Grupo Latinoamericano de Emisores de Normas de Información Financiera

October 25, 2013

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Re: Exposure Draft (ED/2013/7) on Insurance Contracts

Dear Board Members,

The "Group of Latin American Accounting Standard Setters" – GLASS[1] welcomes the opportunity to comment on the Exposure Draft of Insurance Contracts.

This response summarizes the views of our country-members, in accordance with the following due process.

Due-process

The discussions in regard to the ED were held within a specified Technical Working Group (TWG) created in July 2013. All country-members had the opportunity to designate at least one member to participate in this TWG, and the following countries did so: Argentina, Bolivia, Brazil (coordinator of this TWG), Colombia, Mexico, Panama, Uruguay and Venezuela.

Individually, all TWG members summarized the answers from their respective countries, subsequently; the answers presented in each country's summary were compared and discussed before preparing a consensus response.

Overall comments

We welcome the IASB decision to re-expose the Exposure Draft on Insurance Contracts that was first issued in July, 2010. We believe that the Exposure Draft 2013/7 has presented significant improvements in comparison with the "2010 Exposure Draft" and represent an important step to achieve more consistency on the evaluation and presentation of the insurance contracts worldwide. Also, since in many countries the accounting practices for insurance industry are established by

[1] The general objective of the Group of Latin American Accounting Standard Setters (GLASS) is to present technical contributions in respect to all documents issued by the IASB. Therefore, GLASS aims to have a single regional voice before the IASB. GLASS is constituted by: Argentina (Chairman), Bolivia, Brazil (Board), Chile, Colombia (Board),Costa Rica (Observer), Dominican Republic, Ecuador, El Salvador, Guatemala (Board), Honduras (Observer), Mexico (Vice chairman), Panamá, Paraguay, Perú, Uruguay (Board) and Venezuela (Board).

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Supervisory Agencies, the ongoing discussions and educations sections about the ED is important in order to expand the adhesion to the future standard.

Specific comments

Attached please find our specific responses to the ED.

If you have any questions about our comments, please contact glenif@glenif.org.

Yours sincerely,

Jorge José Gil
Chairman
Group of Latin American Accounting Standard Setters (GLASS)

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GLASS'Comment Letter on the IASB Exposure Draft on Insurance Contracts

ED 2013/7 – Insurance Contracts

Question 1

Adjusting the contractual service margin

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if differences between the current and previous estimates of the present value of future cash flows if:

(a) differences between the current and previous estimates of the present value of future cash flows related to future coverage and other future services are added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative; and

(b) differences between the current and previous estimates of the present value of future cash flows that do not relate to future coverage and other future services are recognized immediately in profit or loss?

Why or why not? If not, what would you recommend and why?

Response

We agreed with the principle of unlocking for changes in future cash flows and established a floor of zero. Adjusting the contractual service margin to reflect changes in estimates of cash flows relating to future coverage or other future services that affect the future profitability of the contract, would provide a more faithful representation of the remaining unearned profit in the contract after inception.

We also agreed that differences between the current and previous estimates of the present value of future cash flows that do not relate to future coverage and other future services must be recognized immediately in profit or loss.

We believe that some clarification is need about the following:

i) The unit of measurement for initial recognition is at a portfolio of contracts level, the guidance is too general and without further guidance, will likely result in diversity in practice and therefore difficult for the comparison among entities. We therefore believe guidance, in addition to the principle, is needed;
ii) How would an onerous test at contract inception for new contracts be applied with the context of a unit of account at the portfolio level.

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iii) Should the margin also be adjusted for the changes in the risk adjustment associated with future coverage or future services? This would be conceptually consistent with the revenue recognition principles, the treatment at initial recognition and subsequent measurement and the treatment of changes in estimates of the present value of future cash flows related to future coverage or other future services.

iv) How to deal with adjustments of the CSM for favorable changes in estimates of future cash flows in the subsequent period when a loss has been recognized in a previous period.

v) Also, more guidance on the application of the proposed model on high inflation environments and its effects on the discount interest rates is need.

