FEDERATION BANCAIRE DE L'UNION EUROPEENNE
BANKING FEDERATION OF THE EUROPEAN UNION
BANKENVEREINIGUNG DER EUROPÄISCHEN UNION

EUROPEAN SAVINGS BANKS GROUP
GROUPEMENT EUROPEEN DES CAISSES D'EPARGNE
EUROPÄISCHE SPARKASSENVEREINIGUNG

Sir David Tweedie
International Accounting Standards
Board Chairman
30 Cannon Street
London EC4M 6XH
United Kingdom

CRO(0560.03)

Re: Response of the European Banking Federation (EBF) and the European Savings Banks Group (ESBG) to the proposals of ED5 Insurance Contracts published by the International Accounting Standards Board.

Dear Sir Tweedie,

Please find enclosed the comments of the European Banking Federation (EBF) and the European Savings Banks Group (ESBG) on the Exposure Draft (ED5) on Insurance Contracts.

The EBF and ESBG believe that it is important to consider the issue of insurance contracts not only from the insurance perspective but also to take into account the potential impact it will have on bancassurers.

As mentioned in the general comments' section of the enclosed position paper, the EBF and ESBG would like to draw the attention of the Board to the fact that many of the proposals of the ED 5 anticipate the outcome of decisions which remain to be taken under Phase II. In several instances, the options proposed are more complex and therefore difficult to implement. In the event of any delay to Phase II of the project, these interim measures could be in place for some time. In this regard, the EBF and ESBG would ask the IASB to strongly place an emphasis on consistency, both in terms of the standard itself as well as its interaction with other standards.

The EBF and ESBG fear that the use of current existing accounting policies for the measurement of liabilities and the use of IAS 39 rules for the valuation of assets, proposed during Phase I, would create a mismatch between assets arid liabilities. This mismatch would have as a consequence the loss of a true and fair presentation of an insurer's accounts.

The EBE and ESBG would also like to highlight the fact that, in their opinion. the unbundling of insurance contracts is not currently relevant to be addressed as the developments planned for Phase II should eliminate the Board’s concerns about the omission of assets and liabilities from insurers’ balance sheets.

In terms of deferred acquisition costs and prospectiveness regarding IAS 39 the EBF and ESBG believe that IAS 39 should be amended in order to allow a deferral of acquisition costs for contracts which are consistent with contracts in terms of IAS 18 (“Revenue recognition")

We remain at your continued disposal should you wish to discuss the issues addressed in the position paper.

Yours sincerely,

Sig
Nikolaus BOMCKE
Secretary General of the EBF Secretariat

Sig
Chris DE NOOSE
Chairman of the ESBG Management Committee

c.c Mr. Clark, IASB Senior Project Manager

ED 5 - INSURANCE CONTRACTS
JOINT POSITION OF THE EUROPEAN BANKING FEDERATION AND EUROPEAN SAVINGS BANKS GROUP

1. INTRODUCTION

The European Banking Federation (EBF) and the European Savings Banks Group (ESBG) appreciate the opportunity afforded by the International Accounting Standards Board (IASB) to comment on the Exposure Draft (ED5) on Insurance Contracts.

The EBF and ESBG believe that it is important to consider the issue of insurance contracts from not only the insurance perspective but also to take into account the potential impact on bancassurers. Of particular importance are the potential flow on effects and the interaction with standards on financial instruments, e.g. IAS 39.

These comments while highlighting the problems associated with the proposals will endeavour to focus on those issues of particular complexity for bancassurers.

2. GENERAL COMMENTS

2.1 Timing of the Proposals

ED 5 is regarded as Phase I of the project of accounting for insurance contracts, and is therefore only intended as an interim solution until Phase II is finalised In this regard, many of the issues raised by the EBF and ESBG throughout this paper are related to the interaction of Phase I (ED 5) and Phase U of the insurance contracts project.

Many of the proposals in ED 5 anticipate the outcome of decisions which will be made in Phase II. Moreover, in several cases, the options proposed under ED 5 are more complex and therefore difficult to implement that potential result under Phase II. The requirements under Phase I will require system modifications which may need to be reversed or readjusted dependant upon which decisions are made under Phase II

Furthermore, in the event of any delay to Phase II of the project, these interim measures could be in place for some rime.

As such, the EBF and ESBG asks the IASB to place a strong emphasis on achieving consistency both in terms of the standard itself as well as its interaction with other standards.

