March 5, 2015

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

Dear Sir/Madam,

The Canadian Institute of Actuaries (CIA) is the national organization of the actuarial profession in Canada. The CIA establishes the Rules of Professional Conduct, guiding principles, and monitoring and discipline processes for qualified actuaries. All members are expected to adhere to the profession's standards of practice and support Guiding Principle 1, which holds the duty of the profession to the public above the needs of the profession and its members. The CIA also establishes guidance to support standards developed by the Actuarial Standards Board, which are applicable to actuaries working in Canada.

We acknowledge that the IASB has not requested input at this time. However, the CIA would like to offer the following comments related to the IASB's recent discussions on insurance contracts. We hope that you will find our comments useful.

Contractual Service Margin

We want to raise a concern regarding the IASB's current direction that the level of aggregation for determination of the contractual service margin (CSM) at inception should be such that loss-making contracts are to be separately identified and reported from profit-making contracts. This decision is impractical for insurance entities to implement and fails to accurately reflect the insurance business model. Many common business practices result in some contracts having gains while others have losses at issue for a particular product that are appropriate to net when determining the CSM. In our view, it is appropriate to calculate the CSM at inception on an aggregate basis by product for new business sold in a reporting period.

Pricing processes are designed to achieve a certain level of profitability for a product and not for each individual policy. Under the proposed approach, any policy that is projected to earn profits in its lifetime less than the risk adjustment would report a loss at issue even if the projected profitability for the block in total exceeds the risk adjustment. There are many assumptions used in pricing and valuation, and there may be differences for valid business reasons that result in some policies appearing to be unprofitable within a block of business that is profitable overall.

As an example, expenses are shared among portfolios of contracts and it is a sound business practice that some subgroups of policies may only be required to be profitable excluding certain non-variable expenses. When the size of a policy differs from the overall portfolio average, smaller policies (i.e., lower premium/sum assured) will be less profitable because certain expenses are allocated on a per-policy basis and conversely larger policies are more profitable. Requiring the insurance entity to report a loss at inception on those small policies, while deferring the profit to be recognized over the policy term for the large policies, is a false representation of the insurer's business model.

To require that a portfolio of new business written in a reporting period be reviewed on a contract-by-contract basis to identify onerous contracts at inception is a burdensome reporting requirement. Furthermore, in relation to a March 2014 IASB decision that favourable changes in estimates related to future services should be recognized immediately in profit or loss to the extent that they reverse prior losses, tracking for this purpose must also be on a contract-by-contract basis. This is introducing complexity and cost into the financial reporting system significantly out of proportion to the benefit to users, and can produce results that are not consistent with the insurer's business model.

Treatment of Initial Application of Standards (Transition Rules)

The tentative decision from the October 2014 meeting is to apply the new standards retrospectively, unless this is impracticable. If it is deemed impracticable, insurers can apply the proposed simplifications (e.g., expected cash flows, risk adjustment, discount rates) at transition to approximate a retrospective application. Finally, if these simplifications are also impracticable, insurers can adopt a fair value approach, where the CSM at transition is based on the difference between a fair value of the liability and the fulfilment cash flows. We believe that most, if not all, insurers will find retrospective application impracticable, even with the proposed simplifications, and will have no choice but to follow the fair value approach. Therefore, we believe that more guidance is needed on the implementation of the fair value approach, to improve comparability of reporting across different insurers at transition. Alternatively, further simplifications might help to make the simplified retrospective application practicable.

It would be useful to allow a comment period for any new or additional guidance on the fair value approach or simplifications to retrospective application prior to final decisions being made, in order to assess the practical implications and provide comments.

Participating Insurance

The IASB is reviewing the book yield and effective yield approaches that could be used to determine the interest expense presented in profit or loss, and the effect of changes in discount rates presented in Other Comprehensive Income.

Given the significant implications of using one method or another, it would be useful to allow a comment period on the revised proposal, prior to a final decision being made later this year.

Conclusion

The CIA hopes that its comments provided herein will be of value to you.

Regards,

Jacques Tremblay, FCIA
President