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

24 September 2002

Ref T/701/004

Dear Sir David

Proposed Improvements to International Accounting Standards

I am enclosing the Associations response to IAS1 and IAS8.

I am also enclosing a copy of our submission to the UK Accounting Standards Board on their FREDs 24, 25 and 27 which themselves reflect the proposed changes to IAS21, IAS24 and IAS10.

In their Exposure Drafts, the Accounting Standards Board asked commentators to respond to the questions raised by the IASB on the proposed changes to the equivalent IASs. Our views on these are included in our submission to them.

Yours sincerely

Peter Vipond
Head of Financial Regulation and Taxation

Enclosures

[L062009A*FR&T/DWRI/2002/LETS]

RESPONSE OF THE ASSOCIATION OF BRITISH INSURERS (ABI) TO THE PROPOSED AMENDMENTS TO IAS 1: PRESENTATION OF FINANCIAL STATEMENTS

1 INTRODUCTION

1.1 The ABI represents some 430 insurers accounting for 96% of the business written in the UK by insurance companies.

1.2 Paragraph 3 states that the standard applies to insurance entities. However, given the importance of the insurance industry, and the complexity of insurers' financial statements in comparison with most other types of business, we believe the industry merits its own separate IFRS on presentation. IASB has recognised this in providing for presentation issues to be addressed in the proposed insurance IFRS. Insurers should therefore be excluded from the scope of IAS 1 pending finalisation of the insurance standard.

1.3 A particular issue affecting some financial undertakings, in particular insurance, is how to present the effects of volatility. Accounting for investments provides a current example of where this can be a problem. Where unrealised investment gains and losses are taken to the profit and loss account, significant variations in the market value of investments as witnessed by the recent volatility in financial markets can lead to marked fluctuations in reported profits above or below the long term trend line.

1.4 This tendency will be exacerbated if the proposed insurance IFRS requires an asset-liability approach using fair values for both the assets and the liabilities. Under this scenario, relatively small changes in interest rates could for example lead to significant changes to insurers' claims provisions. While we favour the fair value approach in principle, it will need to be accompanied by rules on presentation that permit the effects of volatility to be disclosed separately from the underlying operating results.

1.5 Our responses to the specific questions raised in IAS 1 are given below. We have also added some further comments.

2 RESPONSES TO THE QUESTIONS RAISED IN IAS1

2.1 Do you agree with the proposed approach regarding departure from a requirement of an International Financial Reporting Standard or an Interpretation of an International Financial Reporting Standard to achieve a fair presentation?

Yes

2.2 Do you agree with prohibiting the presentation of items of income and expense as "extraordinary items" in the income statement and the notes?

Yes

2.3 Do you agree that a long-term financial liability due to be settled within twelve months of the balance sheet date should be classified as a current *liability, even if an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue?*

Yes, because this reflects the position as at the balance sheet date. The refinancing is a non-adjusting event but should be disclosed in the notes if material.

2.4 *Do you agree that:*

(a) *A long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date, even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach?*

(b) *If a lender was entitled to demand immediate repayment of a loan because the entity breached a condition of its loan agreement, but agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement at least twelve months after the balance sheet date and:*

(i) *The entity rectifies the breach within the period of grace; or*

(ii) *When the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified?*

(a) Yes; this reflects the position as at the balance sheet date.

(b) Yes.

2.5 *Do you agree that an entity should disclose the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements?*

Yes

2.6 *Do you agree that an entity should disclose key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year?*

It is difficult to make assumptions about the future. This should only be necessary to the extent that these impact directly on carrying value at the balance sheet date. Instead, reporting entities should provide sensitivity analysis showing the extent to which assets and liabilities may fluctuate in response to changes in key variables.

The proposed IFRS on insurance contracts that is currently in the course of preparation will address disclosure requirements in the context of insurance business. As this standard is unlikely to be completed for some time, IASB is working on an interim solution that may include requirements for enhanced disclosures. These will include such matters as how risk and uncertainty is dealt with in preparing financial statements. The work being undertaken by IASB will address some special issues relating to insurance business that do not apply to other types of business. In view of this specific insurance related work, we consider it inappropriate for insurers to be subject to disclosure requirements in an IFRS of general application such as IAS 1. Insurers should therefore be excluded from the provisions of paragraphs 110 – 115.

