ROYAL & SUNALLIANCE
WORLDWIDE GROUP OFFICE

Julian Hance
Group Finance Director
30 Berkeley Square
London W1J 6EW
Telephone +44 (0)20 7569 6117
Facsimile +44 (0)20 7569 6572

Mr P Clark
Senior Project Manager
International Accounting Standards Board
30 Cannon Street,
London EC4M 6XH,

Dear Peter

COMMENTS ON ED5 – INSURANCE CONTRACTS

I am pleased to submit the response of Royal & Sun Alliance to the IASB's exposure draft ED5 Insurance Contracts.

As you are aware, the Group has maintained a close interest in the development of accounting for insurance contracts during the project to date. We hope that we can maintain our close involvement with the IASB and the staff of the IASB as the project develops the phase I standard and through phase II. We appreciate the time and effort that the IASB has devoted to the project to date and the high level of constructive consultation that has been maintained between the IASB and all interested parties.

We attach our responses to the particular issues on which the IASB invited comments in the attached paper. We would like to take this opportunity to raise a number of specific issues that we believe are of the greatest significance to our Group.

Interim standard representing phase I of the project

We support the IASB's decision to stagger the development of the standard on insurance contracts and appreciate the level of compromise that has been necessary in the development of the phase I proposals as set out in ED5. We acknowledge that the proposals in the exposure draft do not represent a large step forward and that many will have reservations over the apparent lack of consistency in accounting policies that will remain between entities writing insurance contracts. We do however believe that this holding mechanism is necessary in order for European groups to meet the 2005 deadline and that this can provide the best stepping stone towards the speedy development of the final IFRS on insurance contracts that is required by both preparers and users of our industry's financial statements.

Application of IAS 39 to assets backing insurance liabilities

Unlike many respondents, we do not place a great significance upon the potential mismatch of assets backing insurance liabilities and the underlying insurance liabilities. We believe that this is an unfortunate consequence of the mixed measurement model but that the issue can be explained to users.

We would be concerned if the "artificial volatility" described by some commentators is replaced by "artificial smoothness" by using a basis of accounting for the assets that is not in compliance with existing IFRSs.

We do, however, have concerns that the project on performance reporting is incomplete and we would urge the IASB to look specifically at insurers when developing this standard. The increasing use of fair value techniques will make it imperative that the performance reporting techniques developed are able to specifically identify the various components of value changes and report the most relevant information to stakeholders in line with how the management of the business is conducted.

Scope of ED5

Turning to the proposals within ED5, we are broadly in agreement with the IASB's approach of confining the draft standard to insurance contracts but we have concerns over the potential discontinuity between the accounting for such contracts and those contracts that fail to meet the definition of an insurance contract. We would concur that where such residual contracts are sold by entities other than insurers, then it is desirable to account for such contracts on a consistent basis. However we are concerned that there are contracts, which are sold by insurers that are in some way unique to the insurance industry that cannot be adequately accounted for under existing IFRSs. Where an existing IFRS does not cater well for such products and there is a lack of guidance on accounting for such contracts, there is a danger that entities may be forced to devise their own accounting policies which may be at variance with the policies used by another entity. In these circumstances, consistency in accounting for such contracts across entities may not be achieved.

In some cases such contracts may share similar features from the perspective of the investor but a different legal structure of the contract may result in significant accounting issues when such differences are recognised. An example of such contracts is unit-linked contracts and the more complex derivatives of these products that can be compared with similar savings contracts in the Unit Trust industry. For such contracts the bundling together of the management of the contracts and the custodianship of the assets can result in differing accounting treatments. We do not believe that IAS 39 is able to cope with such contracts in a consistent manner with similar contracts that meet the insurance contract definition.

We understand that the IASB acknowledges that there may need to be a review of the working of existing standards in the context of phase II of the project and believe that any review would need to consider similar products falling outside the scope of ED 5. We therefore believe that there may be other products sold by insurers that are not adequately catered for under existing IFRSs, which are not commonly found outside the insurance industry, and which could justifiably be included within the scope of the phase I proposals pending resolution of recognition and measurement issues for insurance contracts and similar products within phase II.

