard which are similar to the exclusions in the existing IFRS 4.

(Q11-c) AOSSG members agree with the proposal because if financial guarantee contract meets the definition of insurance contract, it should be within the insurance contract standard.

In estimating or recognising financial guarantee contracts, it is reasonable to apply the IFRS on insurance contracts as this will satisfy the accounting principle of applying the same accounting standard on the same transaction.

Especially, applying different standards just because financial guarantee contracts are issued by a non-insurance company other than an insurance company, will deteriorate the comparability and may not be able to provide useful information to the users.

One member country argue from the practical perspective that since applying accounting for insurance contracts to financial guarantee contracts which entities other than insurance companies issue is burdensome for those entities and would create confusion, those contracts should be scoped out of the IFRS 4.

Likewise, another member support that non-insurers should be given the option to account for financial guarantees as financial instruments or as insurance contracts. The ED Amortized cost and impairment of financial instruments issued in November 2009 proposed that financial liabilities accounted for at amortized cost should continuously be measured and estimated based on the expected cash outflows at each measurement date.

If the proposal is accepted eventually, the measurement of financial guarantee liabilities should theoretically be similar under both the financial instruments standard and the new insurance contracts standard. In addition, allowing financial guarantee contracts to be accounted for as financial instruments may be more reflective of their economic substance since they transfer credit risk. Further, the proposed presentation and disclosure requirements, which are more suitably applied to insurers, may be too burdensome for these contracts which are mostly issued by non-insurers.

Question 12 – Unbundling
Do you think it is appropriate to unbundle some components of an insurance contract? Do you agree with the proposed criteria for when this is required? Why or why not? If not, what alternative do you recommend and why?

If components of an insurance contract can be explicitly separated, AOSSG members believe that it is appropriate to unbundle in order to enhance the comparability with other financial instruments or other financial institutions. However, more detailed guidelines need to be provided for this ED's 'insurance components that are closely related'.

- For example, in order to unbundle a savings component from an insurance contract, it is required to be measured separately. But, in some countries, insurance premium is calculated per contract and business expenses are shared, which means that in order to separately measure a component, arbitrary allocation is necessary.

In the IAS 39, it contains detailed examples on how to separate an embedded derivative from its host contract when they are closely related to its host contract as well as when they are not closely related to its host contract. Therefore, AOSSG members suggest detailed examples to be provided to clarify the definition of a close relationship in unbundling like the IAS 39.

Question 13 - Presentation

(a)	Will the proposed summarised margin presentation be useful to users of financial statements? Why or why not? If not, what would you recommend and why?
(b)	Do agree that an insurer should present all income and expense arising from insurance contracts in profit or loss? Why or why not? If not, what do you recommend and why?

(Q13-a) AOSSG members suggest retaining the existing presentation of financial statements to present all income and expenses arising from insurance contracts in profit or loss but include the proposed summarised margin presentation as a note to the financial statements.

Summarised margin approach directly presents release of residual or composite margin, change in risk adjustment, experience adjustment, change in estimates of cash flows and discount rates, and interest on insurance contract liabilities in the statement of comprehensive income. Thus, this approach has consistency with the ED's proposed measurement model and clearly presents the changes in building blocks. Considering above facts, AOSSG members conceptually agree in principle that this approach provides useful information to the users of an insurer's financial statements.

However due to following reasons, AOSSG members support the written premium approach for financial statements presentation:

- Importance of the premium income, claims and benefits
- Enhancement of understanding through the reconciliation
- Meaningful application of unbundling

Importance of the premium income, claims and benefits

As stated in basis for conclusion in proposed ED, premium income as well as claims and benefits are very important information to the users of the financial statements since they help in analyzing the information on insurers' origin of revenue.

However, the summarised margin approach that does not present the premium income, claims and benefits is unfamiliar presentation method even to the companies who participate in insurance industry. As a result, other companies who does not participate in insurance industry will have great difficult in understanding and interpreting.