Consistency with IAS 39 is in this regard of vital importance. Phase II may well require accounting for insurance contracts at fair value, however this has not yet been decided. As several uncertainties remain regarding the treatment under IAS 39, the EBF and ESBG would suggest the extension of the use of existing accounting policies in several cases until Phase II has been completed and the full implications of many of the decisions been thoroughly evaluated.
In addition, IAS 39 does not require comparatives, in 2004. A similar exemption should also be granted under ED 5.

2.2 Prospectiveness regarding IAS 39

The EBF and ESBG believe that IAS 39 should be amended such that deferral of all acquisition costs should be permitted, including internal costs such as employee costs. This deferral would however be limited to acquisition costs that are directly attributable. The amortisation of these deferred costs should be matched to the recognition of revenue from the related contracts.

The EBF and ESBG would, however, highlight the fact that a more significant issue arises in the context of liabilities accounted for at fair value where the "deposit floor" approach may preclude the recognition of a DAC asset

2.3 Assets and liabilities mismatch

The EBF and ESBG would like to underline the different and inconsistent measurement of assets and liabilities that will occur in Phase I. The use of current existing accounting policies for the measurement of liabilities and existing IAS 39 (and IAS 40) for the valuation of the assets creates an artificial mismatch which makes the analysis of the financial information less understandable. It can also only distort the true and fair presentation of an insurer's accounts.

3. **SPECIFIC COMMENTS**

Question 1: Scope

The Exposure Draft proposes that the IFRS would apply to insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds, except for specified contracts covered by other IFRSs. The IFRS would not apply to accounting by policyholders (paragraphs 2-4 of the draft IFRS and paragraphs BC40-BC51 of the Basis for Conclusions).

The Exposure Draft proposes that the IFRS would not apply to other assets and liabilities of an entity that issues insurance contracts. In particular, it would not apply to:

(1) assets held to back insurance contracts (paragraphs BC9 and BC109-BC114). These assets are covered by existing IFRSs for example, IAS 39 Financial Instruments: Recognition and Measurement and IAS 40 Investment Property.
(ii) financial instruments that are not insurance contracts but are issued by an entity that also issues insurance contracts (paragraphs BC115-BC117)

Is this scope appropriate? if not, what changes would you suggest and why?

The EBF and ESBG believe that the standard should be renamed "Insurance Contracts and Financial Instruments with a Discretionary Participation Feature". The current title is somewhat misleading since it gives the opinion that the standard deals exclusively with insurance contracts. In actual fact, the current proposals have wider affects on many financial instruments currently coveted under IAS 39.

The EBF and ESBG have no objection to the decision that the accounting principles for insurance contracts apply to insurance contracts regardless by whom they are issued. However, the EBF and ESBG suggest that if there is doubt about the classification of a contract, that the contract should be presumed to be an insurance contract if it is issued by an insurance company.

A second important aspect to be taken into consideration is the mismatch between the measurement basis of assets (normally fair value) and insurance liabilities (usually amortised cost according to current local GAAP). The approach proposed by the IASB is therefore inappropriate since in many cases, the assets and liabilities are economically matched. In this regard, the EBF and ESBG agree with EFRAG that this is a cause for concern.

This approach will potentially result in significant distortions in financial statements which would no longer be representative of the underlying performance of the business. In the European Union, this will be particularly pronounced as a result of many common products, such as with profit contracts. The EBF and ESBG are concerned that the approach proposed will create less reliable, less relevant and more artificial results. Moreover, the resulting artificial volatility from this mismatch will be in equity impacting on the level of risk. As is the case for an insurance entity, this also has implications for solvency requirements for a banking entity. The proposals could therefore increase the volatility of the level of regulatory capital. There is also a risk that a new measurement will make many contracts appear unprofitable or require an increase in cost of capital.

A third aspect to consider is the implication that this approach has on the consistency of accounting treatment. Under the proposals in ED5. certain long-term financial contracts would be accounted for under IAS 39 and others under ED5. IAS 39 currently does not include sufficient guidance to account for long-term financial contracts correctly, and allows different interpretations and options that may result in inconsistent approaches. This is reinforced by the fact that under ED 5, there is also a lack of clear guidance on how insurance liabilities should be measured under either a fair value or amortized cost approach. In this regard, insurance liabilities could be measured in any number of ways. Moreover, fair valuing insurance is one of the more difficult techniques and yet it is proposed to adopt it before due consideration has really been given to the issues. Given the fact that measurement will be discussed under Phase II of the project, therefore, it would seem reasonable that details on how to measure insurance liabilities are also postponed until Phase II. As such, local GAAP rules should apply until after Phase II.

