Amendment to Standard

Accounting and Reporting

Financial Reporting Council

May 2016

Amendments to FRS 103 *Insurance Contracts*

Solvency II

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries, and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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Solvency II

Amendments to FRS 103 Insurance Contracts – Solvency II amends an accounting standard. It is issued by the Financial Reporting Council in respect of its application in the United Kingdom and promulgated by the Institute of Chartered Accountants in Ireland in respect of its application in the Republic of Ireland.

Contents

Summary

(i) With effect from 1 January 2015, the Financial Reporting Council (FRC) revised financial reporting standards in the United Kingdom and Republic of Ireland. The revisions fundamentally reformed financial reporting, replacing the extant standards with five Financial Reporting Standards:

(a) FRS 100 *Application of Financial Reporting Requirements*;

(b) FRS 101 *Reduced Disclosure Framework*;

(c) FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*;

(d) FRS 103 *Insurance Contracts*; and

(e) FRS 104 *Interim Financial Reporting*.

The FRC has also issued FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* to support the implementation of the new micro-entities regime. It is effective from 1 January 2016 with early application permitted.

These limited amendments to FRS 103 update it to reflect the implementation, from 1 January 2016, of the Solvency II Directive.

(ii) The FRC's overriding objective in setting accounting standards is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.

(iii) In meeting this objective, the FRC aims to provide succinct financial reporting standards that:

(a) have consistency with international accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;

(b) reflect up-to-date thinking and developments in the way entities operate and the transactions they undertake;

(c) balance consistent principles for accounting by all UK and Republic of Ireland entities with practical solutions, based on size, complexity, public interest and users' information needs;

(d) promote efficiency within groups; and

(e) are cost-effective to apply.

Amendments to FRS 103 – Solvency II

(iv) These amendments to FRS 103 update the terminology and definitions used for changes in the regulatory framework, following the implementation of the Solvency II Directive. Established accounting policies can continue to be applied if an entity so chooses.

Amendments to FRS 103 *Insurance Contracts*

Amendments to Section 1 *Scope*

1 The following paragraphs set out the amendments to Section 1 *Scope* (deleted text is struck through, inserted text is underlined).

2 Paragraph 1.5 is amended as follows:

1.5 Paragraph 2.3 permits entities to change their **accounting policies**, either on adoption of this FRS or subsequently, providing their new accounting policies meet certain criteria. Entities that are setting accounting policies in relation to insurance contracts, or other financial instruments with discretionary participation features, for the first time, shall for long-term insurance business either:

(a) first consider the requirements of Section 3, the Regulations and any relevant parts of FRS 102~~, as a means of establishing current practice~~ as a benchmark before assessing whether to set accounting policies that differ from those benchmark policies in accordance with paragraph 2.3; or

(b) establish accounting policies that are based on the rules under the **Solvency II Directive** for the recognition and measurement of technical provisions, and any relevant requirements of this FRS, the Regulations and FRS 102. In doing so an entity shall make appropriate adjustments to the Solvency II rules to ensure that the accounting policies result in information that is relevant and reliable.

The Implementation Guidance accompanying this FRS also provides guidance.

3 Paragraph 1.11A is inserted as follows:

1.11A In May 2016 amendments were made to this FRS, to update it for changes in the regulatory framework. An entity shall apply these amendments for accounting periods ending on or after 1 January 2016.

Amendments to Section 2 *Accounting Policies, Recognition and Measurement*

4 The following paragraph sets out the amendments to Section 2 *Accounting Policies, Recognition and Measurement* (inserted text is underlined).

5 Paragraph 2.3A is inserted as follows:

2.3A One basis for changing accounting policies might be to enable them to be more consistent with the rules under the **Solvency II Directive** for the recognition and measurement of technical provisions. In doing so an entity shall make appropriate adjustments to the Solvency II rules to meet the requirements of paragraph 2.3.

Amendments to Section 3
Recognition and Measurement: Requirements for entities with long-term insurance business

6 The following paragraphs set out the amendments to Section 3 *Recognition and Measurement: Requirements for entities with long-term insurance business* (deleted text is struck through, inserted text is underlined).

7 Paragraph 3.1 is amended as follows (and 'realistic capital regime' is no longer shown in bold type):

3.1 This section sets out requirements for entities applying this FRS that are carrying out **long-term insurance business**:

(a) Paragraphs 3.3 to 3.<u>9</u>~~10~~ and 3.16 to 3.18 apply to all long-term insurance business.

