The Hundred Group
of Finance Directors

<u>ED5 – Insurance Contracts – responses to questions on which comments were invited</u>

<u>Question 1 – Scope</u>

(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 believe that the IASB is correct in drafting a standard that applies to insurance contracts and to reinsurance contracts. We have some concerns on the detail of the drafting in respect of the possible inclusion of reinsurance contracts within the scope of other IFRSs. These concerns are dealt with in questions 7 and 13.

We support the Board's decision to concentrate on the application of the standard to the underwriters of insurance risk and to address the aspects of accounting by direct policyholders within phase II. However we do have some concerns regarding the vacuum that this creates for accounting for insurance contracts by policyholders.

Proposed changes to the scope of IAS 32 and IAS 39 exempt insurance contracts (and certain other features) that fall within the scope of IFRS X Insurance Contracts from the scope of these two existing standards. By corollary, it would appear that insurance contracts falling outside the scope of the insurance IFRS would fall within the scope of IAS 32 and IAS 39. This category will include direct insurance contracts that an entity holds. This appears to be a change from the existing scope exclusion of these two standards, which exempts rights and obligations under insurance contracts (i.e including those of policyholders). We acknowledge that for most entities, the exposure to insurance contracts as a policyholder will not be material but we query whether there is sufficient guidance in existence if this is not the case. We suggest that during phase I, either the use of existing accounting policies should be extended to policyholders or that the contracts held by policyholders should continue to be scoped out of IAS32 and IAS39.

Whilst we note certain insurers concerns over the mismatch of the valuation bases used for assets and liabilities, we have far more significant concerns about the accounting for those contracts that are issued by insurers that fail to meet the definition of an insurance contract. We support the IASB in striving to achieve consistency of accounting with similar products issued by other entities, but we are concerned that the parallels may not exist for many financial products issued by insurers. We believe that for such products there will be a continuing lack of consistency between entities. More worryingly, this problem could then be exacerbated by an inconsistent accounting treatment within an individual entity. This may arise as different accounting treatments for insurance contracts and the financial products with very similar characteristics issued by the same entity. The IASB has acknowledged this problem in respect of those financial products that share discretionary participating features but we would urge the IASB to work with the insurance industry to identify other specific products that are commonly sold by insurers and to conclude whether additional guidance is required. An example of a class of contract where specific guidance may be appropriate is unit-linked business.

(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 concur with the IASB's proposed accounting treatment for these contracts.

<u>Question 2 – Definition of an Insurance Contract</u>

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 are satisfied with the definition when applied to those insurance contracts of a pure compensatory nature (e.g. general insurance contracts) whilst acknowledging that the real issues arise in the long term insurance markets where many contracts are composite instruments, with savings element features in addition to the pure insurance products. We acknowledge the efforts expended in devising a "catch all" for the wide spectrum of insurance products and the IASB's attempts to include a definition that embraces as wide a range of products, as is possible, of those contracts typically sold by insurers. As stated in the response to the previous question, we do have concerns that contracts falling outside the scope will by default be accounted for under a standard that has not been developed with particular features of such financial products in mind.

We therefore believe that a more pragmatic solution may be necessary in those circumstances where IAS 39 does not provide adequate solutions for accounting for such products. This could be achieved by defining additional contract features within the scope in the same manner as investment contracts with discretionary participating features have been included. The insurance industry would need to demonstrate that contracts included by the widening of the scope in such a manner satisfy the two criteria:-

- an absence of guidance within IAS 39 as to how such features will affect the measurement of the instrument, and
- demonstration that the specific contract features are rarely found in contracts sold by entities other than insurers.

<u>Question 3 – Embedded derivatives</u>

(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 acknowledge that the IASB has taken steps to minimise the impact of the proposals of ED5 on existing accounting policies of insurers pending the full implementation of the final standard emerging from phase II of the project. There are interrelationships between the various components that could be identified within contracts sold by insurers. We believe that the IASB has strived to ensure that where there is a valid justification for measuring the components within existing GAAP then these policies are allowed to continue in most instances.

Whilst acknowledging that the two examples of embedded derivatives outlined in BC123 may have a significant impact on the valuation of the contract liabilities, we agree that it would be premature in phase I to require such liabilities to be measured at fair value for the reasons set out in BC122. We believe that it would be wrong for the IASB to identify these two situations for a specific treatment thereby running the risk that other contracts containing similar features would avoid this treatment in phase I.

