The Institute of Chartered Accountants of Zimbabwe

INTEGRITY HOUSE, CORNER BATH ROAD & S. NUJOMA STREET, HARARE
P.O. BOX CY1079, CAUSEWAY, HARARE
TELEPHONE: 263-4-793471/793950/793674/252672
FASCIMILE:263-4-706245
EMAIL:administrator@icaz.org.zw
http://www.icaz.org.zw

Peter Clark
Senior Project Manager
International Accounting Standards Board
30 Cannon St
London EC4M 6XH
United Kingdom

22 October 2003

Dear Madam,

RE: ED 5 INSURANCE CONTRACTS

Please find enclosed our comments on ED 5 Insurance Contracts.

Yours faithfully.

C M Billin
Technical Director

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ZIMBABWE

ED 5 Insurance Contracts

Question 1 -Scope

We agree that financial guarantees and insurance against credit risk, product warranties, and accounting by policy holders all do not fall within the scope of the draft IFRS.
We agree that financial guarantees and insurance against credit risk contracts currently fall within the scope of IAS 39; product warranties are not included as insurance contracts as they do not involve a transfer of risk from buyer to seller; and as far as the accounting by policyholders is concerned, the board intends to address the issues in phase 2.
Some issues are addressed in IAS 37 and SIC 14, so there is no need for them to he covered here.
(a)(i) We agree with the concerns expressed that mismatches may arise if financial assets held to back insurance contracts are measured at fair value under IAS 39 whilst insurance liabilities are measured on a different basis. Hence their exclusion from the standard.

(ii) We agree, however, that contracts that do not transfer significant insurance risk should be treated according to the provisions of IAS 39 as applying a single set of accounting requirements to all sets of financial instruments will make an insurer's financial statements more relevant and reliable.

(b)We agree with the Board's decision to remove the existing scope exclusion in IAS 39 and thus make such contracts subject to the IFRS on insurance contracts, if payment is contingent on an uncertain future event that adversely affects the contract holder, and in all other cases contracts subject to

Question 2- Definition of insurance contract

The proposed definition of "insurance contract" is aligned to the definition generally accepted by the insurance industry. The exposure draft is meant to better regulate accounting practices, procedures and policies within the insurance industry. Thus it is pertinent to define insurance contracts in a manner that is generally accepted by the industry the standard is meant to regulate.

It is interesting that the Board seems to have considered the definition of insurance contracts in other accounting standards e.g. GAAP

Perhaps it would be equally or more important to consider the definition of insurance contracts in countries who would potentially be implementing IFRS

Whilst the Board's view in this respect is noted as stated in BC11, it is not the country's definition that is of relevance, but rather consideration of whether there is a general view in the industry regardless of situation, in respect of the definition of insurance contract

Question 2 (Contd.)

If this approach is adopted it would then be possible to define basic aspects of insurance contracts that could supplement the definition in the standard.

Question 3 - Embedded derivatives

(a) We agree that the proposed exemptions are appropriate.
(b) We agree that it is appropriate to exempt these embedded derivatives from fair value measurement in phase 1 of this project.
(c) We consider these disclosures to be adequate.
(d) We agree that no other embedded derivatives should be exempt from the requirements in IAS 39.

Question 4 - Temporary exclusion from criteria in IAS 8

(a) The IFRSs need to consider practical implementation criteria to encourage the wide spread acceptance and use. In this regard the proposal for temporary exclusion from criteria in IAS 8 takes into consideration that Phase II of the project may have a significant costly impact on the insurers method of accounting therefore rendering it impractical to effect change until phase II is complete (BC53 refers).
This exemption is therefore appropriate

(b) (i) The exception of catastrophe and equalization provision is consistent with the view that the IFRS must in quality be consistent.

Furthermore since in the phase II project it is likely that the nature of these provisions will be addressed and not permitted, it is appropriate not to exempt this from IAS 8

(ii) The exemption of the loss recognition test is appropriate.

The need to introduce a measurement basis that is generally accepted already will provide an independent criteria for determining the value of loss recognition.

(iii) The off - selling exemption is appropriate and can be implemented immediately.

Question 5 - Changes in accounting policies

(a) We agree with the proposal that the change must result in a more relevant and reliable financial statements.
(b) We agree that an insurer may continue to use existing accounting policies that involve discounting, excessive prudence, future investment margins, investment management fees and the use of non-uniform accounting policies, but any new accounting policy that involves any of them may not satisfy the requirement of

Question 5 (Continued)

the provision of relevant and reliable financial statements.