Enhancement of understanding through the reconciliation

Disclosing changes in building blocks such as the release of composite or residual margin, the changes in risk adjustment, experience adjustment, changes in estimates of cash flows and discount rates and interest on insurance contract liabilities on financial statements, could sufficiently provide useful information to users.

Meaningful application of unbundling

In summarised margin approach, only residual margin and the change in risk adjustment are recognised in profit and loss, and premium received is accounted for as a deposit. Thus, whether to apply the unbundling does not have any impact on an accounting treatment. Therefore, under the summarised margin approach, since there is no actual differences in accounting treatment whether to apply the unbundling, there is no need of rules related to unbundling.

On the other hand, there is another view that the written premium approach is a cash basis presentation and would result in an overstatement of revenue for a contract that includes a lot of deposit element that would not be unbundled. So, they are of the view that further consideration should be given to the expanded margin model.

(Q13-b) In concept, AOSSG members agree with the proposal because presenting all income and expense arising from insurance contracts in profit or loss can provide users of financial statement with relevant and useful accounting information.

However, due to following practical reasons, some AOSSG members express concern on the proposal that all the income and expenses arising from an insurance contract liability should be presented in profit or loss in a statement of comprehensive income. They suggest review of an alternative of recognizing the change in insurance liability due to the assumption change in discount rate in OCI.

Unlike in Europe, emerging markets do not have advanced long-term financial markets and so that a long-term financial asset that meets the duration of an insurance contract cannot be managed.

Therefore, there will be a difference between gains and losses arising from the subsequent measurement of assets and liabilities even when they are measured at fair value due to the difference in duration. As a result, insurers from the emerging market will face a huge fluctuation in gains and losses from the subsequent measurement.

Thus, some AOSSG members suggest that a part of gains and losses affected by a market variable (e.g. discount rates) to be recognised in other comprehensive income and the rest to be recognised in current profit and loss.

According to the ground of this ED's decision, the IASB expresses the profits or losses occurred in insurance contracts are the core of insurers' operational outcome.

However, the change in insurance liability due to change in discount rate of market is not related to the insurers' operational outcome. Thus, some AOSSG members think that, among the insurance liability's profits or losses, recognizing the portion due to change in market (discount rate) in OCI will provide useful information in presenting company's current outcome.

Question 14 – Disclosures

(a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?

(b) Do you think the proposed disclosure requirements will meet the proposed objective? Why or why not?

(c) Are there any disclosures that have not been proposed that would be useful (or some proposed that are not)? If so, please describe those disclosures and explain why they would or would not be useful.

(Q14-a,b,c) AOSSG members generally agree with the proposals relating to the disclosure, primarily because they are principles-based.

However, AOSSG members suggest providing additional guidelines on sensitivity analysis and uncertainty analysis from perspective of improving comparability.

Additional proposals that can be included in a guideline for sensitivity analysis:

- Basic input and assumption included in disclosure
- Application examples
- Examples for changes in possible risk variables

Additional proposals that can be included in a guideline for uncertainty analysis:

- Examples on how to judge the materiality
- How to estimate when several assumptions change concurrently
- How to determine the correlation between assumptions

Question15- Unit-linked contracts
Do you agree with the proposals on unit-linked contracts? Why or why not? If not what do you recommend and why?

AOSSG members agree with the proposal, because the proposals on unit-linked contracts can faithfully reflect the nature of these contracts and provide to the users of financial statement with relevant information which are decision usefulness.

And also AOSSG members note that insurers should present single line items on financial statements for assets and liabilities relating to the unit-linked contracts. Unit-linked contracts are different from general insurance contracts in a way that the actual investment return would be accumulated. They are also different from investment trust in the sense that additional insurance benefit is provided.

Assets/liabilities relating to unit-linked have different characteristics from the assets/liabilities of a general account, therefore they need to be separately managed and recognised. Also, AOSSG members believe that it is more appropriate to reflect on financial statements of an insurer as they are assets/liabilities of the insurer unlike the investment trust, even though they are independently managed from the assets/liabilities of a general account.

