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30 Cannon Street
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Luxembourg, 06 November 2003

Commentary on the Exposure Draft ED 5 Insurance Contracts:
Recognition of Provision for Insurance Contracts.

Dear Mr. Clark,

Gecalux Group welcomes the decision of the International Accounting Standards Board to invite the industry to comment on the recently publicised Exposure Draft of its proposed IFRS for Insurance Contracts.

Gecalux Group would like to emphasize on the need of the Accounting of a Provision for Insurance Contracts. Currently Catastrophe Provisions are excluded from the scope of Insurance Contracts on the basis that they are not liabilities as defined in the Framework. We would like to detail below the reasons why we consider that Provisions should be included in the accounting of Insurance Contracts.

According to Exposure Draft, the financial situation of an insurer (as well as a reinsurer) related to a portfolio of insurance (or reinsurance) contracts will only be indicated by the Fair Value of this portfolio, which is calculated, under the present definition, from the discounted future cash flows of present contracts, as a result of the closed book approach. However, the Fair Value will not provide the reader of the financial statements any information on the obligation of the insurer to settle future claims up to a maximum that is defined by the limit of the contract. The level of risk resulting from this obligation of the insurer will therefore not be disclosed.

In fact, the Insurance Contract includes a liability as defined in IAS 37.10 : "*a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits*". The past event in this case is the underwriting of the policy which covers the insured up to a certain limit of claims. There is therefore for the insurer a "legal obligation" as a result of this insurance contract signed, and in some countries this legal obligation can even result from the legislation.

Under current Exposure Draft 5 , there will be no distinction between two contracts presenting the same Fair Value, but resulting from different liabilities as explained here above.

In addition, we also want to raise the question of the timing of the contract. The implementation of the Fair Value with a closed book approach will not result in the same valuation of two similar Insurance Contracts if they are not underwritten for the same period : a multiyear contract will not have the same value as a contract annually renewed on a tacit agreement, as only the first period will be valued for the latter. However, an annual contract with tacit renewal represents in our opinion a constructive obligation as defined by IAS 37.10 : "*by an established pattern of past practice, published policies or a sufficiently specific current statement, the enterprise has indicated to other parties that it will accept certain responsibilities".*

We are convinced that for the Insurance and Reinsurance Industry it will be essential for the analysts to have a complete information, not only on the expected present value of Insurance Contracts but also on the level of the obligation, whether legal or constructive. It is therefore important for the Insurance and Reinsurance Industry to recognise a Provision resulting from these obligations on the Insurance Contracts.

Indeed IAS 37.24 mentions that "*where there are a number of similar obligations the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of outflow for any one item may be small, it may well be probable that some outflow of resources will be needed to settle the class of obligations as a whole. If that is the case, a provision is recognised*". This is exactly the case of an insurer or reinsurer, with a portfolio of a large number of similar insured objects.

In addition, IAS 37.39 details how to estimate such a provision, with the 'expected value' method. IAS 37.48 also justifies that it is important to take into account future events that may affect the amount required to settle an obligation.

Finally, when considering Insurance Contracts relating to risks with low frequency but high severity, we estimate that IAS 37.24 should be extended to a class of years as a whole (similarly to considering insured events instead of insured objects as detailed in the IAA Paper *Comments on Catastrophe Provision* CL 103 J) : the probability of triggering the liabilities of such an Insurance Contract in a single year may be small but it may be well probable that some outflow of resources will be needed to settle the class of years as a whole. Therefore, the accounting of a specific Provision for Catastrophic events would also be required.

We trust the board concurs with our analysis, namely that Provisions should be included in the accounting of Insurance Contracts to make sure that users of financial statements can properly assess the liabilities resulting from the insurance contracts.

We thank you very much for your help in clarifying this matter. If you have any questions regarding the issue we raised in this letter, please do not hesitate to contact me directly, by phone +352.40.38.80.1 or by e-mail: fabrice_frere@gecalux.com.

Yours Sincerely,

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