We agree with the proposed disclosures under paragraph 29(e) of the draft IFRS.

We do not have significant numbers of specific examples that fall outside the criteria for retaining existing policies other than the example of unit linked contracts which has been discussed previously. We believe that these contracts may cause problems if they fall to be measured in accordance with IAS 39.

<u>Question 4 – Temporary exclusion from criteria in IAS 8</u>

(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?

The IFRS emerging from ED 5 can only be viewed as a transitional standard and true comparability in accounting for insurance contracts will only occur when the IASB have completed phase II of the project.

Whilst many would view the proposals in ED5 as flawed, we consider that it contains the only practical solution for accounting for insurance contracts in the short term. In order to avoid a disproportionate amount of change for insurers, and in the absence of any likelihood of an industry consensus in the short term on applying a common set of accounting policies, we believe that the most pragmatic solution to the problem is to exempt an insurer from applying the criteria set out above in respect of most aspects of its accounting policies in respect of insurance contracts and reinsurance contracts. If the IASB had not included this clause then, in the absence of a full IFRS on accounting for insurance contracts, each entity underwriting insurance contracts would be forced to review its existing accounting policies and, potentially, to introduce new policies. In the absence of guidance in this complex area, there is then a strong possibility that there would continue to be inconsistency between entities in the choice of accounting policies, thereby perpetuating the current position. We therefore strongly support the exemption granted in paragraph 9 of the draft IFRS.

Under ED5 it is proposed that the exemption from applying these paragraphs in [draft] IAS 8 should last only until the end of 2006. We acknowledge the need to progress with all speed to the solution that will emerge from phase II of the project. However, we are concerned that this timescale has been imposed before there is any clarity as to whether the second phase of the project will have been completed before the expiry of the deadline. If the IFRS emerging from phase II has not been made mandatory for periods commencing after 31 December 2006, then the removal of the exemption could effectively make adoption compulsory at this earlier date. We believe that the industry effort should be focussed on the adoption of the long term solution for accounting for insurance contracts at the earliest date achievable but that this should be addressed within the transitional arrangements in the standard emerging from Phase II.

We note that financial instruments with discretionary participating features are not included in the concession granted in paragraph 9 of the draft standard. We therefore question whether this exclusion is at variance with paragraph 25, which in applying the requirements of paragraph 24(d), permits the continuation of existing policies in most regards.

(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 concur that the elimination of catastrophe and equalisation provisions represents an improvement to existing practice in many jurisdictions and that this is a change that may be achieved with minimal effort by preparers. We note that the wording of paragraph 10(a) refers to such provisions in respect of future insurance contracts. We believe that guidance may be necessary to explain the position in respect of existing insurance contracts.

We also concur with the requirement for a loss recognition test in the absence of a test under an insurer's existing accounting policies and the continuing recognition of insurance liabilities until such time as they are extinguished.

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 concur with the underlying principle that an insurer should not make a retrograde change to existing accounting policies in line with normal practice on changes in accounting policies.

We are concerned however that the conditions contained in paragraph 16 could be construed to be over restrictive and preclude an entity from making significant improvements to existing policies for fear of falling foul of one of the conditions listed.

By way of example, it may be difficult for a preparer to conclude on whether there is any excessive prudence in the measurement of insurance liabilities until such time as "excessive" has been defined within phase II of the project. In a similar vein, it may be possible to demonstrate an entity already applying different accounting policies within subsidiaries, could provide more relevant information by making changes to the accounting policies of a major subsidiary without alignment of the change across the Group. A change of this type would be prohibited under paragraph 16(e).

We agree with the proposal set out in paragraph 35 but question whether the paragraph should be included within the standard emerging from ED5. This change is dealing with financial assets, which are accounted for under IAS 39. It appears to us that the concession detailed in paragraph 35 should be covered within IAS 39.

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 concur with these proposals.

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 have a number of concerns on this subject,

Firstly, we are not convinced that IASB should be addressing this subject within phase I of the project as this may result in changes in existing accounting policies which the IASB is seeking to avoid at this stage. In the UK, existing accounting standards would generate similar results to those identified in the draft standard for those reinsurance contracts where assets and liabilities are created under a reinsurance arrangement but the deferral of gains emerging at the outset of a reinsurance contract could result in changes to existing policies.