In summary whilst consistency of accounting for similar products across entities is a laudable objective for the IASB we believe there is a similar importance that should be placed on consistency of accounting for similar contracts within an entity. To this end we would urge the IASB to consider whether there are other non-insurance contracts that should be included within the scope of ED5 in the same way as the discretionary participating features of financial instruments have been included.

Sunset Clause

We do not support the IASB's proposals for the sunset clause contained in paragraph 9 of the draft standard (i.e. the temporary nature of the exemption).
We fully concur that the standard emerging from ED5 should not be the permanent standard for insurance contracts but believe that it is wrong to force entities to abandon the principles established in this paragraph before the new standard is implemented.

We acknowledge that IASB anticipates that the final standard emerging from phase II will be in place before the sunset clause becomes effective, but as a matter of principle we believe that the clause should remain in force until the interim standard is superceded.

As currently drafted, there is a potential for entities to have to review and revise their accounting policies prior to the introduction of the phase II standard. The basis for conclusions (paragraphs BC52 and BC53) confirms that the IASB acknowledged the difficulty that entities would encounter in complying with the identified requirements of [draft] IAS 8 prior to the conclusion of phase II of the project. This confirms our conclusion that the standard emerging from phase II of the project is the means by which accounting policies should be reviewed and (if necessary) changed.

Fair value disclosures

We do not support the IASB's proposal to require the fair disclosure of insurance assets and insurance liabilities in 2006. We believe that it is premature to mandate such disclosures before the basis of valuation has been debated by the IASB and any resulting guidance field tested by preparers.

We support the IASB's tentative conclusion to introduce a basis of accounting based upon the fair value of insurance assets and liabilities as the solution under phase II of the project. We also recognise the need for this phase of the project to be completed as quickly as is possible. We share the concerns of others that the project may not be sufficiently advanced for preparers to produce fair values for such assets and liabilities in accordance with the final outcome of the second phase of the project by the 2006 deadline.

The introduction of any such requirement, before the phase II solutions are achievable, runs the risk that different calculations will be necessary in the ultimate IFRS thereby imposing additional systems and cost burdens on insurers. We believe that a fair value disclosure should form part of the transitional arrangements to the phase II IFRS.

Other disclosures

There is a need for additional disclosure of the risks borne by insurers and the basis of preparation of an insurer's financial statements, particularly during the interim phase of the project.

We believe that the IASB is correct in setting high-level principles of disclosure, supplemented by guidance as to how the principles should be applied. However, we are concerned at the level of detailed prescription that may be inferred from the implementation guidance. In particular we note the different language used within the guidance that could imply differing levels of status should be accorded to individual paragraphs.

First time adoption

We note the IASB's deliberations on the adoption arrangements of IAS32 and IAS39 for first time adopters in 2005. Our understanding is that entities adopting IFRSs for the first time in 2005 will not be required to adopt these two standards in the comparative information in 2004. There is a clear relationship between the accounting treatment of insurance contracts and those contracts falling outside the scope of ED5 and it will create problems if the latter category is subject to the transitional arrangements whilst insurance contracts are not. We would therefore propose that any transitional arrangements for IAS 32 and IAS 39 should be carried through the insurance contract standard,

There may, however, be some companies that would like to make restatements in the financial statements in 2004 in the interests of comparability. We believe that such entities should be permitted to re-present the primary financial statements but without the necessity to make all of the additional disclosures. We therefore propose that the IASB should be flexible in the manner, and the level of detail, in which comparative information is provided in 2005.

Development of phase II of the project

We have already commented upon the need for consistency in accounting for all products issued by insurers (i.e. for those contracts that meet the definition of an insurance contract and for the other contracts sold that do not meet the definition). We believe that in phase II there will be a need to ensure that all such contracts are accounted for on a consistent basis and hence we would encourage the IASB to review the scope of the project to ensure that all contracts with similar characteristics are brought into its scope. This will also encompass other contracts that are sold by other entities than insurers including those where the rights and obligations under the contract form a subset of the package marketed by insurers (e.g. servicing rights an obligations). We acknowledge that this will entail a review of some contracts that are currently accounted for under existing standards. However, we believe that such a fundamental review is necessary in order to avoid accounting arbitrage between different products and product providers and to ensure consistency across a range of products within the financial services arena.

