Dear Sir David,

The mutual and cooperative insurers of AMICE have studied IASB’s Exposure Draft – Insurance Contracts with interest and welcome the opportunity to express their views. These will mainly address common insurance issues with a special focus on the preoccupations of the small and medium sized insurers which make up a large part of AMICE’s membership.

AMICE represents the mutual and cooperative insurance sector in Europe, with close to 120 direct members in 17 countries and 7 national associations of mutual/cooperative insurers. More than two thirds of all insurers in Europe belong to the mutual and cooperative insurance sector which accounts for close to 25% of all insurance premiums paid by European policyholders.

We are pleased to see the process leading to the ED reaching an end and welcome the fact that it seems to be partially compatible with Solvency II bearing in mind its different objectives. The current ED shows a much better understanding of insurance products but we would have liked to see detailed examples with figures as in previous drafts. This would have enabled a better measurement of the value of one solution over the other.

There are however some areas of concern which are listed below:

- As Ms Koenig pointed out in our meeting on 7 October, the ED deals with contracts. We agree with that approach but want to emphasize that insurance is generally based on highly standardized products (built on tariffs) that are collective by their nature. This is especially true for consumer products (including insured pensions). Additionally, in some jurisdictions, insurance was historically formed with the objective of sharing risks within a group (which today would be classified as consumers or small businesses), for example France (cattle) and Sweden (fire). In other words mutuality and standardized contracts have been the norm and a portfolio approach is natural. In other jurisdictions,
however, the spreading of business risks to “investors” is the historical background and the contracts have been less standardized, for example the UK (shipping). This kind of contract is more unique and fit for a case-by-case examination.

- The IASB is proposing both single contract and portfolio approaches, but it is not always clear how the ED is to be read, especially in those cases (onerous contracts, residual margin) where the text seems to refer to a single contract. For mutuals with consumer products built on risk sharing, this lack of clarity is difficult to cope with.

- Regarding the scope, we believe it is important that the perimeters of the contract are the same in Solvency II as in IFRS accounting. Specifically, whilst we agree that the IFRS should apply to the pool of insurance contracts, we strongly suggest that the arbitrary condition that “there also exist insurance contracts that provide similar contractual rights to participate in the performance of the same insurance contracts” p. 45, be given up. We believe that this condition places form over substance and is hence irrelevant.

- We find it difficult to value the accounts of insurance companies given that a lot of components are far from being convergent (residual margin released in guarantee period, reinsurance released immediately, risk margin released until the end of the contract, changes in estimations recognised immediately etc.) which makes it difficult to provide meaningful results. Part of this confusion comes from the ED’s treatment of life and non life under the same heading in spite of their differences.

- The IASB sets an arbitrary divide between short term and long term contracts (non life contracts can be long term). We understand that short term contracts should cover mainly non-life products. We strongly support the ED’s approach for short term contracts: rebates should be made simpler, more understandable, intuitive and lead to comparability, with one caveat on paragraph 59 which stipulates that “an insurer shall accrete interest on the carrying amount of the pre-claims liability, using the discount rate specified in paragraph 30, updated in each reporting period”; this adds complexity with no real impact and creates a burden for small entities which would just spread the premium.

- As regards paragraph 60 on onerous contracts, we recommend not using the insurer’s arbitrary projection but keeping the mean of two years of the insurer’s claims and expenses (for one branch). Furthermore, paragraph 14, b) second alinea states that an insurer becomes a party to an insurance contract on whichever date is earlier, the date of inception (...) when the insurer can no longer withdraw from its obligation to provide insurance coverage to the policyholder”. In reality, systems are not designed to anticipate future contracts; the practice is that a contract starts when the cover does. Therefore, between the date of inception and the date of commencement, a usual insurance contract is by its nature an executor contract. When this contract is onerous, according to IFRS principles, a corresponding liability is to be recognised.

AMICE agrees with this principle and proposes that insurance contracts be recognised at the commencement of the contract (i.e. the beginning of coverage period), except when executor contracts between the date of inception and the date of commencement meet the definition of an onerous contract. However, we believe that if we follow the IASB’s approach and base the calculations on a model whereby the company evaluates its claims rate and expenses prospectively, it is very improbable that it considers future contracts as onerous. No substantial modification is likely to intervene between the pricing and sales dates. We thus recommend combining this paragraph
with the definition on insurance contract (p 46): insurance contract effectively start when the insurer provided a cover, not before. This view is also more coherent with the fact that residual margin should be amortised from the beginning of coverage period and not before.

