FEDERATION OF FINNISH INSURANCE COMPANIES
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Helsinki, 31 October 2003

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

COMMENTS ON EXPOSURE DRAFT 5 - INSURANCE CONTRACTS

The Federation of Finnish Insurance Companies is a joint body for insurance companies operating in Finland, representing their interests to government authorities, other trade organizations and the public. The Federation works to promote sound insurance business, adequate risk management and effective loss prevention, setting out from the idea of insurance. The total number of members in the Federation is 51, which includes 9 foreign insurers. In 2002 the volume of premium income was €6.0 billion for life and non-life, direct and reinsurance companies and €6.4 billion for statutory pension insurance companies.

The Federation of Finnish Insurance Companies supports the principle of aiming at achieving world-wide accounting standards. We appreciate the IASB's initiative to develop an interim standard in the absence of a comprehensive final standard for insurance companies. We have taken part in the work of the Comité Europeén des Assurances (CEA) and we fully support the CEA position paper on ED 5. However, we would like to draw your attention to certain questions and comments, which are not dealt with in the CEA position paper. Additional guidance regarding these questions would help insurance companies when they prepare their first IFRS financial statements in tight schedule. It would also prevent costly retroactive changes in accounting policies. We would also like to highlight the importance of treating equalisation provision as a part of technical provisions and giving insurers the option to change the measurement basis of assets in certain circumstances during Phase I.

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.**

and

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.

In many countries there are taxes and levies associated with insurance contracts. In the Finnish GAAP these (premium tax, fire brigade charge, road safety charge, occupational safety charge and government medical treatment charge) are deducted from premiums written. Insurance companies include these taxes and levies in premiums in full or in part, collect them together with premiums and transfer the amounts to appropriate bodies. For some levies, the charge is a percentage based on the premium. For some levies, the government determines both the costs to be covered and their allocation to different insurance companies. (Appendix 1 gives more information on these taxes and levies.) The above-mentioned taxes and levies are based on legislation that concerns insurance contracts although the taxes and levies do not themselves meet the definition of insurance contract. *Therefore additional guidance would be needed to clarify the application of ED 5 (that means local GAAP) or existing IFRS (eg IAS 18.8).* This guidance would also help enhancing comparability between insurance companies. Premiums are a key figure to describe the size of insurance business.

The same also applies to credit losses associated with insurance contracts. In Finland credit losses are recognised as adjustment items of the revenue originally recognised as premiums or reinsurance recoveries. Most of the credit losses on premiums originate from motor liability and workers' compensation, which are compulsory non-life insurance lines in Finland, representing about 40 per cent of the whole non-life business. As the lines involved represent compulsory cover insurance companies are not allowed to choose their clients. According to IAS 18.22 the uncollectable amount is recognised as an expense. *Additional guidance would be needed to clarify the application of ED 5 (that means local GAAP) or existing IAS 18 during Phase I.* During Phase II credit losses would perhaps not be an issue, because only cash flow items and changes in insurance assets and liabilities are entered in P/L account. Cash flow would be automatically adjusted in respect of credit losses. The effect of future credit losses would be taken into account in the estimate of future premium cash flow. The difference between the ultimate actual credit losses and the estimate would be small and possible to disclose as "changes in assumptions".

The existing IAS 1.75 (draft IAS 1.76) requires presentation of a line item "Revenue" on the face of the Income Statement and requires the presentation of additional line items when this is necessary. ED 5 draft implementation guidance (IG 14) lists revenue from insurance contracts (gross) and income from contracts with reinsurers as such (sub) line items. The EU directive on the annual accounts of insurance undertakings does not require a line item of total revenues for the P/L Account. It was not included in the DSOP draft either. Furthermore the above-mentioned directive (article 63) provides that, in place of turnover, insurance undertakings shall disclose other volume figures eg Gross premiums written. *Since neither the term Turnover nor (total) Revenue is established in the insurance sector and the preparation of Reporting Performance is under way, it would be reasonable to abolish this requirement in IAS 1 for insurance companies in Phase I.* This would enable the application of a P/L format which is, as far as possible, similar to that in the directive. This would enhance comparability and continuity. For example in Finland only listed companies can apply IFRS during Phase I.

(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.

We understand the idea of proposal to eliminate catastrophe and equalisation provisions from insurance liabilities in the context of IAS Framework definitions. *However, as the definition of the fair value of technical provisions in Phase II is not yet known there should not be any major changes in the definition of technical provisions in Phase I.* All major changes should be concentrated into one single point in time to avoid misleading situations for preparers and users of financial statements.

As the technical provisions of European insurance companies are nowadays estimated in many different ways, containing more or less prudential margin, it would not be fair in Phase I that those insurance companies which show the prudential margin as an equalisation provision on the balance sheet and give information on the methods used to calculate it are punished for openness and not treated equally with those companies which "hide" the prudential margin in technical provisions. We consider that it should be acceptable to include equalisation provisions in technical provisions, but the amount of the equalisation provision and the methods of calculating it should be given in the financial statements or in the notes.

Finally the calculation of the fair value of technical provisions is not yet determined, but it has been suggested that fair value should include market value margins, which reflect the risks and uncertainties associated with those liabilities. In Finland equalisation provision is calculated in the way that it represents a part of the market value margin.

Question 5 – Changes in accounting policies

The draft IFRS:

(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).