Question 6 — Unbundling

a We feel that unbundling deposit components of insurance contracts is appropriate in terms of avoiding omission of assets and liabilities. However, unbundling would not be feasible due to the following

a. The split of deposit components is difficult as some contracts are priced holistically, making the unbundling process purely academic and leading to inconsistencies between two insurance companies splitting an identical transaction.
b. IT systems would require costly modifications in order to comply with this requirement. This would derail acceptance of the entire standard if it were deemed onerous.
c. The unbundled deposit component is not only subjective to fluctuations/inconsistencies arising from discount rate fluctuations, but is affected by the varying levels of claims from year to year (which is already accounted for in the technical account).

It is therefore suggested that unbundling should not be pursued due to the subjectivity and cost and consideration should be given towards expanded disclosures where there is any indication of potential financial commitments / assets.

b. Unbundling should be required in cases where there are large customized contracts where the visible intention of the contract is to create identifiable assets and liabilities that can be reliably measured. This would be fairly subjective and dear guidelines would be required to demarcate contracts where unbundling is required.
c. it is not currently clear when unbundling is required. Perhaps a numerical level should be set above which unbundling is required. For example for contracts with a deposit component that potentially exceeds 20% of the value of the total contract. Whilst it is likely (that this could lead to accounting arbitrage this could be countered by requiring mandatory disclosures where unbundling was not done. A secondary requirement would be to state that deposit components that have not been unbundled and are merely should not exceed a certain percentage (e.g. 5%) of the lesser of total assets and total liabilities per the balance sheet.

Question 7 - Reinsurance purchased

We consider the proposals to be appropriate

Question 8 - Insurance contracts acquired in a business combination or portfolio transfer

The proposals in paragraphs 20 to 23 of the draft JFRS seem appropriate in terms of fair valuing of insurance assets and insurance liabilities. It is already current practice in most cases to measure at fair value insurance liabilities and assets acquired in a business combination.

The draft IFRS permits the splitting of acquired insurance contracts into two (liability measured as per insurer's accounting policies and secondly an intangible asset to the extent that the initial liability does not reflect fair value. The paragraph states that the intangible asset should be subsequently measured in line with the related measurement liability. The potential shortcoming of this is that an insurer may seek to limit the intangible asset to manipulate amortisation thereafter. It is therefore suggested that the liability measured as per the insurer's accounting policies should be more clearly defined. For example, the liability in such an instance could be measured as the present value of future cash out / in flows with a stated discount rate to be used as is the case with IAS 36. The main risk is that this could pre-empt issues that

Question 8 (continued)

will be more fully addressed in Phase II which will probably have more specific guidance in terms of the fair value measurement

Another issue is that in a business combination the acquirer will probably have a different accounting policy for insurance contracts in comparison the acquirees policies. It is possible that the acquiree's policies could be more appropriate to the particular insurance contracts acquired which will clearly highlight the distortion that occurs on acquisition. Thus the guidelines need to cater for such an eventuality

Paragraph 20 - 23 of the draft IFRS is probably appropriate in the meantime given the fact that phase II wilt give, more specific guidance as to fair value measurement of insurance liabilities and assets Furthermore, the paragraph only permits instead of requiring the expanded presentation which is just as well given the subjectivities

Conclusion: Adopt Paragraph 20 - 23, although consideration should the given towards finding a way of outlining more specific criteria to split the fair value of acquired Insurance contracts in the next phase.

Question 9 - Discretionary participation features

We consider these proposals to be appropriate

Question 10 Disclosure of the fair value of insurance assets and insurance liabilities

We agree that it is appropriate to require an insurer to disclose the fair value of its insurance assets and liabilities. However in the absence of a definitive fair value model, we do not see how practical this could be. Implementation should follow when measurement basis has been agreed, otherwise comparison of different companies will be difficult.

Question 11 - Other disclosures

(a) We are in agreement with the proposed disclosure requirements.
(b) We agree that this approach is appropriate
(c) We agree that no changes need be made to this transitional relief.

Question 12- Financial guarantees by the transferor of a non-financial asset or liability

Yes we believe that it is appropriate that IAS 39 should apply to a financial guarantee given in connection with the transfer of non - financial assets or liabilities