We attach our responses to the specific questions that the IASB raised concerning the draft standard. If you have any queries about our response please do not hesitate to contact either Doug Logan (+44 (0) 1403 235001) or myself.

Yours sincerely

Julian Hance
Group Finance Director

ROYAL & SUNALLIANCE

ED5 – Insurance Contracts – responses to questions on which comments were invited

Question 1 – Scope

(a) 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:

(i) 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?

We agree that the proposed IFRS should focus on transactions rather than entities but we do have concerns about the limited scope of ED5, in particular the exclusion of certain classes of long term contracts that are typically sold by insurers. We return to this issue below.

We understand that necessity has focussed upon the need for a standard to cater for insurance contracts issued by an insurer but we believe that there may be need for some guidance for policyholders in view of the change of the scope exemptions in IAS 32 and IAS 39. Under the existing versions of these standards insurance contracts held by a policyholder would be exempt from the scope, but we believe that the changes proposed in ED5 may now have included policyholders interests in insurance contracts within their scope. We are not aware of entities where such contracts would be material but we question whether it was the intention of the IASB to include such contracts within the scope of these two standards; particularly bearing in mind the difficulties of measurement that the IASB has encountered to date in the insurance contracts project.

We agree with the IASB's decision to leave the accounting for investments held to back insurance contracts under the existing accounting principles within IAS 39 but we do have some comments on the proposals in respect of assets arising under reinsurance contracts (see questions 7 and 13).

We acknowledge that many preparers and others have concerns over the potential within ED5 for different measurement bases to be applied to insurance liabilities when compared with non-insurance assets but believe that this a consequence of the latitude allowed during this interim phase of the insurance contracts' project in the valuation basis of the former. There are other examples where mixed measurement bases are applied within individual entities and we are not convinced that a better solution would be achieved by allowing assets to be valued on a basis that is contrary to existing IFRSs.

We have not seen any detailed proposals that would require a demonstration of the close match between insurance liabilities and investments held to back these liabilities along the lines of those required for other hedging arrangements. In the absence of such clear evidence of a hedging relationship, there is a danger that the "artificial volatility in equity" that is claimed by some to be introduced by the IASB's current proposals, would be replaced by an artificial smoothing.

We do however have concern that the volatility identified above should be adequately identified and explained to stakeholders. This issue will be of particular significance as the IASB develops its proposals on performance reporting and we would urge the IASB to pay specific attention to industries such as insurance where changes in fair value (of both assets and liabilities) will form an integral and highly significant part of any statement of comprehensive income.

As stated above, we do have particular concerns regarding those contracts issued by insurers that will fall outside of the scope of the emergent IFRS. We understand the IASB's reluctance to grant a blanket exemption of such contracts from other standards (and in particular IAS32 and IAS 39) since this would run the risk of similar products being accounted for differently by individual entities. However we feel that it is of parallel importance that contracts with similar features are accounted for consistently within the same entity.

There is a danger that there will be contracts issued by insurers that fall outside the scope of ED5 yet contain features similar to those within the scope of ED5. The existing accounting policies for these insurance contracts that would be permitted within the proposals in ED5 may be incompatible with the basis of accounting for the other contracts where the constraints of IAS 39 would apply.

A possible solution would be to modify existing accounting policies for insurance contracts to align with the IAS 39 requirements but this would necessitate the change in accounting policies that the IASB is seeking to minimise within phase I of the project. Also, we understand that phase II of the project may need to question some of the principles of IAS 39 when applying these principles to the valuation of insurance contracts. Any changes arising from any such a review would necessitate a further change in accounting policies when implementing phase II.

We therefore ask the IASB to consider whether there are other contracts, that are sold principally by insurers, for which IAS39 either does not provide a realistic basis of accounting, or for which there is insufficient guidance to apply to such contracts. In the latter case, the lack of guidance will result in individual reporting entities having to introduce their own accounting policies for such contracts. This would run the risk that inconsistent treatment between entities would emerge thereby defeating one of the objectives of applying IAS 39 to such contracts.

We emphasise that any further concessions to scoping contracts out of IAS 39 should be conditional upon there being no significant suppliers for such contracts other than insurers. We have already seen a similar concession granted in respect of investment contracts with discretionary participating features.