AOSSG members also agree that insurers should present single line items on financial statements for both income and expense for the same reasons explained above.

However, when considering the possibility of unbundling, it is not specified clearly in the exposure draft up to what extent of income/expense should be presented.

Therefore, AOSSG members believe that examples or additional explanation on presentation of unit-linked contracts should be provided in case of unbundling.

Question 16 – Reinsurance
(a) Do you support an expected loss model for reinsurance assets? Why or why not? If not, what do you recommend and why?
(b) Do you have any other comments on the reinsurance proposals?

(Q16-a) Reinsurance assets are a cedant's net contractual rights under a reinsurance contract. Like general accounting receivables, a cedant faces the risk that the reinsurer may default.

AOSSG members believe that the impairment test of a reinsurance asset should follow the same principle applied on the impairment test of a financial asset.

Therefore, the principle that is applied on the impairment of the reinsurance asset should be aligned with the principle to be set in the future financial instrument standards.

(Q16-b) At initial recognition and in subsequent measurement, a reinsurance contract is measured. In case of a reinsurance ceded, a cedant can measure the reinsurance asset on the same basis as its underlying direct insurance liability.

However, the reinsurer may have difficulties in measuring the reinsurance contract on the same basis as its underlying direct insurance due to the lack of information on the underlying direct insurance.

Generally, cedants do not provide enough information about the underlying direct insurance to a reinsurer, because the corresponding information such as premium rate is considered to be confidential, especially for the business insurance.

Therefore, estimating with the information the reinsurer has, without relying on the information from the cedant would require judgement, and will be practically very difficult.

For the reasons stated above, reinsurers in some countries recognise the same amount informed by the cedant as provisions. Reinsurance liabilities of a reinsurer, especially, if the cedant is a foreign insurer, are difficult to estimate as information on the occurrence of the insured event does not exist.

The rationale for recognising the same amount informed by a cedant as provisions is that the need to re-estimate the reinsurance liability is low as the amount is already estimated by the cedant.

Therefore, AOSSG members believe that additional guidance on estimating reinsurance liability of a reinsurer is necessary in order to supplement its practical limitation.

For example, assuming that a cedant has made a reasonable estimation on the reinsurance liability, the reinsurer will be able to use the estimation from the cedant if there is guidance which allows this. However, the reinsurer should not recognise the impairment of reinsurance assets estimated by the cedant in any case.

In addition, some short-duration insurance contracts are currently covered by 'umbrella' reinsurance contracts that run for more than one year. Under the proposals, the direct insurance contracts would be measured using an unearned premium approach whereas the reinsurance contract would be measured using the comprehensive measurement approach, which is arguably inconsistent with the IASB's intentions.

Question 17- Transition and effective date

(a) Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?
(b) If the Board were to adopt the composite margin approach favoured by the FASB, would you agree with the FASB's tentative decision on transition (see the appendix to the Basis for Conclusions)?
(c) Is it necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9? Why or why not?
(d) Please provide an estimate of how long insurers would require to adopt the proposed requirements.

(Q17-a) Some AOSSG members supported full retrospective restatement method rather than modified retrospective approach, because insurance companies in their country have adopted retrospective restatement method already, so they consider transition requirements to be unduly onerous. Thus they are suggesting that if entities can reliably restate their financial statement to comply with the proposals, they should be permitted to do so.

On the other hand, most AOSSG members argue that the full retrospective application may not be practicable particularly where insurers have made distributions to policyholders and shareholders prior to the implementation of this proposed standard. It is also legally not possible to 'claw-back' previously distributed surpluses to policyholders and shareholders.

Furthermore, it is impracticable to determine composite margins, residual margins and risk adjustments for legacy insurance contracts. It is also doubtful whether this requirement would address cost-benefits to insurers and users of financial statements.

Thus, most AOSSG members agree with the use of the prospective application of the proposed standard for new insurance contracts.