Question 2

Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items

If a contract requires an entity to hold underlying items and specifies a link between the payments to the policyholder and the returns on those underlying items, do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if the entity:

(a) measures the fulfillment cash flows that are expected to vary directly with returns on underlying items by reference to the carrying amount of the underlying items?

(b) measures the fulfillment cash flows that are not expected to vary directly with returns on underlying items, for example, fixed payments specified by the contract, options embedded in the insurance contract that are not separated and guarantees of minimum payments that are embedded in the contract and that are not separated, in accordance with the other requirements of the [draft] Standard (i.e. using the expected value of the full range of possible outcomes to measure insurance contracts and taking into account risk and the time value of money)?

(c) recognizes changes in the fulfillment cash flows as follows:

(i) changes in the fulfillment cash flows that are expected to vary directly with returns on the underlying items would be recognized in profit or loss or other comprehensive income on the same basis as the recognition of changes in the value of those underlying items;

(ii) changes in the fulfillment cash flows that are expected to vary indirectly with the returns on the underlying items would be recognized in profit or loss; and

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(iii) changes in the fulfillment cash flows that are not expected to vary with the returns on the underlying items, including those that are expected to vary with other factors (for example, with mortality rates) and those that are fixed (for example, fixed death benefits), would be recognized in profit or loss and in other comprehensive income in accordance with the general requirements of the [draft] Standard?

Why or why not? If not, what would you recommend and why?

Response

We agreed that if the entity is required to hold underlying items and specifies a link to returns on those underlying items, there will be no economic mismatches, therefore any accounting mismatches would also be eliminated if the fulfillment cash flows is measured on the same basis of the recognition of changes in the value of those underlying items.
The requirement to measure and present the expected cash flows that are expected to vary directly with returns on underlying items on a different basis from other cash flows would better represent the effects/results of the contracts on the financial position, profit and loss and other comprehensive income. Although separating the contract cash flows into several different categories may be too complex and onerous and may lead to different interpretation.

Question 3

Presentation of insurance contract revenue and expenses

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if, for all insurance contracts, an entity presents, in profit or loss, insurance contract revenue and expenses, rather than information about the changes in the components of the insurance contracts?

Why or why not? If not, what would you recommend and why?

Response

We support that the insurance contract revenue brings consistency with the revenue recognition model, both in how it reports premiums as revenue over time and what elements of premiums are reported as revenue. Also many users of financial statements use the measures of revenues and expenses to assess gross performance.

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Question 4

Interest expense in profit or loss

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if an entity is required to segregate the effects of the underwriting performance from the effects of the changes in
the discount rates by:

(a) recognizing, in profit or loss, the interest expense determined using the discount rates that applied at the date that the contract was initially recognized. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows; and

(b) recognizing, in other comprehensive income, the difference between:

(i) the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date; and

(ii) the carrying amount of the insurance contract measured using the discount rates that applied at the date that the contract was initially recognized. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows?

Why or why not? If not, what would you recommend and why?

Response

The use of OCI for interest movements will avoid accounting mismatches for debt instruments accounted for using OCI, but does not resolve situations where a company holds debt instruments at fair value through profit and loss, derivatives, private equity funds, etc. in order to fulfill the obligations created by insurance contracts.

The mandatory application of the OCI in the cases that a company holds debt instruments with non-fixed interest rate, equity, derivatives to back insurance liabilities could generate accounting mismatches. A possible solution of this accounting mismatch issue would be to make use of OCI for insurance liabilities a requirement, unless it would lead to an accounting mismatch. The disadvantage would be, perhaps, less comparability, although we believe this would be outweighed by the benefits of avoiding accounting mismatches. Another possibility to reduce mismatches due to differences in accounting for financial instruments as per IFRS 9 would be a requirement for entities to measure the assets linked to long term insurance contracts at fair value through OCI.