(b) The Exposure Draft proposes that weather derivatives should be brought within the scope of IAS 39 unless they meet the proposed definition of an insurance contract (paragraph C3 of Appendix C of the draft IFRS). Would this be appropriate? if not, why not?

The EBF and ESBG support EFRAG's view stated that it is appropriate that weather derivatives are brought within the scope of IAS 39 unless they meet the proposed definition of insurance contract.

Question 2 - Definition of Insurance Contract

The draft IFRS defines an insurance contract as a 'contract under which one party (the insurer) accepts significant insurance risk from another parry (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary' (Appendices A and B of the draft IFRS, paragraphs BC10-BC39 of the Basis for Conclusions and 1G Example 1 in the draft Implementation Guidance).

Is this definition, with the related guidance in Appendix B of the draft IFRS and IG Example 1, appropriate? If not, what changes would you suggest, and why?

The EBF and ESBO in general support the EFRAG position that the definition of an insurance contact set out in ED 5 when read in conjunction with the related guidance in Appendix B is acceptable.

It should be recognised that many financial products currently covered under IAS 39 will become insurance contracts under the new proposed definition. Moreover, many insurance related products would in turn be covered under IAS 39.

The definition proposed by the IASB however provides too much scope for different interpretations as to whether contracts should be classified as insurance or investment. The IASB should consider expanding its implementation guidance Including examples, particularly for marginal cases. It is however unlikely that additional implementation guidance could resolve this issue.

The EBF and ESBG believe it is however important to collaborate further on one example:

Many banks currently offer personal loans where the balance is not required to be repaid upon the death of the customer. Many mortgages require die borrower to have life insurance, but even so, early repayment penalties are often waived if the borrower dies. Any policy with this type of construction will need to be analysed to determine if there is "significant insurance risk". ED5 includes in the Implementation Guidance Example 1.2, a contract where the "death benefit could exceed amounts payable on surrender or maturity. The Implementation Guidance points to this type of instrument meeting the definition of an *"insurance contract (unless contingent amount is insignificant in all plausible scenarios). Insurers could suffer a significant loss on an individual contract if the policyholder dies early".*

The EBF and ESBG agree with the EFRAG comment letter that this example is too widely drawn, and that it will catch almost any contract that has a redemption penalty that is waived upon death. This would affect many loans and mortgages otherwise accounted for under IAS 39. The EBF and ESBG would suggest that, in the case where the death benefit exceeds the surrender amount, as stated in Example 1.2 the Board should narrow the wording in order to refer only to surrenders where the penalty is in excess of the recovery of outstanding acquisition costs, otherwise almost any contract that has a redemption penalty waived on death will be considered. (ie. delete the phrase *for the rest of the policyholders life").*

The EBF and ESBG also support EFRAG when it states *"EFRAG disagrees that pure endowment are best described as investment contracts unless there is a significant mortality risk Such policies make no payment unless the policyholder survives to the maturity of the policy and they are priced on the assumption that a proportion of policyholders will fail to survive until maturity of the policy. If a larger than expected proportion does survive to maturity, then the insurance company would make a significant loss. Conversely! if a smaller proportion survives the company would make a significant profit In each case the risk is significant and it is an insurance risk rather than an investment risk."*

Moreover, the EBF and ESBG believe that pure endowment contracts are insurance contracts and as a consequence should be included in the scope of ED5 considering that the policyholder of such a contract would be adversely affected if he had not a financial protection in case of survival.

Question 3—Embedded Derivatives

(a) IAS 39 Financial Instruments: Recognition and Measurement requires an entity to separate some embedded derivatives from their host con tract, measure them at *fair value and include changes in their fair value in profit or loss. This requirement would continue to apply to a derivative embedded in an insurance contract, unless the embedded derivative:*

(i) meets the definition of an insurance contract within the scope of the draft IFRS; or
(ii) is an option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate).