We are also concerned about the requirement in paragraph 19 to apply IAS 36 to a cedant's rights under a reinsurance arrangement. We take this to mean that such assets should be valued at the lower of carrying value and their recoverable amount. The latter amount is likely to be calculated under IAS 36 as the value in use. Under IAS 36 this amount is calculated by estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal and applying the appropriate discount rate to these future cash flows. Such a measurement is likely to fall short of the value calculated under existing accounting policies. These would normally measure the asset using the same valuation basis as is used for the gross liability covered by the contract (subject to any allowance made for credit risk). We believe that the existing basis of valuation should be permitted under ED5 in accordance with paragraph 9(b) and that the IASB should delete the requirement set out in paragraph 19.

As a separate issue we believe that the IASB will need to consider the relationship between reinsurance assets and the underlying gross liabilities when deliberating the valuation basis of such 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 acknowledge that IAS 22 contains no exceptions to requiring assets and liabilities acquired as a part of a business combination to be valued at fair value and that accordingly this principle should be applied to any assets and liabilities arising under contracts within the scope of ED5. We therefore welcome the IASB's acknowledgement that there is likely to be a difference between the fair value of the assets and liabilities acquired and the ongoing measurement basis used when valuing such items in accordance with the reporting entity's own accounting policies. These paragraphs within ED 5 are therefore offering a solution to deal with this discontinuity in the post acquisition period.

Whilst we find the proposals helpful, there is no information on the basis of measuring the fair value of these assets and liabilities. We acknowledge that it is not possible to provide this guidance within phase I of the project for the reasons that are well documented. We would therefore recommend that guidance should be included that would allow the use of an existing accounting policy in the calculation of the fair value until such time as the measurement issues are finalised within phase II of the project. Further, the basis of recognition and measurement of any intangible assets arising from the implementation of these paragraphs will need to be revisited within the phase II project with an opportunity to restate such assets on a basis consistent with the phase II approach.

As a last point, the wording of the guidance 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.

<u>Question 9 – Discretionary participation features</u>

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 support the direction taken by the IASB in this difficult area of discretionary participating features, including the widening of the scope of ED5 to deal with such features within contracts that fail to meet the definition of an insurance contract.

We concur with the proposals set out in paragraph 24(b) that unallocated surplus should be recognised as either a liability or equity or split between the two. We also agree that an intermediate category should not be used in the classification of the surplus.

We do have concerns if the requirements of paragraph 24(b) are applied in such a way that any liability recognised has to comply with the IASB's framework and represent a constructive obligation to existing policyholders. We believe that it would be misleading to recognise any balance of surplus in excess of the constructive liabilities, as equity.

This can be demonstrated in the context of an unallocated surplus held within the with-profits fund of a UK life assurer. In many such companies, there will be an amount held in the fund that is in excess of the constructive liabilities that is unlikely to be distributed by way of bonus to existing policyholders. However, this amount is unlikely to be realisable by shareholders as the basis of distribution from the fund to shareholders is normally limited by the constitution of the fund that is itself only variable by Court approval. In such instances it would be a misrepresentation to describe such surplus as equity (i.e. in this instance the difference between the assets and liabilities of the individual life fund is not equity available to shareholders).

The optimal solution would be for the IASB to confirm that recognition of the surplus, as a liability should not be constrained by the IASB's framework during phase I of the project.

Whilst the approach may result in different accounting treatments, we believe that it would be premature for the IASB to introduce any more prescriptive guidance.

We note that disclosure of the accounting policies relating to such features is contained in the implementation guidance only. In this instance we believe that it may be helpful for there to be an explicit requirement for such disclosure within the standard. We note that within implementation guidance (IG 7(g)) the feature is described using a slightly different wording ("discretionary performance feature") and suggest that the terminology is aligned.

We also note that the proposed changes to the scope of IAS 32 contained in Appendix C4 limits the exemption to compliance with paragraphs 18-29G inclusive. The other requirements of IAS 32 (and in particular the disclosure requirements on fair value) remain applicable. In view of the Board's decision to defer fair value disclosures in respect of insurance contracts, in the context of a lack of guidance as to how such measurements should be completed, we believe that it would be an appropriate and a consistent treatment to make similar concessions in respect of investment contracts with similar features.

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 are concerned by the introduction of a requirement for disclosure of fair value of insurance assets and liabilities within ED5 since there is currently no agreed basis of calculating such values. We firmly believe that before mandating such disclosures, IASB should consider any implication for Phase II of the project. If a fair value basis of recognition and measurement is selected for Phase II, then any disclosures from 2006 would need to be consistent with the calculations under the eventual final standard. We consider that it is premature to commit companies to have developed the systems and knowledge in preparation of a 2006 deadline, while the methodology remains to be developed and tested.