- Present value of the fulfilment cash flows, p.24: it is difficult to say that expected cash flows are reliable in the long term; their place in the model should be better framed. Theoretically, it is correct that the figure is hard to obtain and is not accurate. We do not disagree with the principle that it is volatile but somehow it will have to be connected to Solvency II. This situation does not mirror reality and is contrary to the purpose of bookkeeping which should be faithful to reality and should not aim to steer the business. Some provisions are not built for products as sold and built today and even less tomorrow.

- Question 9 – Contract boundary principle: we believe this issue to be more Solvency II related (it is still open in the QIS 5 exercise). We would like to link this issue with expected cash flows: if the customer has the ability to make voluntary contributions into a contract, expectations will be very risky and imprecise. Additionally, we note that everything is inter-related (good remuneration will probably result in the customer investing more money, in particular in contracts with discretionary features). If the marginal liability caused by a future premium on a previous contract is equal to the liability caused by the same premium on a new identical contract, then this future premium should not be taken into account.

- In the IASB’s model, the valuation of the contract at the beginning is crucial: the residual margin is locked at the beginning and there is no changing of this margin even if later valued differently. Margins locked in at the beginning should not be used as shock absorbers: we support EFRAG’s position that the residual margin should be adjusted to offset the changes from the re-measurement of the present value of fulfilment cash flows that affect future periods. What would happen if a company artificially inflated its future cash flows at inception to reduce the locked margin? This company would then gain supplementary leeway to amortize its costs in the future. This could be avoided if the residual margin is changed for the future.

- Paragraph B73 limits the choice of techniques for estimating risk adjustments to the confidence level, conditional tail expectation (CTE) and cost of capital techniques. We believe that one single method is not necessarily adapted to all branches of insurance.. Consequently the company must chose and justify ex ante the method it deems to be more adapted to the fulfilment approach according to the nature and type of contract. Thus, the confidence level method seems more pertinent for short time non life insurance whereas the cost-of-capital method could be preferred for life insurance.

- Question 10 participating features: We agree that the measurement of insurance contracts should include participation benefits on an expected present value basis as we believe that this theoretically reflects the true economic value of such contracts. However, we note that participating contracts are significantly different in terms of contract and fund structures within different jurisdictions. In particular, there are significant differences in relation to how the excess over policyholder liabilities is treated. The Basis for Conclusions states that the Board decided not to address accounting for unallocated surplus in the ED and we believe that further consideration is required in this area. In this regard, we recognise that one solution will not suit all types of contracts. For example, the ED proposals do not adequately address Swedish
mutuals where unallocated surplus is utilised as risk capital and hence is more akin to equity.

- Contracts with participation benefits are however mutual by nature and when such contracts are covered by a mutual insurance company a “double mutuality” appears. It therefore becomes necessary to split the accumulated profits (the surplus funds) into a member/company part and a participation/contract part. In that case accurate calculations built on both historic data and assumptions of the future will be needed. AMICE asks the IASB to look at this issue again in order to clarify the situation taking into account the diversity of insurance contracts. Special consideration also must be made to jurisdictions where surplus funds are fully loss absorbent.

- We do not have the impression that the ED addresses contracts with participating features in which participation is based on realised financial gains in a coherent way whereas the underlying assets are potentially valued according to fair value measurement. We believe that an alternative solution could be to create an identical mechanism to the one featured in IAS 12 on deferred taxes. When a temporal difference exists between the accounting value of an asset and its assessed value for the calculation of the profit sharing, a deferred participation in the profits should be recorded. This would avoid complex and arbitrary calculations of future projections regarding profit sharing which should in the end lead to quite similar results.

- Question 17: transition and effective date: the proposed method, consisting in setting the residual margin at zero during the transition phase could be seen as a simplification method. We believe the latter should be maintained for companies which do not wish to adopt a fully retrospective method, more coherent with IAS 8.

---------------------------------