We believe that, in the first instance, the IASB may wish to consider the accounting for Unit Linked contracts that we believe meet such a test. There are similarities from the perspective of investor with other types of contract, but there are particular features for the issuer (in particular the dual roles of owner of the underlying assets and liabilities of the contracts and of scheme manager) that distinguish such contracts from those provided by suppliers of similar investment vehicles.

(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?

We agree with the IASB's proposals for these contracts.

Question 2 – Definition of an Insurance Contract
The draft IFRS defines an insurance contract as a 'contract under which one party (the insurer) accepts significant insurance risk from another party (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 IG 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?

We agree with the definition proposed by IASB. As set out above in our response to question 1, our concerns relate to those contracts that are issued by insurers that fall outside the scope (primarily long term contracts). These concerns could be addressed by including other features within the scope of the proposed standard rather than by changing the definition.

Question 3 – Embedded derivatives
(a) IAS 39 Financial Instruments: Recognition and Measurement requires an entity to separate some embedded derivatives from their host contract, 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?

(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 measurement 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?

(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-IG58 of the draft Implementation Guidance). Are these proposed disclosures adequate? If not, what changes would you suggest, and why?

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

We believe that the IASB is correct in applying existing principles in respect of unbundling derivatives and in seeking to minimise the accounting changes necessary to comply with such requirements. We believe that phase II of the project should be the time to review these principles.

We acknowledge that there is a need to disclose the effect of 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) and we are content with the proposals in the draft standard and the related guidance.

We are not aware of any other issues that need addressing under this heading.

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 1 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?

We acknowledge the shortcomings of the proposals contained in ED5 but view the compromises contained therein as a necessary transitional step to a comprehensive standard in due course. We view the concessions granted in paragraph 9 in respect of [draft] IAS 8 as necessary for insurers to be able to make the transition through to the ultimate standard on insurance contracts. Without these concessions we believe it would be extremely difficult and possibly impossible for European insurers to meet the 2005 deadline of reporting under IFRSs. Even if insurers could satisfy the requirements of paragraphs 5 and 6 of [draft] IAS 8, we are not convinced that this would result in consistent accounting policies being adopted, by all insurance companies, without further guidance from the IASB. There would therefore be a need for further development and change before a consistent framework of accounting for insurance contracts would be achieved.

We view the long term retention of the interim standard proposed by ED5 as an unsatisfactory solution and we will therefore support the IASB in reaching a swift conclusion to the development of the phase II proposals. However we believe that the introduction of the time limit of the concessions as flawed. We are not convinced that, in isolation from the development of the phase II solution, insurers will be any better placed in 2006 to make the necessary changes to existing accounting policies.

We therefore believe that the insurance industry should be focussed on achieving the adoption of the final standard at the earliest possible date without the possible distraction of a second interim solution from 2007. We support the views expressed by other respondents that the sunset clause should be dropped and that the concessions should be allowed to continue until the phase II standard is adopted.

There is no explicit reference within the scope of paragraph 9, to financial instruments with discretionary participating features. This appears to contradict the requirements of paragraph 25, which applies the requirements of paragraph 24(d), thereby permitting the continuation of existing policies in respect of such contracts.

(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 under an insurer's existing accounting policies.

(iii) require an insurer to keep insurance liabilities in its balance sheet until they are discharged or cancelled, or expire, and to report insurance liabilities without offsetting them against related reinsurance assets (paragraphs 10-13 of the draft IFRS and paragraphs BC58-BC75 of the Basis for Conclusions).

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

We support IASB in its assertion that the elimination of catastrophe and equalisation provisions represents an improvement to existing practice in many countries. This is a change that may be achieved with minimal effort by preparers. However, we believe that further guidance is required in respect of the wording of paragraph 10(a) that refers only to "future" insurance contracts. Further guidance may be necessary to clarify that provisions in respect of existing insurance contracts are calculated on a consistent basis across each accounting period in order to avoid possible distortions arising from the measurement basis adopted.

We agree with the other restrictions imposed in paragraph 10 of the draft standard.

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 its 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?

We support the IASB's normal principle that an entity should only make changes to existing accounting policies that improve the basis of accounting. We would however ask the IASB to consider whether the conditions imposed by paragraph 16 of the draft standard may be too harsh in seeking to meet the objective above.