Alternatively, a different model may ultimately emerge under Phase II of the project. In this case, there would be an even greater argument for reliable and consistent disclosures of fair values. It is unlikely that this reliability and consistency would emerge by consensus amongst preparers and hence the need for formal guidance and a tested methodology under the auspices of the IASB would remain.

To summarise, we believe that the requirement to present fair value information should be deferred until the basis of calculation is agreed by the IASB, and that any such requirement more logically belongs within the next phase of the project.

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 acknowledge the need to improve the level of disclosure in respect of insurance contracts and the assets and liabilities arising there from. This need is heightened by the probable diversity of accounting policies that will exist between entities when the IFRS is first adopted in 2005.

We also support the use of high level principles rather than prescribed rules that may result, on the one hand with the production of information that is not relevant to an individual entity, or conversely, could result in relevant information being omitted.

We do have concerns regarding the lack of consistency of the language used in the implementation guidance. By way of example paragraph IG37 uses the preface "An insurer discloses, for example" whereas the following paragraph states "to achieve this an insurer discloses". We recommend a consistent terminology consistent with the statement that the guidance accompanies, but is not a part of, the [draft] IFRS.

We do not have detailed comments about the specific examples given in the guidance but some of our membership may respond individually on specific issues.

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 have no comment on the boundary between those financial contracts that fall within IAS 39 and those that are covered by ED5 in the context of financial guarantees.

<u>Question 13 – Other comments</u>

Do you have any other Comments on the Exposure Draft and Implementation Guidance?

Consistency between accounting for insurance contracts and other financial contracts issued by insurers

We reiterate our point that consistency of accounting is needed for all products issued by an insurer. Where there is an existing practice or guidance in dealing with financial products we would agree that this principle should be overridden in the interests of applying a consistent accounting treatment across entities. However, where the financial contracts sold by the insurance industry are demonstrably different from those sold by other entities and no guidance currently exists on accounting for such products, then we believe that the IASB should consider permitting the use of existing accounting policies until such time as a tested basis of accounting for such products is introduced.

Transitional arrangements for first time adopters in 2005

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. There is a strong interaction between the contracts falling within the scope of ED5 and those falling within the scope of IAS39 and hence we would expect similar transitional measures to be considered in respect of those contracts falling under the scope of the insurance IFRS. This should extend to both the recognition and measurement proposals and to the additional disclosures proposed under ED5.

We appreciate that some companies will in any event wish to restate comparative results on a basis complaint with existing IFRSs in 2005. An entity may wish to do this in order to provide additional information to stakeholders. It would be helpful if the IASB would consider adopting a flexible approach to the disclosure of comparative information for 2004 in the primary statements without imposing the detailed disclosure requirements to the non-current periods.

Application of disclosure requirements to subsidiary undertakings

We believe that the disclosure requirements could be particularly onerous and of reduced relevance in the context of the financial statements of a subsidiary undertaking. We would therefore encourage the IASB to consider relaxing the disclosure information requirements for such undertakings.

Application of other IFRS by insurers

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.

Firstly, under IAS 16 - Property, Plant and Equipment, any revaluation of an owner occupied property is required to be recognised directly in equity (or as a charge against income when the revalued amount falls below amortised cost). Within insurance companies such assets may be held within a portfolio that contributes to the unallocated surplus arising from a discretionary participating feature and hence it would to be consistent to allow such surplus to be dealt with in accordance with ED5. It would be helpful if the IASB could confirm that such treatment is permitted.

Secondly, 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.

Other financial products issued by insurers

We have already commented on the practical issues of applying IAS 32 and IAS 39 to those products issued by insurers for which there is currently little or no guidance. The crux of the issue is the restrictive nature of the intereaction between fair value rules that introduce a deposit floor into the measurement of a liability, and the strict application of existing standards in the recognition of assets arising from the deferral of expenses.

These two features combine to result in the potential for losses at the outset of contracts which have been entered into on an expectation of a long term relationship with policyholders and with a view to profit. We understand that the IASB acknowledges the need to revisit the interaction of such issues as a part of the phase II project. It would seem perverse if an insurer was forced to recognise results that recognise losses at outset and gains if the expected profits emerge at a later date.