(b) Paragraphs 3.1<u>0</u>~~1~~ to 3.15 apply to **with-profits business** and with-profits funds, to which the **Prudential Regulatory Authority (PRA)** realistic capital regime <u>(as set out in section 1.3 of **INSPRU** as at 31 December 2015)</u> ~~i~~<u>wa</u>s being applied, either voluntarily or compulsorily<u>, prior to 1 January 2016</u>.

8 Paragraph 3.1A is inserted as follows:

<u>3.1A This section sets out the benchmark for setting **accounting policies** for long-term insurance business as at 1 January 2015. Entities are permitted to change their accounting policies in accordance with paragraph 2.3. Entities that are setting accounting policies for the first time may apply this benchmark in accordance with paragraph 1.5(a) or are permitted to set alternative policies in accordance with paragraph 1.5(b).</u>

9 Paragraph 3.2 is amended as follows:

3.2 Where an entity has changed its **accounting policies** in accordance with paragraph 2.3 <u>or adopted accounting policies in accordance with paragraph 1.5(b)</u>, and its ~~new~~ accounting policies are ~~no longer~~<u>not</u> consistent with this section, the requirements of this section that are ~~no longer~~<u>not</u> consistent with the entity's accounting policies need not be applied.

10 Paragraph 3.7 is amended as follows, and renumbered as paragraph 3.10:

3.~~7~~<u>10</u> **Acquisition costs** shall not be deferred for with-profits funds~~ to which the PRA realistic capital regime is being applied, either voluntarily or compulsorily~~.

11 Paragraphs 3.8 is amended as follows, and renumbered as paragraph 3.7:

3.~~8~~<u>7</u> Except as required by paragraph 3.<u>10</u>~~7~~, acquisition costs shall be deferred except to the extent that:

(a) ...

12 Paragraphs 3.9 and 3.10 are renumbered as paragraphs 3.8 and 3.9.

13 Paragraph 3.11 is amended as follows:

3.11 The established accounting treatment for long-term insurance business is to measure liabilities for policyholder benefits under the **modified statutory solvency basis (MSSB)**. This FRS requires ~~those~~ with-profits funds ~~within the scope of the PRA realistic capital regime~~ to use the **realistic value of liabilities** as the basis for the estimated value of the liabilities to be included in the **financial statements**.

14 Paragraph 3.12 is amended as follows:

3.12 For with-profits funds~~ to which the PRA realistic capital regime is being applied, either voluntarily or compulsorily~~:

(a) liabilities to policyholders arising from with-profits business shall be stated at the amount of the realistic value of liabilities adjusted to exclude the shareholders' share of projected future **bonuses**;

(b) **reinsurance recoveries** that are recognised shall be measured on a basis that is consistent with the value of the policyholder liabilities to which the reinsurance applies;

(c) an amount may be recognised for the **present value** of future profits on **non-participating business** written in a with-profits fund if~~:~~

~~(i) the non-participating business is measured on a realistic basis for the purposes of the regulatory returns made under the PRA realistic capital regime;~~

~~(ii) the value is determined in accordance with the PRA regulations; and~~

~~(iii)~~ the determination of the realistic value of liabilities in that with-profits fund takes account, directly or indirectly, of this value;

(d) where a with-profits life fund has an interest in a subsidiary or associate and the determination of the realistic value of liabilities to with-profits policyholders takes account of a value of that interest at an amount in excess of the net amounts included in the entity's consolidated accounts, an amount may be recognised representing this excess; and

(e) adjustments to reflect the consequential tax effects of (a) to (d) above shall be made.

Adjustments from the MSSB necessary to meet the above requirements, including the recognition of an amount in accordance with paragraph 3.12(c) or 3.12(d), shall be included in **profit or loss**. An amount equal and opposite to the net amount of these adjustments shall be transferred to or from the **fund for future appropriations (FFA)** and also included in profit or loss.

Amendments to Section 4
Disclosure

15 The following paragraph sets out the amendments to Section 4 *Disclosure* (deleted text is struck through, inserted text is underlined).

16 Paragraph 4.5 is amended as follows:

4.5 To comply with paragraph 4.4 an insurer shall disclose:

(a) ...

(b) the process used to determine the assumptions that have the greatest effect on the measurement of the recognised amounts described in (<u>a</u>~~b~~). When practicable, an insurer shall also give quantified disclosure of those assumptions;

(c) ...