We can foresee instances in which an entity may be precluded from making partial improvements in its accounting policies by the restrictions within paragraphs 16(b) and 16(e). For example we believe that it may be difficult for an entity's management to conclude that no residual excessive prudence exists in the measurement of its insurance liabilities until such time as the IASB has concluded on the phase II deliberations on how risk margins are to be calculated.

Similarly, we believe that an entity could make overall improvements to its accounting policies by making changes within an individual subsidiary without making this change in other subsidiaries in the group.

Question 6 – Unbundling
The draft IFRS proposes that an insurer should unbundle (ie 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 IG6 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?

We agree with these proposals.

We note that the requirement of paragraph 7 refers only to insurance contracts and not to reinsurance contracts that it holds. The example given in IG example 3 does however refer to a reinsurance contract. We believe that the IASB should make clear that references to insurance contracts within the draft standard encompass reinsurance contracts that it holds. There is some ambiguity because of the clear distinction made in paragraph 2(a) of the draft standard between the two types of contract. This point is also covered under question 13.

Question 7 – Reinsurance
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?

We are not convinced of the need to introduce new rules into the standard that would change the existing basis of accounting for reinsurance contracts. We believe that the IASB is making these changes to address certain reinsurance contracts that contain significant financing elements.

In the UK the use of a "substance over form" basis of accounting already addresses such issues and hence we believe that the proposals are not necessary. In addition the IASB has introduced the concept of unbundling in paragraphs 7 and 8 of the draft IFRS and these will themselves capture some of these features.

In particular, we do not believe that the amortisation of gain at inception as described in paragraph 18(d) is a step forward in accounting policy.

In addition, we are concerned by the requirement contained in paragraph 19 to apply IAS 36 - Impairment of Assets, to a cedants rights under a reinsurance contract. Our interpretation of this requirement, is that this will in many case change the existing basis of accounting.

Currently the recoverable amount will be measured on a consistent basis with the underlying liability (subject to any credit risk); which in many cases would be on an undiscounted basis. Applying IAS 36 would, we believe, change this measurement basis for the reinsurance asset onto a discounted basis. This change runs contrary to the principles established in paragraph 9(b) of the draft IFRS. We ask the IASB to review this proposal and to revisit the measurement basis to be adopted for reinsurance assets within phase II of the project.

Question 8 – Insurance contracts acquired in a business combination
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

(b) 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 part of the contractual rights and obligations acquired.

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?

We agree with the IASB's proposals to accommodate the treatment of the differences that arise from the use (post acquisition) of a different measurement basis for the acquired insurance assets and liabilities.

We believe that it may be helpful for the IASB to provide limited guidance on the basis of measuring acquired rights and obligations at fair value. The recurring issue arises of the basis of measurement to be applied. Until such time as the IASB has provided guidance within phase II of the project, we believe that where an entity has an existing accounting policy for measuring the fair value of such assets and liabilities, then this should continue until phase II is introduced. At this time reporting entities should be able to revise the calculation in accordance with the revised guidance.

As a general insurer, we note that the wording of the guidance contained in BC93(b) appears to imply that such intangible assets only arise in respect of long term insurance business. It would be helpful if the IASB could clarify that this an example and that similar issues may also arise in respect of general insurance contracts.

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 IFRS 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?

We agree with the IASB's proposals on accounting for discretionary participating features, including those arising in contracts that do not meet the definition of an insurance contract. We acknowledge that choices will remain as to how the features are dealt with but agree that a firm decision on the basis of accounting for this issue cannot be made until the phase II of the project is completed.

We believe that sufficient information should be provided in the notes to the financial statements for users to understand the basis on which the surplus assets arising from the discretionary feature have been recognised. We recommend that IASB should include an explicit statement in the disclosure requirements within the IFRS that this policy is presented within the accounting policies.

In the draft IFRS there is currently no relaxation of the disclosure requirements in IAS 32 in respect of investment contracts that contain a discretionary participation feature. The difficulties of measuring the fair value of insurance contracts with such a feature will be replicated in measuring the fair value of similar contracts that fail the insurance contract test. We therefore recommend that the fair value disclosures of IAS 32 in respect of such contracts should mirror those of insurance contracts.