AOSSG members also suggest the following matter to be considered by IASB for inclusion in the final standard.

If a new measurement model is applied on an existing insurance contract at the date of transition and its residual margin is regarded as zero, the contract's residual margin's applicable amount will all be reflected in the retained earnings at the date of transition. In other words, when considering characteristics of insurance contracts that its outcome is occurred over long term basis, the revenue is supposed to be distributed over the insurance contract period. However, the revenue is applied as retained earnings immediately, thus this creates distortion on profit and loss. Moreover, there is possibility that this will deteriorate the comparability with revenue of new insurance contracts originated after the transition date

In order to solve the problem mentioned above, AOSSG members suggest following alternative methodology that allows the subsequent release of residual margin of the existing insurance contracts at the transition date over the remaining insurance coverage period.

Residual margin: Max [0, (A-B)]

(A) Insurance liability recognised under existing provision on the date of transition (But, only if it satisfies the adequacy test for liability required by IFRS 4 (Phase I). If it does not satisfy the test, reflect immediately in retained earnings.).

(B) Present value of future fulfilment cash flows measured using the ED's measurement model on the date of transition.

Although the proposed ED states in the basis for conclusion that estimated value of a residual margin using the method stated above is not comparable with the residual margin of the new subsequent contracts, AOSSG members believe this problem can be complemented by separately presenting the residual margin of the existing and new subsequent contracts.

(Q17-b) Using the risk adjustment measured according to the IASB's selected approach (in order to measure the composite margin of currently existing contracts) as proxy value of composite margin is not consistent with FASB's approach who opposes classification between risk adjustment and residual margin.
In addition, applying the composite margin (except for the amount related to risk adjustment) of currently existing contracts on the date of transition to retained earnings rather than releasing will cause same problems as residual margin.

Therefore, there is need for an alternative method to measure the composite margin other than the risk adjustment. Refer to our review comments on (a) regarding this alternative.

(Q17-c) AOSSG members consider that the effective date of the IFRS on insurance contracts should be aligned with that of the IFRS 9, because doing it can reduce or eliminate accounting mismatch and increase accounting information understandability and decision usefulness.

According to this proposed ED, the financial assets can be re-designated as measured in financial assets that are recognised in profit or loss at the beginning of the earliest period presented. Hence, AOSSG members believe that there would not be a significant problem even if the guidance on recognition and measurement in IFRS 9 is first adopted in 2013. As long as the effective date of IFRS 4 is not earlier than that in IFRS 9, there will be no operational problems with IFRS 9 in applying IFRS 4.

However, if there is a timing difference between the effective dates of IFRS 9 and IFRS 4, it will be burdensome for an entity since it must go through the IFRS conversion process twice and the existing business model may have to be modified to comply with IFRS 4. Therefore, we believe that the setting up same effective date for both IFRS 9 and IFRS 4 will be effective and efficient from companies' perspectives.

(Q17-d) According to the survey done in Korea, the preparers of financial statements expressed that in order to adopt the IFRS (Phase 1); it will take at least 5 years as a preparation period. The table below is the summary of expected period in order to adopt ED's Phase II in real operations that is calculated on the basis of actual period taken to adopt IFRS 4 Phase I in real operations.

<The actual time taken to adopt IFRS 4 Phase I>

Stages	Large-sized insurer	Small to medium-sized insurer
Analysing the effect of IFRS 4 on regulatory accounting and insurance industry	1 year	1 year
Selecting a consulting firm	2 months	1 month
Observing the process of a large-sized insurer	6 months	3 months
Analysing the difference of IFRS 4 Phase I	N/A	1 ~ 1.5 years
System designing, building and testing	1 year	6 months
Stabilisation of the system and preparation of financial statements	6 months	3 months
Total estimated period	**3 years and 2 months**	**3.1 ~ 3.5 years**