Amendments to Appendix I: Glossary

17 The following glossary terms and definitions, and footnote 8 (subsequent footnotes will be renumbered sequentially), are deleted:

~~**long-term fund**~~	~~The fund or funds maintained by an undertaking in respect of its **long-term insurance business** in accordance with the **PRA** rules.~~
~~**realistic capital regime**~~	~~As set out in section 1.3 of INSPRU[8].~~

~~[8] References to the PRA's Prudential sourcebook for insurers, and to individual rules therein, are to the rules made on 1 April 2013 by the FCA and PRA Handbook Designation (General Modifications) Instrument 2013.~~

18 The following glossary term and definition is inserted in alphabetical order:

<u>**Solvency II Directive**</u>	<u>Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), as amended by Directive 2013/58/EU, and as implemented in the United Kingdom and Republic of Ireland.</u>

19 The following glossary terms and definitions are amended as follows (deleted text is struck through, inserted text is underlined):

equalisation provisions	As defined in the relevant regulatory framework~~ (eg **INSPRU**)~~.
gross premium method	A form of actuarial valuation of **liabilities** arising under long-term insurance contracts where the premiums brought into account are the full amounts receivable under the contract. The method includes explicit estimates of cash flows for: (a) premiums, adjusted for renewals and lapses; (b) expected claims and for **with-profits business** future regular but not occasional or terminal **bonuses**; (c) costs of maintaining contracts; and (d) future renewal expenses. Cash flows are discounted at the valuation interest rate. The methodology may be set out in the relevant regulatory framework. ~~For UK companies this is included in the **PRA** Handbook.~~ The discount rate is based on the expected return on the assets deemed to back the **liabilities**~~ as prescribed by the PRA Handbook. This may be further constrained by a maximum rate set by the PRA~~. This will be adjusted to reflect any further risks although, under this method, most of the key risks will be reflected in the modelling of the cash flows. For **linked business**, allowance may be made for the purchase of future units required by the contract terms and credit is taken for future charges permitted under those terms.

modified statutory solvency (MSSB)	The basis for determining **insurance liabilities** which is the **statutory solvency basis** adjusted for the following items: (a) to defer new business **acquisition costs** incurred where the benefit of such costs will be obtained in subsequent **reporting periods**; and (b) to treat investment, resilience and similar reserves, or reserves held in respect of general contingencies or the specific contingency that the fund will be closed to new business, where such items are held in respect of **long-term insurance business**~~within the **long-term fund**~~, as reserves rather than provisions. These are included, as appropriate, within shareholders' capital and reserves or the **fund for future appropriations (FFA)**.
mutual	As defined in the **PRA** ~~Handbook~~Rulebook.
net premium method	An actuarial valuation of **liabilities** arising under long-term **insurance contracts** where the premium brought into account at any valuation date is that which, on the valuation assumptions regarding interest, mortality and disability, will exactly provide for the benefits guaranteed. A variation of the net premium method involves **zillmerisation**. The detailed methodology for UK companies is included in regulations contained in the **PRA** ~~Handbook~~Rulebook as at 31 December 2015.
non-participating business	**Long-term insurance business** where **policyholders** are not entitled to share in the surplus of the relevant ~~**long-term fund**~~ long-term business.
principles and practices of financial management (PPFM)	The statement that the ~~**PRA**~~Financial Conduct Authority requires each **with-profits** life fund to make available to its **policyholders** containing, inter alia, a description of the fund's investment management and bonus distribution policies.
Prudential sourcebook for insurers (INSPRU)	The section of the **PRA** ~~Handbook~~Rulebook detailing the prudential rules for **insurers**, including capital requirements, credit, market and **liquidity risk** for periods ending before 1 January 2016.
realistic value of liabilities	That element of the amount defined by rule 1.3.40 ~~in~~of **INSPRU** as at 31 December 2015, excluding current **liabilities** falling within the definition set out in rule 1.3.190 of INSPRU as at 31 December 2015 that are recognised separately in the **statement of financial position**.
regulatory capital resources	An entity's capital resources as calculated in accordance with the ~~capital resources table in **INSPRU**~~regulatory framework.
statutory solvency basis	The basis of determination of **insurance liabilities** in accordance with rule 1 of **INSPRU** as at 31 December 2015.
with-profits business	**Long-term insurance business** ~~where **policyholders** are contractually entitled to share in the surplus of the relevant **long-term fund**~~which provides benefits through eligibility to participate in discretionary distributions based on profits arising from the **insurer**'s business or from a particular part of the insurer's business. A with-profits contract is an example of a contract with a **discretionary participation feature**.

Amendments to Appendix IV: Note on legal requirements

20 The following paragraph sets out the amendments to Appendix IV: *Note on legal requirements* (deleted text is struck through, inserted text is underlined).

21 The table in paragraph A4.3 is amended as follows (only the line that is amended is shown here):

Legislation	**Overview of requirements**
~~Industrial and Provident Societies Act 1965~~ <u>Co-operative and Community Benefit Societies Act 2014</u>	The Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008 require every society that is an insurance undertaking to prepare its financial statements substantially as though it were a company registered under the Companies Act 2006.