However, an insurer would still be required to separate, and measure at fair value:

(i) a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in an equity or commodity price or index; *and*

(ii) an option to surrender a financial instrument that is not an insurance contract. (paragraphs 5 and 6 of the draft IFRS paragraphs BC37 and BC118-BC123 of the Basis for Conclusions and IG Example 2 in the draft Implementation Guidance)

Are the proposed exemptions from the requirements in IAS 39 for some embedded derivatives appropriate? If not, what changes should be made, and why?

The EBF and ESBG are of the opinion that an embedded derivative which meets the definition of an insurance contract or is an option to surrender an insurance contract for a fixed amount should be excluded from the requirement to fair value. The EBF and ESBG however, support the IASB's view that other embedded derivatives should be measured at fair value as this could be in line with the approach proposed for Phase II. It is believed however that the need to identify and separately measure embedded derivatives may only be a temporary requirement given that the Phase II proposals may require the whole contract to be fair valued.

The measurement of a whole contract at fair value is easier to undertake than the unbundling of the contract to bifurcate the derivative. Moreover, given that the decision to use fair value at Phase U has not yet been taken therefore the work required at Phase I is unnecessarily complex.

In order to avoid significant time arid effort in Phase I, the EBF and ESBG would propose that the Board consider an exemption for all embedded derivatives within insurance contracts and investment contracts with a discretionary participation feature and instead place reliance on a loss recognition test to ensure that the level of provisions is adequate in Phase I.

(b) Among the embedded derivatives excluded by this approach from the scope of IAS 39 are items that transfer significant insurance risk but that many regard as predominantly financial (such as the guaranteed life-contingent annuity options and guaranteed minimum death benefits described in paragraph BC123 of the Basis for Conclusions). Is it appropriate to exempt these embedded derivatives from fair value measurenent in phase I of this project? If not, why not? How would you define the embedded derivatives that should be subject to fair value measurement in phase I?

We agree with the IASB's proposals and welcome the Board's decision that GAOs and GMDBs should be regarded as having insurance features which would not require them to be fair valued in Phase I. We agree that note disclosure should still be required, however, detailing theft existence and potential impact

(c) The draft IFRS proposes specific disclosures about the embedded derivatives described in question 3(b) (paragraph 29(e) of the draft IFRS and paragraphs IG54-1G58 of the draft implementation Guidance). Are these proposed disclosures adequate? If not. what changes would you suggest, and why?

It appears that ED 5 will require fair value disclosures and sensitivities in respect of embedded derivatives not separated from their host contracts. We would recommend that these disclosures be eliminated from the requirements until all Phase II measurement issues have been fully addressed.

(d) Should any other embedded derivatives be exempted from the requirements in IAS 39? If so, which ones and why?

We do not believe that any other embedded derivatives should be exempted.

Question 4- Temporary exclusion from criteria in IAS 8

(a) Paragraphs 5 and 6 of [the May 2002 Exposure Draft of improvements to] IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors specify criteria for an entity to use in developing an accounting policy for an item if no IFRS applies specifically to that item. However, for accounting periods beginning before I January 2007, the proposals in the draft IFRS on insurance contracts would exempt an insurer from applying those criteria to most aspects of its existing accounting policies for:

(i) insurance contracts (including reinsurance contracts) that it issues; and
(ii) reinsurance contracts that it holds.

(paragraph 9 of the draft IFRS and paragraphs BC52-BC58 of the Basis for Conclusions).

Is it appropriate to grant this exemption from the criteria in paragraphs 5 and 6 of [draft] IAS 8? If not, what changes would you suggest and why?

This exemption appears to be appropriate in Phase I and the EBF and ESBG consider that EDS should also explicitly address not only insurance contracts but also financial instruments with a discretionary participation feature.

Therefore, the EBE and ESBG in agreement with EFRAG disagree with the inclusion of the sunset dause, as it makes no provisions for any delay in the development of Phase *II* beyond 1 January 2007. In case of a delay in the Phase U, entities would have to use different accounting regimes entirely or partially, therefore creating their “own GAAP"

(b) Despite the temporary exemption from the criteria in [draft] IAS 8, the proposals in paragraphs 10-13 of the draft IFRS would:

(i) eliminate catastrophe and equalisation provisions..
(ii) require a loss recognition test if no such test exists tinder an insurer's existing accounting policies.