We consider that it should be possible to reclassify some or all financial assets into the category of financial assets to be measured at fair value, with changes in profit or loss, also in other situations than only when an insurer changes its accounting policies for insurance liabilities. Given that national provisions relating to the IFRS standards are still unfinished and may in 2005 prevent insurance companies from changing over to measuring assets or part of the assets at fair value, with changes in profit or loss, it would be vitally important that insurers were able to make that change later during Phase I. In the present setting, insurers will have to choose their asset valuation principles in their 2005 accounts and are prevented from changing them during Phase I (even if national legislation allowed it during Phase I). The abovementioned option to change the valuation method during Phase I would give more relevant information for investors' decision making needs in situations where technical provisions or a major part of technical provisions are discounted as the case is in Finland. Moreover, the option would save insurers expenses when they could prepare individual accounts according to the same valuation principles as consolidated accounts. This would be a way to get rid of double accounting.

According to paragraph 16 (b) of ED 5 Insurance Contracts: "An insurer may continue using existing accounting policies that involve the following, but a new accounting policy that involves any of them does not satisfy the requirements of paragraph 14:

(b) measuring insurance liabilities with excessive prudence.

We understand the above-mentioned text so that insurance companies may continue to discount their technical provisions in Phase I and then use discount rates prescribed by the local authorities. In Finland non-life technical provisions are also discounted partly because motor third party liability and workers' compensation provisions include annuities. These annuities represent about half of the whole non-life underwriting provisions. The duration of annuities is over ten years. The authorities have considered to lower the highest possible discount rate of four per cent gradually during a transition period. *Is it possible in Phase I to continue to measure insurance liabilities by using discount rates given by authorities, if authorities change the discount rate in a direction which is opposite to the trend in market interest rates for liabilities of the same duration?*

Draft Implementation Guidance ED 5 Insurance Contracts

IG 49

IG Example 4 shows one possible format for presenting claims development information. The table shows how an insurer's estimates of total claims for each underwriting year develop over time, which reflects profitability. *As this is only an example, we would like to know whether it would be possible to present claims development not by underwriting year but by the year of occurrence over time. This would reflect the adequacy of provisions for the claims experience.*

Yours sincerely,

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Managing Director

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FEDERATION OF FINNISH INSURANCE COMPANIES
Marja-Liisa Kahola

APPENDIX 1

31 October 2003

IAS – TREATMENT OF PARAFISCAL CHARGES

1. Occupational safety charge

Subsection 4 of section 35 of the Workers Compensation Insurance Act provides that all premiums charged on compulsory workers compensation insurance are to include a 2% charge to be applied towards promotion of health and safety at work. The charge is transferred to the Federation of Accident Insurance Institutions, who pays the amount on to the Finnish Labour Protection Fund.

2. Road safety charge

Under section 18a of the Motor Liability Insurance Act, the Ministry of Social Affairs and Health imposes a reasonable charge on motor liability insurers to be used for the promotion of road safety. The annual size of this charge is fixed nationwide by a separate decision made by the Ministry every year. Insurers pay the charge, which is allocated to individual insurers according to their market shares, in four instalments to the Finnish Motor Insurers Centre, which transfers the funds on to the Central Organisation for Traffic Safety in Finland and to the local government of the Aland Islands.

The estimated size of the road safety charge is taken into account as one expense item among others when motor liability premiums are rated. But since the road safety charge is based on the insurer's estimated market share and estimated premium income, the amount actually paid by the insurer in road safety charge does not necessarily equal the amount loaded into the premium to cover this charge.

3. Government medical treatment charge

Government medical treatment charge is a statutory charge imposed by legislation on workers compensation and motor liability insurers to cover the cost of medical treatment given by public health care providers to patients covered by workers compensation and motor liability insurance. Workers compensation and motor liability insurers pay this charge, which is fixed annually nationwide and allocated to individual insurers in proportion to the volume of premiums written in the classes concerned, to the Social Insurance Institution.

Insurers pay the medical treatment charge in 12 instalments to the Federation of Accident Insurance Institution or, as the case may be, the Finnish Motor Insurers' Centre for further transfer to the Social Insurance Institution.

Section 3 of the relevant law says that the increase in the costs incurred by workers' compensation insurers as a result of this charge may be included in the premiums charged on workers compensation insurance.

4. Insurance premium tax

Any party doing insurance business in Finland must pay insurance premium tax to the state on premiums charged for the insurance lines covered by section 1 of the law governing insurance premium tax. Premium tax is charged at 22% of the premium amount before inclusion of the tax. The amount of the premium tax is calculated on premiums collected in each calendar month, and the total amount is paid to the state not later than the 25th day of the following calendar month.

5. Fire brigade charge

Section 1 of the law on fire brigade charges provides that insurers covering real or movable property against fire must pay a fire brigade charge for the property covered. This charge is applied to direct insurance covering property in Finland. The fire brigade charge for temporary fire insurance is 3% of premiums collected in the preceding year. For perpetual fire insurance, the charge is 3% of the amount of interest accrued in the preceding fiscal year on the insurer's provision for unearned premiums on perpetual fire insurance, calculated at the rate of technical interest adopted for the calculation of technical provisions.

Yet the total fire brigade charge never exceeds 0.006% of the total sum insured under fire policies in force in the preceding year. In practice, this upper limit based on the sum insured is never reached nowadays.

The fire brigade charge is paid to the Finnish Fire Protection Fund, which is supervised by the Ministry of the Interior.

In practice, the size of the fire brigade charge is equal for every temporary fire policy, collected from the policyholder. As to perpetual fire insurance policies, no fire brigade charge is collected after the year the policy was granted.