Amendments to Implementation Guidance to accompany FRS 103 *Insurance Contracts*

Amendments to Implementation Guidance – Section 1
Guidance for entities with long-term insurance business

22 The following paragraphs set out the amendments to Implementation Guidance – Section 1 *Guidance for entities with long-term insurance business* (deleted text is struck through, inserted text is underlined).

23 Paragraph IG1.1 is amended as follows (footnote 1 is not amended and is not repeated here):

IG1.1 An entity may, but is not required to, adopt the requirements of paragraph 3.12 of **FRS 103** *Insurance Contracts* for UK[1] **with-profits business** that does not fall within the scope of ~~the **PRA realistic capital regime** or for which the PRA has granted a full waiver from compliance with this regime~~paragraph 3.1(b) of FRS 103. If an entity changes its **accounting policy** for such with-profits business it shall only do so in accordance with paragraph 2.3 of FRS 103.

24 Paragraph IG1.2 is amended as follows:

IG1.2 The shareholders' share of projected future **bonuses** deducted in accordance with paragraph 3.12(a) of FRS 103 should be calculated as the value of future transfers to shareholders calculated using market consistent financial assumptions, and assuming that transfers take place at a level consistent with those assumptions used to calculate the **realistic value of liabilities**~~within the PRA realistic balance sheet~~. Where an explicit assumption is not required in order to calculate the **liabilities** ~~under the PRA's approach~~ then continuation of the current profit sharing arrangements should be assumed unless the firm has plans to change this approach. Non-economic projection assumptions should be consistent with those used in determining the realistic value of liabilities~~elsewhere in the realistic balance sheet~~. The amount deducted in accordance with this paragraph should be taken to the **fund for future appropriations (FFA)**. If shareholders transfers have been included as part of the ~~PRA~~ realistic value of liabilities~~y~~ (or otherwise included in liabilities) then the amount of such transfers should be taken out of liabilities and included in the FFA, together with any related tax liability. If shareholders transfers have not been set up as part of the ~~PRA~~ realistic value of liabilities~~y~~ or elsewhere, no adjustment is required.

25 Paragraph IG1.3 is amended as follows and 'realistic value of liabilities' is no longer shown in bold type:

IG1.3 ~~Under the PRA realistic capital regime~~In determining the realistic value of liabilities, a with-profits life fund may take account of~~includes within assets~~ the value of future profits expected to arise from any **non-participating business** that forms part of the with-profits fund—sometimes referred to as the **value of in-force life assurance business (VIF)**. Excluding the VIF from the **statement of financial position** whilst recognising the realistic value of liabilities in full, and valuing the non-participating liabilities in the with-profits fund on a statutory basis, would give rise to an inconsistency in the fund's net assets. An entity is therefore permitted to recognise the VIF if that business has been taken into account in measuring the liability, in the circumstances of paragraph 3.12(c) of FRS 103, even though there is not a direct link between the value of the asset and the amount of the liabilities. Where there is not a direct link between the value of the business and the amount of realistic liabilities, but the value is taken into account in determining those liabilities, it is appropriate to recognise the total value of the business. Although not separately identifiable, any excess value over that included in realistic liabilities will be taken to the FFA.

26 Paragraph IG1.4 is amended as follows:

IG1.4 Paragraph 3.12(c) of FRS 103 permits an amount to be recognised for VIF on non-participating business written in a with-profits fund when~~: (i) the non-participating business is measured on this basis for the purposes of the regulatory returns made under the PRA realistic capital regime; (ii) the VIF is calculated on the basis used in the PRA realistic capital regime; and (iii)~~ the determination of the realistic value of liabilities takes account of this value either directly or indirectly. Where with-profits **policyholders** are entitled to a share of the profits on non-participating business it would generally be expected that the determination of the realistic liabilities would take account, directly or indirectly, of the value of future profits on this business.

27 Paragraph IG1.6 is amended as follows:

IG1.6 The VIF recognised within assets ~~for regulatory purposes~~ as described in paragraph IG1.3~~2~~ is determined as the discounted value of future profits expected to arise from the policies, taking into account liabilities relating to the policies measured on the~~a~~ **statutory solvency basis**. ~~When~~This includes adjustments ~~are~~ made onto a **modified statutory solvency basis (MSSB)** for the purposes of the **financial statements** (for example, to adjust liabilities to exclude certain additional reserves included in the liabilities ~~for regulatory purposes~~when measured on the statutory solvency basis, or where future income included in the VIF covers **deferred acquisition costs** included in the ~~MSSB~~ statement of financial position).~~,~~ A~~a~~ corresponding adjustment to the value of in-force policies will need to be made in order to ensure a consistent valuation.