There is also an issue where the revaluation of owner occupied properties contributes to the surplus arising from such contracts. It is unclear as to whether the revaluation surplus is covered by the requirements of paragraph 24 of the draft IFRS or by the requirements of IAS 16 - Property, Plant and Equipment. There is an apparent conflict between the two accounting policies and we would expect the policy within ED5 to override that contained in IAS16. It would be helpful if the IASB could confirm this interpretation.

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?

We do not agree with the IASB's proposals that the disclosure of the fair value of insurance assets and insurance liabilities should be mandatory in 2006. We understand that it is the intention of the IASB to have developed phase II of the project prior to this deadline and that this will contain sufficient guidance for the measurement of these items to be undertaken on the fair value basis.

We do not believe that the IASB should be introducing the proposed IFRS whilst uncertainty remains as to whether such guidance will exist at this date. We propose that the IASB should introduce this requirement as an implementation phase of the phase II proposals which will allow the measurement basis to be agreed and tested and for preparers to make any changes necessary to existing systems to enable the information to be prepared reliably. If the requirement is introduced before these processes are complete there is a danger that entities will make calculations that will lack comparability and that further changes will be necessary when the final standard emerges from phase II.

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 straightforward 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, BC134 and BC135).***
Should any changes be made to this transitional relief? If so, what changes and why?

We appreciate that there is need to improve the disclosures of insurers in order to provide users with a deeper insight into the business. In phase I the continuing use of existing local accounting policies will provide for a further need for information in order for users to gain a better understanding of each individual entity.

The IASB proposes introducing a small number of high level principles relating to disclosure, supplemented by additional guidance as to how these principles may be applied. In view of the diversity of practices that may exist on first time adoption of the IFRS, we believe that this is the correct approach in order to attain a level of relevant and reliable information.

We have concerns regarding the volume of the disclosures included in the guidance and the practicalities of providing the necessary balance between detailed disclosure and sensitivity analysis, and the level of consolidated information that may be practicable from the perspective of both preparers and users.

We also are concerned about the status of the implementation guidance, not withstanding the statement that it is "not part of the [draft] IFRS". The use of different styles of language within the guidance implies various levels of mandatory status that we do not believe was intended.

On a minor point of drafting, we found the wording in IG 42 confusing and suggest that the first three words could be amended to "An insurer should avoid….".

Question 12 – Financial Guarantees
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?

We are happy with the proposed treatments.

Question 13 – Other comments
Do you have any other Comments on the Exposure Draft and Implementation Guidance?

Phase II issues

Earlier in this response, we have discussed the need to review the accounting for those contracts that are sold by insurers that do not meet the definition of an insurance contract. We view it to be of great importance that there is consistency of accounting for insurance contracts and other contracts sold by insurers that fall on either side of the insurance contract definition. We have suggested solutions as to how greater consistency may be achieved in phase I of the project, but we believe that this issue will need to be addressed in the latter stages of the insurance project.

We believe that there are distinct characteristics that distinguish many of the contracts sold be insurers from those sold by other providers of financial products. However, we acknowledge that the financial services sector is becoming more complex with new products being provided by an increasing number of types of enterprise. Whilst differences may remain in the legal responsibilities of the providers, it will still be important to ensure that unbundled components of a financial contract and composite products are accounted for on a consistent basis in order to ensure that accounting arbitrage does not afford benefits to one provider over another merely as a result of the manner in which the package is legally presented.

In order to avoid such arbitrage, it will be necessary to review the accounting of all such contracts and to provide a common framework that provides a single basis of accounting. We therefore believe that the scope of phase II of the project should be expanded to cover the accounting of all long term financial contracts (including insurance contracts).

If on the other hand, insurance contracts are singled out for review there is the danger that accounting arbitrage would continue. Additionally, there would be the possibility that a further change in accounting for insurance contracts could be necessary as and when the wider review of accounting for other financial instruments under IAS 39 is concluded.