The EBF and ESBG agree with the exclusion from ED 5 of the calculation of equalisation and catastrophe provisions as a matter of principle, but not on the grounds of practicality. It is worthwhile underlining therefore that the consequences of such a decision will lead to the immediate recognition of artificial and undue earnings if no transitional arrangement is introduced in ED5. The EBF and ESBG recommend however a modification in the wording of paragraph 10(a) to ensure general understanding that the permission to keep provisions for existing contracts should not cover renewals of contracts.

Supporting EFRAG's view, the EBF and ESBG believe that more guidance should be provided on the way a loss recognition test should be conducted and especially more details about the scope (i.e. types of insurance contract) the test should cover. The EBF and ESBO would like to underline the fact that most of the local GAAPs require loss recognition tests, in accordance with local GAAP which are not necessarily compliant with IAS 37. As a consequence, some contracts may show losses under IAS 37 that would not occur under the local GAAP, even though looked at systematically, the two approaches would lead to comparable strength of provisions.

Question 5 - Changes in accounting policies

The draft IFRS:

(a) proposes requirements that an insurer must satisfy if it changes its accounting policies for insurance contracts (paragraphs 14-17 of the draft IFRS and paragraphs BC76-BC88 of the Basis for Conclusions).

(b) proposes that, when an insurer changes it's accounting policies for insurance liabilities, it can reclassify some or all financial assets into the category of financial assets that are measured at fair value, with changes in fair value recognised in profit or loss (paragraph 35 of the draft IFRS).

Are these proposals appropriate? If not. what changes would you propose and why?

The EBF and ESBG believe that a change in the accounting policies regarding the measurement of insurance liabilities and related investments should not be restricted.

The EBF and ESBG disagree with the requirements that an insurer must satisfy if it changes its accounting policies for insurance contracts. The requirements included in paragraph 16 assume that the measurement basis adopted in Phase II will be fair value. The EBF and ESBG do not believe that this decision should be pre-empted.. and hence suggest that no changes in accounting policy should be permitted for entities during Phase I.

While the EBF and ESBG recognize that it was not the intention of the IASB to create this outcome the proposals have an unintentional ensuing effect. The EBF and ESBG are in this respect concerned that the requirements of IAS 27, which requires a line-byline consolidation of subsidiaries, would be considered to be a change in accounting policy for those bancassurers who currently consolidate the results of their insurance businesses using a single-line embedded value approach or a single-line net equity method. We consider that a change in accounting policy of this type, which is merely presentational and unrelated to the actual accounting for insurance contracts should not constitute a change in accounting policy for insurance contracts as provided for in ED5
BC76-BC88

Regarding point (b), the EBF and ESBG consider that the possibility of transfer of financial assets from one category to another in accordance with IAS 39 should not be limited and be considered as optional. Effectively, at this juncture, the EBF and ESBG have insufficient detail regarding the accounting treatment for insurance liabilities and for financial contracts with a participation discretionary feature which depends on the completion of Phase 2 of the project.

Question 6 - Unbundling

The draft IFRS proposes that an insurer should unbundle (i.e account separately for) deposit components of some insurance contracts, to avoid the omission of assets and liabilities from its balance sheet (paragraphs 7 and 8 of the draft IFRS, paragraphs BC30-BC37 of the Basis for Conclusions and paragraphs IG5 and 1G6 of the proposed implementation Guidance).

(a) is unbundling appropriate and feasible in these cases? if not, what changes would you propose and why?

(b) Should unbundling be required in any other cases? if so, when and why?

(c) Is it clear when unbundling would be required? If not, what changes should be made to the description of the criteria?

The EBF and ESBG support the EFRAG draft comments, which state:

"(a) EFRAG regards the current proposal in paragraph 7 of ED 5 as an improvement to previous draft proposals as it recognises that unbundling is required only when the bundled nature of the plan obscures the proper accounting for the obligations.

However, EFRAG does not favour the unbundling of insurance contracts in principle, except in cases where the structure of the contract is clearly artificial This is because insurance contracts are, in general, designed, priced and managed as packages of benefits and, in consequence, any unbundling required solely for accounting purposes would necessarily be artificial.

Where the structure of a contract does obscure the accounting for the deposit element and unbundling of the insurance and investment components may he require, we believe the criterion should be that "the cash flows of the insurance component and the investment component do nor interact" rather than the current one-sided proposal to test if "the cash flows from the insurance component do not affect the cash flows from the deposit component". This change would lead to a more balanced approach and leave bundled a number of traditional products, where the one-sided test might apply unnecessarily.