28 Paragraph IG1.7 is amended as follows:

IG1.7 Paragraph 3.12 of FRS 103 ~~requires~~permits ~~that~~ the recognition of a VIF asset ~~recognised~~when the ~~should be~~ determin~~ed~~ation ~~in accordance with~~ of the realistic value of liabilities takes account of this value~~capital regime requirements~~. Paragraph IG1.4 explains that the value calculated ~~under the realistic capital regime requirements~~ must be adjusted to ensure consistency where adjustments have been made onto the MSSB measurement basis in relation to non-participating contracts. The measurement of the VIF asset ~~recognised in accordance with the realistic capital regime~~ may take into account the release of capital requirements for non-participating business. It would not be appropriate to recognise this release of capital requirements within the VIF asset presented in the accounts because the MSSB liabilities do not include an allowance for capital. Therefore the amount of the VIF asset ~~determined for the purposes of the PRA realistic capital regime~~ should be adjusted accordingly.

29 Paragraph IG1.8 is amended as follows:

IG1.8 The profit recognition profile for non-participating contracts which do not satisfy FRS 103's definition of an insurance contract or contain a **discretionary participation feature** will be determined by the requirements of Sections 11, 12 and 23 of **FRS 102**. Where these contracts are written in a with-profits fund, paragraph IG1.4 will apply but the VIF recognised for such contracts ~~for the purposes of the PRA's realistic capital regime~~ should be adjusted to reflect the difference in the profit recognition bases between the basis used to determine the VIF ~~used in~~taken into account in determining the realistic value of liabilities~~capital regime~~ and the profit recognition profile determined by FRS 102.

30 Paragraph IG1.9 is amended as follows:

IG1.9 Paragraph 3.12(d) of FRS 103 permits that when~~re~~ a with-profits fund has an interest in a subsidiary or associate and the determination of~~that is valued for PRA regulatory purposes~~ the realistic value of liabilities takes account of a value for that interest at an amount in excess of the net amounts that would be included in the entity's consolidated accounts, an amount may be recognised representing this excess ~~if the determination of the realistic value of liabilities to with-profits policyholders takes account of this value~~. As explained in paragraph 3.15 of FRS 103 this situation could arise where the subsidiary or associate writes non-participating business and the value of the subsidiary or associate ~~recognised for PRA reporting purposes~~ incorporates the VIF of non-participating business written in the subsidiary or associate. The value of the subsidiary or associate ~~recognised for PRA reporting purposes~~ is reduced by the subsidiary's or associate's capital requirement as noted in rule 1.3.33(3) of **INSPRU** as at 31 December 2015. When preparing both consolidated and non-consolidated accounts, the excess value that may be recognised should therefore be taken as the excess before deduction of the subsidiary's or associate's capital requirement.

31 Paragraph IG1.10 is amended as follows:

IG1.10 Where the amounts on a 'realistic' basis determined in accordance with paragraph 3.12 of FRS 103 are different from the amounts on the~~a~~ MSSB, a corresponding amount is transferred to or from the FFA, so that there is no effect on **equity**. The potential shareholders' share corresponding to additional bonuses to policyholders that have been included in the policyholders' liability should be accounted for in the FFA. As a result, there will generally be no change in the profit for the **reporting period** except where the adjustments result in a negative balance on the FFA and the entity determines that this negative balance should result in a deduction from equity through **profit or loss**.

32 Paragraph IG1.11 is amended as follows:

IG1.11 Entities with with-profits business within the scope of paragraph 3.1(b) of FRS 103~~the PRA realistic capital regime~~ are required to measure the liability of that business in respect of **options and guarantees** relating to policyholders either at **fair value** or at an amount estimated using a **market-consistent stochastic model** ~~in accordance with PRA regulations~~.

33 Paragraph IG1.12 is amended as follows (footnote 2 is not amended and is not repeated here):

IG1.12 For all entities with **long-term insurance business**, the best basis for measuring policyholders' options and guarantees is one that includes their time value[2]. Any **deterministic approach** to valuation of a policy with a guarantee or optionality feature will generally fail to deal appropriately with the time value of the option. Therefore stochastic modelling techniques to evaluate the range of potential outcomes should be used unless a market value for the option is available. The ~~PRA realistic capital regime~~regulatory framework includes a requirement to value options and guarantees on this basis. For the liabilities of businesses not falling within the scope of ~~the PRA realistic capital regime~~paragraph 3.1(b) of FRS 103, entities are encouraged, but not required, to adopt these valuation techniques. Where options are not valued on this basis, additional disclosures are required; these are set out in paragraph IG3.14(c).