3 OTHER COMMENTS

3.1 Paragraph 20 requires the accruals basis to be used. Under this basis, only assets and liabilities that satisfy the definitions and recognition criteria in the IASB Framework may be recognised. Under the deferral and matching arrangement currently adopted by insurers, some assets and liabilities are recognised that do not satisfy these definitions and criteria (e.g. unearned premiums provisions; deferred acquisition costs). The application of paragraph 20 to insurance contracts is inappropriate given that the accounting treatment for these contracts will be laid down in the proposed insurance IFRS. In the meantime we understand that IASB is considering an interim solution that may, subject to certain amendments, permit continuing use of the deferral and matching approach.

3.2 The current/non-current presentation advocated in paragraph 49 cannot be applied to the assets and liabilities of insurers in a manner which has any credibility or usefulness to users of financial statements. This is because it is not possible to say in advance which of their assets and liabilities fall within the definitions of non-current in paragraphs 54 and 57. An order of liquidity basis of presentation is equally invalid because it is not possible to estimate the order in which insurers assets will be realised or liabilities discharged. More appropriately, an insurance specific form of presentation should be developed as part of the interim solution.

Ref T/701/004
20 September 2002

RESPONSE OF THE ASSOCIATION OF BRITISH INSURERS (ABI) TO THE PROPOSED AMENDMENTS TO IAS 8: ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

1 **INTRODUCTION**

The ABI represents some 430 insurers accounting for 96% of the business written in the UK by insurance companies.

One of our major concerns is how the provisions on selection of accounting policies (paragraphs 4 to 6) will be applied to European insurers if, as now seems inevitable, the proposed insurance IFRS is not in place by 2005 when the EU Regulation requiring the adoption of IFRSs in the group accounts of EU companies comes into effect.

A possible solution might be to provide in IAS 8 that, where an IFRS is in course of development on a subject not previously covered by IFRSs, entities should not be required to change their accounting practice until that IFRS comes into force. We understand that this may form the basis of an interim solution for insurance contracts that is currently under consideration by the IASB. Alternatively, insurance contracts could simply be excluded from these provisions of IAS 8.

Our comments on the specific questions raised in IAS 8 are given below.

2 **RESPONSES TO THE QUESTIONS RAISED IN IAS 8**

2.1 Do you agree that the allowed alternative treatment should be eliminated for voluntary changes in accounting policies and correction of errors, meaning that those changes and corrections should be accounted for retrospectively as if the new accounting policy had always been in use or the error had never occurred?

Yes (but see response to question 2).

2.2 Do you agree with eliminating the distinction between fundamental errors and other material errors?

Yes, but prior year restatement should not be required for immaterial errors.

3 **ADDITIONAL COMMENT**

3.1 Depending on the type of business written, non-life insurers may need to include in their year-end claims provisions a large number of relatively small value claims. Although sufficient information may be available to determine the amount of the provision for these on a case by case basis, in practice given year end time constraints, the provision is often calculated by multiplying the number of claims by an average cost per claim.

3.2 The amount at which these claims are settled however may differ from the provision made on the basis described in paragraph 3.1 giving rise to an “error”.

3.3 We consider that, rather than constituting an error within the definition of paragraph 3 of IAS 8 requiring adjustment in the period in which it arose, this should be treated as a change in an accounting estimate, the effect of which should be recognised in the accounting period in which it is identified.

3.4 We repeat again our concerns that the constraints imposed by paragraphs 4 to 6 may be incompatible with the development of an interim solution on accounting for insurance contracts. In the absence of a fair value model any interim solution may be established partially in the context of a deferral and matching approach which may or may not conflict with certain aspects of the IASB framework. We would suggest that paragraphs 4 to 6 be altered, in particular paragraph 6 should give priority to any IASB interim solution, guidance or standard in relation to the issue in question. This will enable sufficient flexibility in the development of an interim solution for insurance contracts.