(b) EFRAG does not believe that unbundling should be required in any other cases and we agree that surrender values should not be unbundled from traditional life contracts,

(c) Subject to the comments made under (a), EFRAG believes it is clear when unbundling is required during phase I."

In addition, the EBF and ESBG do not believe that unbundling of insurance contracts is appropriate especially given that the developments at Phase II should eliminate the Board's concerns. Should this requirement be maintained, this may mean that systems changes will need to be made for Phase I for something which may not be required under Phase II. The EBF and ESBG believe that this is contrary to one of the Board's objectives for Phase I.

Question 7 - Reinsurance Purchased

The proposals in the draft IFRS would limit reporting anomalies when an insurer buys reinsurance (paragraphs 18 and 19 of the draft IFRS and paragraphs BC89-BC92 of the Basis for Conclusions).

Are these proposals appropriate? Should any changes be made to these proposals? If so, what changes and why?

The ED 5 proposals prevent a reinsurance asset from being greater than the premium paid which will result in inconsistent measurement bases for insurance and reinsurance contracts and may cause significant problems for the insurance industry.

The EBF and ESBG support the EFRAG draft comments which propose that it is more appropriate to consider the accounting for reinsurance in Phase II along with the accounting for directly written insurance contracts and to only include the principles for financial reinsurance already in Phase 1 of the project.

These ED 5 proposals would also require significant systems development and would be superseded by the requirements of Phase II contrary to the Board's objectives for Phase I

The EBF and ESBG therefore believe that reinsurance should be considered under Phase II along with the accounting for directly written insurance contracts.

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

IAS 22 Business Combinations requires an entity to measure at fair value assets acquired and liabilities assumed in a business combination and ED 3 Business Combinations proposes to continue that long-standing requirement. The proposals in this draft IFRS would not exclude insurance liabilities and insurance assets (and related reinsurance) from that requirement However, they would permit, but not require, an expanded presentation that splits the fair value of acquired insurance contracts into two components:

(a) a liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues; and an intangible asset, representing the fair value of the contractual rights and obligations acquired, to the extent that the liability does not reflect that fair value. This intangible asset would be excluded from the scope of IAS 36 impairment of Assets and IAS 38 intangible Assets. Its subsequent measurement would need to be consistent with the measurement of the related insurance liability. However, IAS 36 and IAS 38 would apply to customer lists and customer relationships reflecting the expectation of renewals and repeat business that are not pan of the contractual rights and obligations acquires

The expanded presentation would also be available for a block of insurance contracts acquired in a portfolio transfer (paragraphs 20-23 of the draft IFRS and paragraphs BC93-BC101 of the Basis for Conclusions).

Are these proposals appropriate? If not, what changes would you suggest and why?

Although we agree with the IASB's proposals, we note that IAS 22 (and its replacement ED3) does not appear to permit entities that recognise an asset on their balance sheet for the value of the in-force business to include this asset in determining goodwill. We would recommend that ED 3 be amended to specifically refer to this type of asset in the determination of goodwill in a business combination otherwise the acquirer would not be following the accounting policies of the acquiree. Moreover, the EBF and ESBG are convinced that the "Present Value of Insurance in Force" has to be amortised according to the already realised benefits. It is necessary that the recognised amount of the asset have to be taken into consideration in course of the loss recognition test.

Question 9 - Discretionary participation features

The proposals address limited aspects of discretionary participation features contained in insurance contracts or financial instruments (paragraphs 24 and 25 of the draft 1FRS and paragraphs BC102-BC108 of the Basis for Conclusions). The Board intends to address these features in more depth in phase II of this project.

Are these proposals appropriate? If not, what changes would you suggest for phase I of this project and why?

The EBF and ESBG are of the opinion that paragraph 25 of ED 5, which requires the application of paragraph 24 to investment contracts that contain both a discretionary participation feature and a fixed element that requires non-discretionary payments. Will have as a consequence the continuation of existing accounting policy for such contracts as premiums. This appears to conflict with the principles applying to other investment contracts. As such, the resolution of this issue should be postponed until Phase II.