34 Paragraph IG1.13 is amended as follows:

IG1.13 In determining the value of guarantees and options under the ~~PRA realistic capital regime~~regulatory framework, the entity will take into account under each scenario in the market-consistent stochastic modelling management actions it anticipates would be taken in response to variations in market variables (such as changing the balance of the investment portfolio between debt instruments and equity, varying the amount charged to policyholders, or varying its bonus policy) that will affect the amount payable under the guarantee or option. Such actions must be realistically capable of being implemented within the timescale assumed in the scenario analysis, and be consistent with the entity's published **principles and practices of financial management~~s~~ (PPFM)**.

Amendments to Implementation Guidance – Section 2 *Guidance for entities with general insurance business or long-term insurance business*

35 The following paragraphs set out the amendments to Implementation Guidance – Section 2 *Guidance for entities with general insurance business or long-term insurance business* (deleted text is struck through, inserted text is underlined).

36 Paragraph IG2.28 is amended as follows:

IG2.28 Disclosure should be made where an equalisation reserve has been established in accordance with the **PRA** ~~Handbook~~Rulebook. Where equalisation reserves are established, an entity should disclose the following in the notes to the financial statements:

(a) that the amounts provided are not liabilities because they are in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the reporting date;

(b) notwithstanding this, they are required by Schedule 3 to the Regulations to be included within technical provisions; and

(c) the impact of the equalisation reserves on **equity** and the effect of movements in the reserves on the profit or loss for the reporting period.

37 Paragraph IG2.42 is amended as follows:

IG2.42 The long-term business provision may be calculated on the basis used for regulatory reporting ~~under PRA rules~~ subject to appropriate adjustments including~~:~~

~~(a) reassessment of the provisions and reserves included in the statutory liabilities for solvency purposes to consider the extent to which they should be included in the long-term business provision. This will require the exclusion of the appropriate proportion of reserves (such as investment reserves, reserves to cover general contingencies and reserves to cover the specific contingency of the fund being closed to new business). Any amount in excess of the necessary provision should be disclosed in the financial statements as a reserve or in the **fund for future appropriations (FFA)** as appropriate; and~~

~~(b)~~ the reversal of any reduction in policyholder liabilities ~~in the regulatory returns~~ where these liabilities already implicitly take account of a pension fund surplus through future expense assumptions which reflect lower expected contributions.

38 Paragraph IG2.48 is amended as follows:

IG2.48 The net assets held to cover linked liabilities at the reporting date may differ from the technical provisions for linked liabilities. The reasons for any significant mismatching should be disclosed. ~~In practice this should apply only to overseas companies included in consolidated financial statements because of the requirements of rule 3.1.57 of **INSPRU**.~~

39 In paragraph IG2.50 the first occurrence of 'FFA' is replaced by 'fund for future appropriations (FFA)' in bold type.

40 Paragraph IG2.53 is amended as follows:

IG2.53 The investment return (which includes movements in realised and **unrealised investment gains and losses**) and related tax charges on assets representing reserves which are held for~~within~~ the relevant **long-term insurance**

business~~**long-term fund**~~ for solvency purposes ~~under the PRA rules~~ should be credited to the technical account for long-term business. Allocations may then be made as appropriate to the **non-technical account** in accordance with paragraphs IG2.65 and IG2.66 or to the FFA. When the regulatory framework does not require the entity to set up a long-term fund for its long-term insurance business, the entity shall make the allocations as appropriate between the technical and non-technical account and disclose the basis of its allocation in the notes to the financial statements.

41 The rubric before paragraph IG2.56 is amended as follows:

Paragraphs IG2.56 to IG2.58 ~~provide guidance for applying the requirements of paragraphs 2 and 3 of the instructions for completing Form 47 in the PRA rules. They~~ are only relevant to long-term insurance business.

42 Paragraph IG2.60 is amended as follows:

IG2.60 On consolidation, the profit or loss of any non-insurance entity belonging to the long-term fund (as defined in **INSRPU** as at 31 December 2015) may be included directly in the technical account for long-term business. Where material, more detailed disclosure should be provided in the notes to the financial statements. Where an entity carrying on general insurance business is ~~owned by~~an asset of the long-term ~~fund~~insurance business, the profit or loss of this business should be transferred from the non-technical account to the technical account for long-term business using new lines for this purpose.

Approval by the FRC

Amendments to FRS 103 Insurance Contracts – Solvency II was approved for issue by the Board of the Financial Reporting Council on 19 May 2016, following its consideration of the Corporate Reporting Council's Advice.