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We believe that some clarification is need about what to do with the amounts previously booked in OCI, as those amounts would not reverse over time in a natural way.

Some further clarification is also need on how to deal with the reversal of OCI amounts when assets are sold, what to do then with the reversal of the insurance liability related amount in OCI.

Question 5

Effective date and transition

Do you agree that the proposed approach to transition appropriately balances comparability with verifiability?

Why or why not? If not, what do you suggest and why?

Response

We agreed that applying IAS 8 gives consistency in the measurement of the insurance contracts liability, contractual service margin, revenue and profit on the insurance contracts in force at the date of transition and those for new contracts issued after transition. We understand that in many cases entities will be able to make a reasonable estimative of the remaining contractual service margin based on internal historical information of its insurance contracts portfolios. However, if the IASB will require different effective dates for IFRS 9 and the new standard for insurance contracts, we recommend that for all insurance entities:

a) The effective date of IFRS 9 should be deferred until the effective date of the new standard for insurance contracts. In our opinion, early application of both IFRS 9 and the new standard for insurance contracts should be allowed in order to facilitate the application of provisions related to both IFRS 9 and the new standard of insurance contracts as soon as possible, and;
b) Institutions should be authorized to reconsider the use of the fair value option and classifications of investments accounted for under IFRS 9, at first time adoption of the new standard for insurance contracts

We do have some concern about the creation of simplification approach “C5” and “C6”, when preparers assess that is impracticable to apply the Standard to measure an insurance contract retrospectively that could lead preparers to conclude that it is not practicable to apply the general retrospective approach to some portion of their existing policies in-force.
Also, estimates that may not be verifiable as assumptions used to define contractual service margin, discounting rates can create additional complications for auditors given the subjective nature of the guidance provided.

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We agree with an implementation period of three years from the date of publication of the new standard on insurance contracts. Due to the complexity of the Standard associated with the fact that the implementation will compete with day to day activities, regulatory requirements, etc., some respondents also suggested that the Board should consider the effective transition to take place in 4 years after the issuance of the Standard.

Question 6

The likely effects of a Standard for insurance contracts

Considering the proposed Standard as a whole, do you think that the costs of complying with the proposed requirements are justified by the benefits that the information will provide? How are those costs and benefits affected by the proposals in Questions 1–5?
How do the costs and benefits compare with any alternative approach that you propose and with the proposals in the 2010 Exposure Draft?

Please describe the likely effect of the proposed Standard as a whole on:

(a) the transparency in the financial statements of the effects of insurance contracts and the comparability between financial statements of different entities that issue insurance contracts; and
(b) the compliance costs for preparers and the costs for users of financial statements to understand the information produced, both on initial application and on an ongoing basis.

Response

As currently proposed the standard will improve comparability among insurance accounting globally as many countries have not made significant changes on the implementation of IFRS 4 Phase I in respect to the local accounting practices used to measure and present insurance contracts. Life insurers will face the main impacts due to its characteristics, duration of contracts, etc., but that will also impact non-life insurers since they will need to discount some liabilities, including the application of OCI for the effect of changes in discount rates.

The benefits of having a more consistent standard to measure insurance contracts is really positive, but implementation will certainly generate costs for systems, training, data, definition of models, etc., which is a concern, especially in countries that adopted the IFRS also for statutory purpose, because it will affect all companies that issue insurance contracts independently of their size. At this point is difficult to access the cost-benefit of the implementation of the proposed standard, which can vary significantly depending on the case.

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Question 7 **Clarity of drafting** Do you agree that the proposals are drafted clearly and reflect the decisions made by the IASB? If not, please describe any proposal that is not clear. How would you clarify it?

Response

We do understand that IASB's objective is to have principles-based standard, but we believe the guidance and given examples are not comprehensive and detailed enough, as we have commented in the questions above, which can result in significant differences of interpretation and application compromising the uniformity and comparison.

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