Ref T/701/004
20 September 2002

RESPONSE OF THE ASSOCIATION OF BRITISH INSURERS (ABI) TO ASB FINANCIAL REPORTING EXPOSURE DRAFTS 23 (FINANCIAL INSTRUMENTS: HEDGE ACCOUNTING), 24 (THE EFFECT OF CHANGES IN EXCHANGE RATES) AND 25 (RELATED PARTY DISCLOSURES)

1 INTRODUCTION

1.1 The ABI represents some 430 insurers accounting for 96% of the business written in the UK by insurance companies.

1.2 This response is restricted to comments on FREDs 23, 24 and 25 as these Exposure Drafts have the most relevance to insurance business.

2 GENERAL OVERVIEW

2.1 Given that ASB had previously announced that it did not envisage issuing any new UK standards in the run-up to 2005, it is a cause for some concern that ASB should now choose to issue so many new Exposure Drafts. It is unclear why ASB considers it necessary to do this at a time when IASB is also consulting on revisions to its own standards that cover the same issues.

2.2 Precisely how listed European Groups will move to IFRSs will be set out in a new IASB Standard "First-time Application of International Financial Reporting Standards". This requires first time reporting under IFRSs with effect from 1 January 2005 but with a corresponding adjustment to comparative figures.

2.3 The ASB through the introduction of its new standards however is now proposing that UK GAAP should be changed in a piecemeal way up to 2004 but not necessarily in a way that will lead to full compliance with IFRSs.

2.4 The concerns over phased introduction are both general and insurance industry specific.

2.5 In common with many observers ABI members have a general concern that the implementation of new ASB standards ahead of 2005 will be highly counterproductive. This is because, by requiring significant changes and restatements to financial statements in successive years up to 2005 it will give rise to considerable confusion amongst the users of accounts. This confusion will be further compounded if ASB standards represent only an interim step to full implementation of IAS requirements.

2.6 On insurance industry specific issues the ABI is concerned that the timing of implementation and interaction of the proposed requirements of FRED23, FRED30, and the IASB project for an interim solution to 2005 reporting in the absence of an insurance standard has not been considered by the ASB. Proposals by IAS are not yet fully developed and leading insurers in both the UK and the rest of Europe are continuing to attempt to assist the IASB with an extremely difficult technical area.

2.7 This process is likely to be lengthy and we would emphasis the necessity for any ASB's standards intended to be effective ahead of 2005 to be properly considered as regards the impact on the insurance industry, in particular as regards the reporting of investment assets, insurance liabilities, and related derivative instruments of insurers as a whole. Given the likely timescale for resolving the 2005 reporting solution we would are extremely concerned at the prospect of FREDs 23 and 30 being implemented ahead of 2005.

2.8 If despite these concerns the ASB is of the view that it is desirable to implement these FREDs ahead of 2005 we would request as a matter of the utmost urgency that the ASB discuss these issues with the ABI so that a sensible interim reporting solution for 2003 or 2004 be agreed.

2.9 If ASB's intention is to influence the direction of the revised IFRSs, it could do so equally effectively by working directly with the new IASB Board. Any pronouncement of its own at this stage should be restricted to Discussion Papers or Draft Standards. Any ASB standards should not take effect until 1 January 2005 by which time the final shape of the related IFRSs will be known.

2.10 ASB has already recognised this principle in its decision to defer the full adoption of FRS 17 pending further consideration of IAS 19, the equivalent international standard.

2.11 Notwithstanding our reservations over the desirability of publishing ASB standards at this time, we have considered the specific questions raised by ASB on FREDs 23, 24 and 25 and our comments are set out below.

3 **FRED 23**

3.1 Do you agree that a UK standard on hedge accounting is needed at this time to improve UK accounting and to prevent a gap appearing in UK accounting literature on hedges of net investments in foreign operations?

We understand the concerns the ASB has as regards ensuring that guidance is in place for hedges for the generality of transactions. However, the proposed requirements cannot be divorced from the, as yet, very unclear impact of IAS32 and 39 for certain insurance contracts and the proposed IAS "interim solution" for other insurance contracts. It cannot be over emphasised just how opaque the current position is and that resolution of these issues by the IASB will take considerable time. For example, currently it is not known to any level of specificity that is useful for planning purposes which contracts fall under IAS32 and 39, if they do the valuation methodology for liabilities, and given recent IASB debate whether embedded derivatives are to be scoped in or out of the requirements.