The Corporate Reporting Council's Advice to the FRC to issue *Amendments to FRS 103 – Solvency II*

Introduction

1 This report provides an overview of the main issues that have been considered by the Corporate Reporting Council in advising the Financial Reporting Council (FRC) to issue A*mendments to FRS 103 Insurance Contracts – Solvency II*.

2 The FRC, in accordance with the *Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012* (SI 2012/1741), is a prescribed body for issuing accounting standards in the UK. The *Foreword to Accounting Standards* sets out the application of accounting standards in the Republic of Ireland.

3 In accordance with the *FRC Codes and Standards: procedures*, any proposal to issue, amend or withdraw a code or standard is put to the FRC Board with the full advice of the relevant Councils and/or the Codes & Standards Committee. Ordinarily, the FRC Board will only reject the advice put to it where:

(a) it is apparent that a significant group of stakeholders has not been adequately consulted;

(b) the necessary assessment of the impact of the proposal has not been completed, including an analysis of costs and benefits;

(c) insufficient consideration has been given to the timing or cost of implementation; or

(d) the cumulative impact of a number of proposals would make the adoption of an otherwise satisfactory proposal inappropriate.

4 The FRC has established the Corporate Reporting Council as the relevant Council to assist it in the setting of accounting standards.

Advice

5 The Corporate Reporting Council is advising the FRC to issue *Amendments to FRS 103 Insurance Contracts – Solvency II.*

6 The Corporate Reporting Council advises that these proposals will update FRS 103 *Insurance Contracts* for changes in the regulatory framework and ensure that established accounting policies can continue to be applied if an entity so chooses.

7 The Accounting Council's Advice[1] to the FRC to issue FRS 103 was set out in that standard. The Corporate Reporting Council's Advice to the FRC in respect of these amendments will be included in the revised FRS 103.

Background

8 When FRS 103 was issued in March 2014 the Accounting Council advised the FRC to review, in due course, whether or not consequential changes to FRS 103 would be required for the commencement of Solvency II.

9 As Solvency II is effective from 1 January 2016 this review has now been carried out and the Corporate Reporting Council advises that limited amendments are made to FRS 103

[1] From 1 April 2016 the Accounting Council was renamed as the Corporate Reporting Council.

to reflect the changes in the regulatory regime. The Corporate Reporting Council does not advise making any other changes to FRS 103 at this time.

10 The FRC consulted on the proposals for amendments to FRS 103 in FRED 64 *Draft amendments to FRS 103 – Solvency II*. The responses to FRED 64 have been considered in developing this advice.

Amendments to FRS 103

11 FRS 103 makes a number of references to the PRA realistic capital regime, which was replaced by Solvency II from 1 January 2016. In addition, it refers to the Prudential sourcebook for insurers (INSPRU), which was replaced from the same date. As these references are out of date, amendments are required to FRS 103.

12 In considering the amendments that are required, the Corporate Reporting Council advises that entities should be permitted to continue to apply established accounting practices in their financial statements, if they choose to do so. It notes that FRS 103 already includes the ability for an insurer to change its accounting policies for insurance contracts if it judges certain criteria are met, and therefore there is no need to introduce specific new accounting policies relating to Solvency II.

13 In response to suggestions from respondents to FRED 64, the Corporate Reporting Council advises making it clearer in FRS 103 that one basis for changing accounting policies might be in order to achieve greater alignment with Solvency II. This is reflected in paragraph 2.3A.

Scope of Section 3 Recognition and Measurement: Requirements for entities with long-term insurance business of FRS 103

14 The Corporate Reporting Council notes that paragraph 3.1(b) of FRS 103 describes the circumstances in which the requirements for with-profits liabilities and related assets apply, which was based on those to which the PRA realistic capital regime applied. The Corporate Reporting Council considered the following two options for revising the description of the scope of these requirements:

(a) describe more fully the current scope; or

(b) describe the scope by reference to Solvency II.

15 The Corporate Reporting Council noted that describing the scope by reference to Solvency II may extend the application of the relevant requirements of FRS 103 to entities not previously within their scope. As the Corporate Reporting Council's aim was to limit the amount of change in accounting policies that would be required, the Corporate Reporting Council advises effectively retaining the existing definition, but qualifying it to note that entities are within the scope of the requirements if they applied the realistic capital regime prior to 1 January 2016.

Revised definitions

16 Some of the key definitions within FRS 103 were based, either directly or indirectly, on the rules of INSPRU. As a result of INSPRU being replaced by Solvency II for many insurers, these definitions needed revising. In FRED 64 the FRC proposed a revised description for the 'established method of accounting for long-term insurance business' (to replace the modified statutory solvency basis) and that both that definition and the definition of the 'realistic value of liabilities' should be principles-based, and consistent with accounting policies applied in periods ending before 1 January 2016.