As a part of the review of accounting for long term contracts that we have recommended above, it would be necessary to consider two specific issues that appear to cause illogical results when measuring contracts at fair value. These two issues are the deposit floor in [draft] IAS 39 and the treatment of acquistion costs. Other respondents have covered these issues in greater depth and we shall limit our comments to the observation that we believe that it will be necessary for IASB to examine the current definition of fair value and to conclude on whether the issues identified above together with the restrictions on the recognition of intangible assets are compatible with the definition.

The above comments relate to long term products sold by insurers. Our Group is primarily focussed on general insurance products and we would like to take this opportunity to make a comment upon a particular issue inherent in the tentative proposals for phase II of the project. This concerns the basis of fair valuing insurance liabilities under a stochastic approach with identifiable margins for risk and uncertainty.

In our field visit, we have already expressed our concern to the IASB regarding the practicality of applying these theoretical techniques across all classes of insurance contract. Currently, a wide range of techniques is used to assess the value of insurance liabilities including the use of deterministic estimates. The data to model every conceivable outcome for contracts containing a multitude of different risks is not available – not least because some of the risk exposures have not crystallised within the time spans of existing records. We therefore urge the IASB to consult closely with the industry on how the techniques to calculate fair value can be developed at the practical level.

Transitional arrangements on first time adoption of the insurance contract IFRS

The phase I IFRS for insurance contracts is currently expected in March 2004. Whilst the implications of the new standard for insurance contracts, should be relatively straight forward, there will be remaining uncertainty on the accounting for the residual contracts that do not meet the insurance contracts definition. We understand that the IASB is considering the relaxation of applying IAS32 and IAS39 to the 2004 comparatives when an adopter produces IFRS compliant financial statements for the first time in 2005. This appears to leave an absence of guidance where an insurer's existing policy on accounting for such "non-insurance" contracts is to account for such contracts as insurance contracts. We therefore would expect the IASB to consider the interaction between the insurance contract IFRS and IAS39 and in particular to conclude on whether 2004 results should be restated.

Disclosure requirements in subsidiary undertakings

We believe that the disclosure requirements could be particularly onerous when applied to wholly owned subsidiaries. Where there is little value in providing the detailed information (for example if the liabilities are all reinsured to the parent undertaking, or the parent guarantees the liabilities) then we believe the disclosure requirements should be relaxed.

Application of other IFRS by insurers

We reproduce below our concerns that are reflected in the response of the 100 Group of Finance Directors.

We again acknowledge the need for a consistent approach across entities in accounting for similar transactions however there are a number of specific areas in which current International Accounting Standards would give misleading results and which may need to be considered further.

In the UK many life products provide benefits to policyholders on a net of tax basis (i.e. the insurer bears the income taxes on behalf of the policyholder). Under IAS 12 such taxes meet the definition of an income tax and hence there will be a mixture of pre-tax and post tax items appearing in the income statement within the pre-tax result. This will lead to distorting and non comparable information within the income statements of some UK insurers. This has a knock-on effect on the results recorded under IAS 14 - Segment Reporting, since paragraph 16 of this standard explicitly prohibits the recognition of income tax as a segmental expense. We therefore suggest that IASB reviews the application of these standards in those circumstances where a mixed attribute (pre-tax and post-tax) basis of measurement of policyholder income and expenses is included within the same income statement.

In question 7, we have commented on the proposals within ED5 to require insurers to apply IAS 36 to cedant's rights under a reinsurance arrangement. We notice that the proposed amendments to IAS 32 and IAS 39 contained in Appendix C1 and C2 remove from the scope of these standards "insurance contracts within the scope of IFRS X Insurance Contracts" and "rights and obligations under a contract that is within the scope of IFRS X Insurance Contracts because the contract is an insurance contract" respectively. It could be interpreted that these references align themselves to the first half of paragraph 2 (a) of ED5 (i.e. "insurance contracts (including reinsurance contracts) that it issues") and thereby exclude the contracts within the second half of the sentence (i.e. "to reinsurance contracts that it holds"). We presume that this is not the IASB's intention and that the exclusions in each of IAS 32 and IAS 39 should cover all contracts within paragraph 2(a). It should be noted that if it was intended to include reinsurance contracts held within the scope of IAS 39, then such assets would be excluded from [draft] IAS 36 under the exclusion of those financial assets that are included in the scope of [draft] IAS 39, Financial Instruments: Recognition and Measurement.