It is believed that it is inappropriate to require the fair value disclosure of these contracts as the treatment of discretionary participating features is unclear under IAS 39 and the fair value requirements for long-term investment contracts remain ill-defined.
Moreover, ED5 specifies for such contracts, that "the issuer shall recognise a liability measured at no less than the measurement that IAS39 would apply to the fixed element". EBF and ESBG. This position is based on the fact that;:

- The EBF and ESBG do not see the necessity during Phase 1 to introduce different accounting treatment for financial contracts and insurance contracts with a discretionary participating feature (paragraphs 24 and 25);
- A definition of the 'fixed element', and clarification of 'clearly higher' is necessary to be able to apply this paragraph;
- This unbundling would require major changes in the insurer's data systems,
- The existing loss recognition test is sufficient to ensure a correct valuation of the liabilities of such contracts"

Moreover, the EBF and ESBG believe that the use of different measurement bases for assets and liabilities in profit participating contracts should not create mismatches if the unallocated surplus (unrealised gains and profits) are considered as constructive obligations without taking into account the nature of the discretionary features and even though the allocation of unrealised profits or losses to shareholders or policyholders is still to be made. The EBE and ESBG understand that during Phase I unrealised gains and losses resulting from carrying assets at fair value relating to participating contracts with discretionary features will be considered as constructive obligations and not as equity.

The EBF and ESBG would also request the Board to clarify in the final standard that discretionary participation features should be considered as constructive obligations if the payment of the benefits are made reasonably certain by market practices.

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

The proposals would require an insurer to disclose the fair value of its insurance assets and insurance liabilities from 31 December 2006 (paragraphs 30 and 33 of the draft IFRS, paragraphs BC138-BC140 of the Basis for Conclusions and paragraphs IG60 and IG61 of the draft Implementation Guidance).

Is it appropriate to require this disclosure? If so, when should it be required for the first time? If not, what changes would you suggest and why?

The EBF and ESBG consider that the requirement to disclose the fair value of insurance contracts in 2006 is premature given that the Board has not yet finalised how the fair value of insurance contracts, in particular insurance liabilities, will be measured. The position stated by EFRAG in its comment letter is therefore welcomed. Given the wide number of views as to what is meant by fair value (entry or exit value) arid the practical difficulties in setting up models to determine the values since there is no active market for insurance contracts, provides a wide degree of room for manoeuvre and could lead to non-comparable and unreliable information

In full support of the EFRAG proposition, therefore, the EBG and ESBG would rather suggest, for the time being, to include in the financial statements a paragraph on the methodologies followed to measure insurance assets and liabilities. This should be applied until the finalisation of Phase II of the project. This would provide the users of annual accounts with additional information.

Nevertheless, it should be mentioned that the value of the portfolio disclosed in the notes is highly dependent on the measurement of the liabilities of the insurance contracts. The lower the measurement of such liabilities is, the lower is the value of portfolio-values not recognised in the balance sheet.

Question 11— Other disclosures

(a) The Exposure Draft proposes requirements for disclosures about the amounts in the insurer's financial statements that arise from insurance contracts and the estimated amount, timing and uncertainty of future cash flows from insurance Contracts (paragraphs 26-29 of the draft IFRS paragraphs BC124-BC137 and BC141 of the Basis for Conclusions and paragraphs IG7-IG59 of the draft Implementation Guidance).

Should any of these proposals be amended or deleted? Should any further disclosures be required? Please give reasons for any changes you suggest.

To a large extent, the proposed disclosures are applications of existing requirements in IFRSs, or relatively straight forward analogies with existing IFRS requirements. If you propose changes to the disclosures proposed for insurance contracts, please explain what specific attributes of insurance contracts justify differences from similar disclosures that IFRSs already require for other items *b) The proposed disclosures are framed as high level requirements, supplemented by Implementation Guidance that explains how an insurer might satisfy the high level requirements.*

Is this approach appropriate? if not, what changes would you suggest, and why?

(c) As a transitional relief an insurer would not need to disclose information about claims development that occurred earlier than five years before the end of the first financial year in which it applies the proposed IFRS (paragraphs 34, BC 134 and BC135).

Should any changes he made to this transitional relief? If so, what changes and why?