17 Respondents noted that the definitions described features that could be attributed to many bases and included the term ‘appropriate’ without further guidance. Some respondents suggested that retaining the current definitions, but clarifying that the references to INSPRU were to INSPRU as at 31 December 2015, would be a preferable solution. The Corporate Reporting Council noted that, as it did not intend the changes to FRS 103 to result in changes in accounting practice, however the phrases were defined, in practical terms entities would need to refer to INSPRU as at 31 December 2015 in order to continue with their existing accounting policies. Therefore the Corporate Reporting Council advises retaining the existing definitions of the ‘modified statutory solvency basis’ and the ‘realistic value of liabilities’, and amending them to refer to INSPRU as at 31 December 2015. The Corporate Reporting Council noted that the PRA Rulebook can be accessed ‘as at’ a certain date, and therefore this is a practical solution.

New entrants

18 Some of the respondents to FRED 64 noted that paragraph 1.5 of FRS 103 required new entrants establishing accounting policies for insurance contracts for the first time to consider the requirements of Section 3 of FRS 103 as a means of establishing current practice as a benchmark before assessing whether to ‘improve’ those policies. They noted that this might be unduly burdensome as new entrants would be required to assess their accounting policies against a benchmark which they would not need to consider for regulatory reporting purposes.

19 The Corporate Reporting Council considered the framework that should apply to new entrants, which might include both entirely new entities and new entities established within an existing group or business, as a result of a business reorganisation. Section 3 of FRS 103 was developed from previous UK accounting practice, and does not have an equivalent in IFRS. As a result, some respondents suggested that Section 3 of FRS 103 could be deleted, which would be consistent with IFRS and have little, or no, practical effect on existing entities.

20 The Corporate Reporting Council advises that a benchmark should be retained, in order to maintain a consistent starting point for insurers selecting their accounting policies for insurance contracts for the first time. The Corporate Reporting Council also notes that, although existing entities are not required to change their accounting policies, the change in regulatory regime may be a trigger for some entities to ‘improve’ their accounting policies, in order to make them more consistent with the new regulatory framework. As a result, ‘current practice’ may be evolving. Therefore, in light of the fact that the current benchmark is based on the previous regulatory regime, and the possible changes in current practice, the Corporate Reporting Council advises permitting two alternative starting points for new entrants. One is the requirements of Section 3 of FRS 102, and the other is to establish policies that are consistent with the relevant requirements of the Solvency II Directive, subject to any appropriate adjustments.

Accounting policies based on the requirements of Solvency II

21 The Corporate Reporting Council considered whether aspects of the rules under the Solvency II Directive might need amendment for use in measuring liabilities for financial reporting purposes. The Corporate Reporting Council advises that appropriate adjustments may be necessary in order to ensure that the financial statements meet the qualitative characteristics of information in financial statements (as set out in Section 2 *Concepts and Pervasive Principles* of FRS 102). This is reflected in paragraphs 1.5(b) and 2.3A of FRS 103.

22 The Corporate Reporting Council notes that items to consider, when determining whether and to what extent appropriate adjustments are required, might include the following:

(a) transitional adjustments that may be made for regulatory purposes;

(b) the volatility adjustment to the discount rate that is made for regulatory purposes;

(c) the risk margin that is applied for regulatory purposes; and

(d) 'surplus funds' when these reflect contractual obligations of cash flows to policyholders.

Regulatory framework

23 Not all entities applying FRS 103 will be subject to the same regulatory framework. In some instances the regulatory framework will set requirements relating to amounts to be recognised in the financial statements. When FRS 103 refers to a requirement of the regulatory framework, the Corporate Reporting Council advises that an entity shall apply the requirements of the regulatory framework that applies to it. This may result in differences in accounting between some entities. For example, most entities will not be required by the regulatory framework to recognise an equalisation provision from 1 January 2016.

Effective date

24 The Corporate Reporting Council advises that these amendments should be effective for accounting periods ending on or after 1 January 2016. Early adoption should not be permitted because this is consistent with the effective date of the new regulatory framework.

Future development of FRS 103

25 When FRS 103 was issued, the Accounting Council advised that, in addition to reviewing FRS 103 when Solvency II was implemented, once the IASB had issued its new insurance standard the requirements of FRS 103 should be reviewed. This project has not yet been completed by the IASB, and consequently it is still not possible to determine the appropriate timing for this further review of FRS 103.

Approval of this advice

26 This advice to the FRC was approved by the Corporate Reporting Council on 10 May 2016.

FRC

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