Insurers may use hedge contracts and / or reinsurance arrangements in respect of cash flows and exposures for investments and insurance liabilities and it is important that the requirements in respect of these items for the 2005 EU deadline are implemented in a consistent, timely manner with full regard for the overall performance statement impact. Given the complexity of these issues it would be highly undesirable to implement FRED23 as regards hedges in respect of insurance activity ahead of the 2005 deadline.

We are also concerned that the combination of the new requirements in respect of overseas operations has been insufficiently considered for hybrid entities such as London Market operations which currently fall within the definition of a foreign branch. (See FRED24 responses)

3.2 The ASB has taken the view that, in order to start the process of bringing UK practice on hedge accounting into line with the practice adopted internationally, the proposed UK standard's restrictions on the use of hedge accounting should be based on the main principle that underlies the hedge accounting restrictions in IAS 39: that hedge accounting should be permitted only if the hedging relationship is pre-designated and meets certain effectiveness criteria.

(a) Do you agree that the UK standard should be based on the principles underlying IAS 39 as set out in the FRED?

(b) Does the principle need to be supplemented by any other principles?

(a) Insurance contracts as defined in IAS 32 are exempt from the requirements of IAS 39. This exemption should be incorporated into FRED 23 on whatever basis IASB decides it should apply in IAS 39. In particular IASB may decide that, as part of an interim solution in the absence of an IFRS on insurance contracts, the exemption should apply to all insurance contracts rather than just those meeting the IAS 32 definition.

Without this exemption, it is possible that for example reinsurance arrangements would fall within the scope of FRED 23. This would be undesirable and not presumably what is intended.

(b) No.

3.3 The ASB has taken the view that the UK standard should contain those detailed restrictions in IAS 39 that appear to it to be necessary to implement the aforementioned principle, but should not at this stage include any other restrictions on the use of hedge accounting.

(a) Do you agree that the FRED's proposed restrictions on hedge accounting are all necessary to implement the aforementioned principle?

(b) Do you agree that the FRED should not contain any other restrictions on the use of hedge accounting? If not, what should those other restrictions be?

(a) Yes.

(b) Yes.

3.4 ***Do you agree with the material in the FRED on measuring hedge effectiveness? If you do not, what if any changes would you make to the material (bearing in mind that the material is drawn largely from IAS 39 and that one objective of the FRED is to bring about convergence of accounting practice)?***

Yes.

3.5 ***The ASB has taken the view that, in the main, the proposed FRS should not prescribe how hedge accounting should be done. Do you agree with this approach?***

Yes.

3.6 ***The ASB has nevertheless decided that the FRED should propose some minimum requirements on the hedge accounting techniques to be used. Do you agree with the FRED's proposals on:***

(a) ***The treatment of hedges in net investments in foreign enterprises?***

(b) ***The treatment of the ineffective portion of a gain or loss on a hedge that is not a hedge of a net investment in a foreign operation?***

(c) ***The treatment of hedging instruments that cease to qualify for hedge accounting?***

(a) Yes.

(b) This is correct in principle but it appears to require application of the true and fair override as referred to in the Note on Legal Requirements, as undertakings subject to Schedules 4 and 4A CA 1985 must take unrealised investment gains to revaluation reserve. Moreover, the requirement to disclose gains/losses on ineffective hedges in the profit and loss account is only consistent with a situation where other unrealised investment gains and losses are also required to be treated in this way. Currently IAS 39 would only impose this in a limited way (i.e. to investments held for trading).

(c) In relation to paragraph 17(a), our response to question 3.6(b) applies. With regard to paragraph 17(b), although this consistent with paragraph 163(b) of IAS 39, it is difficult to see why hedge accounting should in effect continue to be permitted (i.e. recognition in STRGL so as to offset the gains/losses

arising on the hedged item) where the conditions allowing it no longer apply.