Although the EBF and ESBG generally support these proposals as long as the information disclosed is relevant and the quantification only necessary where it is practical to do so, concerns exist about the workload involved. More specifically, the requirements will impose a far heavier workload in terms of data collection procedures and systems, but without the benefit of providing useful information to the users of the accounts if the Implementation Guidance is taken as being mandatory. Insurance companies should not be requested to disclose internal information in more detail than is requested for other industries. Moreover, the information indicated in the implementation guidance is too detailed. Like the standard, the focus should be on explaining principles albeit with examples, rather than establishing a detailed list which could potentially be used as a mandatory "checklist" which it is not the objective of the implementation guidance.

The EBF and ESBG consider the proposals on sensitivity analysis to be broadly acceptable, although, as differing practices may emerge in respect of the ranges and variables disclosed, the Board should consider providing more guidance by giving examples and using wording in conformance with that used in the standard.

The proposal of EFRAG to delete references of value based information is also supported.

Finally, the EBF and ESBG also support the proposals for transitional relief in respect of claims development disclosures.

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

The Exposure Draft proposes that the transferor of a non-financial asset or liability should apply IAS 39 Financial Instruments: Recognition and Measurement to a financial guarantee that it gives to the transferee in connection with the transfer (paragraphs 4(e) of the draft IFRS, C5 of Appendix C of the draft IFRS and BC41-BC46 of the Basis for Conclusions). IAS 39 already applies to a financial guarantee given in connection with the transfer of financial assets or liabilities.

Is it appropriate that IAS 39 should apply to a financial guarantee given in connection with the transfer of non-financial assets or liabilities? If not, what *changes should be made and why?*

The EBF and ESBG support the opinion of EFRAG that the proposal provides a clear distinction between financial guarantees given by a transferor of non-financial assets or liabilities and a credit insurance given by a credit insurer. Financial guarantees provided by industries other than the insurance industry, e.g banks, would also be treated as insurance contracts if they meet the definition.

Question 13— Other comments

Do you have any other comments on the draft IFRS and draft implementation Guidance?

Mismatch-Measurement principles for insurance assets and liabilities:

The EBF and ESBG supports EFRAG when its states that: *"the interaction between IAS 39, including the current proposed changes and ED 5 creates a measurement mismatch for insurance contracts. This results from the recognition in Phase I, that insurance liabilities will continue to be measured under existing accounting policies, which usually adopt some form of amortised cost approach, while the assets backing these insurance liabilities will, in most practical circumstances, need to be held on an available-for-sale basis, which results in the assets being held on the balance sheet at market value. This will result in volatility, often for artificial reasons, in equity. We describe the volatility as artificial because, even when the assets and liabilities are perfectly matched, movement in equity would occur solely due to the different measurement bases"*

In contradiction to the solution proposed by EFRAG whereby the IAS 39 held to maturity criteria should be relaxed, the EBF and ESBG believe a better solution to avoiding the mismatch problem would be achieved by establishing a new category of assets the measurement of which should be based on current local accounting policies:
assets held to back insurance liabilities. The proposal suggested by EFRAG could cause practical difficulties as it disregards normal investment strategies.

The EBF and ESBG would therefore favour the second solution as proposed by the insurance industry to the Board and which recommends the creation of a new category of assets the measurement of which should be based on current local accounting policies, i.e. assets held to back insurance liabilities.

Deferred acquisition costs:

The EBF and ESBG support the position of EFRAG that deferred acquisition costs for insurance contracts and financial contracts should be treated consistently in Phase I of the project

IAS 39 should, however, be amended such that the deferral of acquisition costs is permitted. even if these costs are internal costs, such as staff costs, provided that they are directly attributable. The amortisation of these deferred costs should be matched to the recognition of revenue from the related contracts.

Fair value measurement of contracts issued by insurers at no less than surrender value

Paragraph BC117 suggests that the fair value of a financial liability with a demand failure be no less than the amount. payable on demand.

At this stage, the EBF and ESBG consider that the introduction of a "deposit floor" for the valuation of contracts issued by insurers is premature. Many complex issues are to be addressed in phase II to take into account all the specific characteristics of insurance contracts and financial instruments with a discretionary participation feature: behaviour of the policyholders, tax incentives, participating features (...) that directly impact the surrender patterns.

Unit-linked contracts

Many issues are still pending concerning the valuation of unit linked contracts:

- how to separate the host contract and the embedded derivative?
- how to measure the amortized cost of the host contract and the fair value of the derivative?

At this stage, the EBF and ESBG consider that it is necessary to further investigate all aspects of measurement of such contracts and recommend maintaining existing accounting policies during phase 1.