<Estimated time taken to adopt IFRS 4 Phase II>

	Stages	Large-sized insurer	Small to medium-sized insurer
1)	Translation into a local language	1 month	1month
2)	Analysing the effect of IFRS 4 on insurance industry	3~6 months	3~6 months
3)	Establishing the management plan for regulatory accounting	6 months~1 year	6 months~1year
4)	Selecting a consulting firm	2~3 months	1~2 months
5)	Analysing the difference of IFRS 4 Phase II	6 months~1 year	3 months
6)	Data accumulation and observing the process of a large-sized insurer	6 months~1 year	3~4 years
7)	System designing, building and testing	1.5~2 years	6 months~1 year
8)	Stabilisation of the system and preparation of financial statements	6 months~1 year	3~6 months
Total estimated period		**4~7 years**	**5~7.5 years**

Translation into a local language

Even if the final draft is published in June 2011, it will take time to translate it into a local language and accordingly, this should be taken into consideration when deciding the effective date.

Analysing the effect of IFRS 4 on insurance industry and establishing the management plan for regulatory accounting

Like in the Phase I project, it is essential to analyse the macroeconomic effect of the standard throughout the industry before launching the Phase II project. It also plays a very crucial role in establishing the management plan for regulatory accounting. Therefore, a preparation period is required to understand and establish basic management plan through the macroeconomic analysis before starting the project, even if a detailed management plan for regulatory accounting will be established later.

Selecting a consulting firm

Like all the other IFRS conversion projects, it is practically impossible for a company to conduct the IFRS 4 project alone. Therefore, the project should be conducted in coalition with an accounting firm and consulting firms like an IT system building company. It is likely to be a very large project leading to a very dramatic change in systems that costs a large amount of time and money. It may take a long time to select a consulting firm as it needs to be discreet.

Analysing the difference, system designing, building and testing / system stabilisation and preparation of financial statements

A dramatic system change is required as a new measurement model needs to be applied in IFRS 4 Phase II. Considering the fact that Phase I, which did not require a dramatic system change took around 3 years, we believe that 5 years of preparation time would still be short as Phase II requires a dramatic change of system, building and testing.

Data accumulation and observing the process of a large-sized insurer

For small to medium-sized insurers, it is difficult to launch the implementation at the same time as the large-sized insurers due to its costs. Therefore, they should start implementing after the large-sized insurers establish the system to an extent so that they can share the knowledge and experience from the large-sized insurers. This means that it will take a good amount of time for the overall industry to adopt IFRS 4.

Data accumulation for the new measurement model is a different matter even if the small to medium-sized insurers can share the knowledge and experience. Considering that the majority of the small to medium-sized insurers depend on the data produced by Korea Insurance Development Institute (KIDI), a preparation period to gather the own historic data of the company for the new measurement model will be required. For example, as non-market external data such as a mortality rate has lower credibility than the internal data, internal data is absolutely required. However, as these data are not accumulated, a long preparation time will be required.

Others

IFRS 4 and 9 are likely to have an important impact on establishing a business plan such as asset management plan or risk management plan. Therefore, time to establish or modifying such plans will also be required.

Question 18 – Other comments Do you have any other comments on the proposals in the exposure draft?

AOSSG members question whether, in practice, insurers could always clearly and consistently distinguish between portfolio transfers and business combinations.
Unless the replacement Standard for IFRS 4 includes more robust criteria for distinguishing between such transactions, we would recommend the replacement standard require portfolio transfers and business combinations to be accounted for on the same basis.

Question 19 – Benefits and cost
Do you agree with the Board's assessment of the benefit and cost of the proposed accounting for insurance contracts? Why or why not? If feasible, please estimate the benefit and cost associated with the proposal.

AOSSG members agree with the Board's assessment that the benefit will be greater than the cost.

AOSSG members also note that presenting the source of revenue on financial statements, measuring liabilities at the end of every reporting period, and detailed disclosure of change in insurance liability as a footnote will provide more useful information to the users than the previous IFRS 4 Phase I.

However, AOSSG members believe that parts of the exposure draft need to be improved to increase the benefit of the financial information, and parts need to be improved to lower the cost of the financial information.