3.7 ***The ASB is proposing that the standard should come into effect for reporting periods ending on or after a date in early 2003, although it is also proposing certain transitional arrangements. Do you agree with this approach?***

See 3.1 above

4 FRED 24

4.1 ***(ASB (i)) Do you agree with the ASB's proposed timetable for the implementation in the UK of standards based on a revised IAS 21 and IAS 29?***

No. We would prefer the FRED to be issued as a draft standard, and only to be developed into a full standard when the requirements of the corresponding IFRSs have been settled. The effective date for the ASB standard should be accounting period beginning on or after 1 January 2005, in line with the recent EU Regulation.

4.2 ***(ASB(ii)) Do you agree with the proposal not to include the IAS 21 provisions on the recycling of certain exchange gains and losses?***

This is justifiable on the grounds that it is consistent with ASB thinking on recycling generally. We would question however whether it is appropriate to write this prohibition into a new UK standard when this issue is still undergoing consideration at the international level. On the other hand, there may be practical difficulties in attributing for recycling purposes exchange differences arising over a period of time to individual foreign operations. Therefore, if recycling were to be required, it should apply only to the disposal of foreign operations acquired after the recycling requirement came into force.

4.3 ***(ASB(iii)) Do you agree with the proposal not to include any transitional arrangements in these UK standards?***

Yes, subject to the responses to questions 4.2 and 4.8.

4.4 ***(IASB(i)) Do you agree with the proposed definition of functional currency as "the currency of the primary economic environment in which the entity operates" and the guidance proposed in paragraphs 7-12 on how to determine what is an entity's functional currency?***

In practice the definition may be difficult to apply. For example an insurance company might be said to operate in a number of different economic environments, if it is located for example in the UK and regulated there, but its policyholders are mainly based overseas.

Applying the tests in paragraphs 7 and 8 might produce the following results:

- **Premiums may be charged in the various currencies of the policyholders;**
- **Regulation may be in the UK but the company may be subject to international competitive forces;**
- **Labour costs may be mainly denominated in UK currency.**
- **Capital may be raised in various different currencies while the geographical location of investments will need to match the currency in which liabilities become payable.**

In these circumstances, paragraph 10 permits management to exercise its judgement. This could lead to the selection of different functional currencies where the surrounding circumstances were broadly similar.

4.5 (IASB(ii)) Do you agree that a reporting entity (whether a group or stand-alone entity) should be permitted to present its financial statements in any currency (or currencies) that it chooses?

Yes. This will be important where accounts users, capital providers, etc require accounts denominated in their own currencies.

4.6 (IASB(iii)) Do you agree that all entities should translate their financial statements into the presentation currency (or currencies) using the same method as is required for translating a foreign operation for inclusion in the reporting entity's financial statements?

Yes, except that the requirement to translate income and expenses at the exchange rate applicable at the date of the transaction may in many cases be unduly onerous. Paragraph 38 of IAS 21 indicates that the average rate for the period can be taken as an approximation unless exchange rates fluctuate significantly. Even where exchange rates fluctuate significantly however, it should be permissible for entities to use an appropriate averaging mechanism that has regard to the size and frequency of transactions and the extent of movements in the exchange rate.

4.7 (IASB(iv)) Do you agree that the allowed alternative to capitalise certain exchange differences in paragraph 21 of IAS 21 should be removed?

This is a difficult issue. It could be argued that the additional translation cost reflects an additional cost of the asset itself which should be recognised in the financial statements subject to an impairment test. This is the alternative treatment currently permitted by IAS 21. The new approach is to regard the additional cost as a capitalised exchange difference which does not meet the definition of

an asset in the IASB Framework. On balance it is probably correct to separate out the exchange effect from the cost of the asset and then write it off to profit and loss account. Removal of the alternative in IAS 21 is therefore justified.

4.8 ***(IASB(v)) Do you agree that***

(a) Goodwill; and

(b) Fair value adjustments to assets and liabilities

that arise on the acquisition of a foreign operation should be treated as assets and liabilities of the foreign operation and translated at the closing rate?

Generally we consider goodwill to be an asset of the acquirer that should therefore be translated at the historic rate. We concede that where goodwill reflects the acquisition of an intangible asset, there is an argument for treating it as an asset of the acquired company and translating it at the closing rate. We would hope that this treatment would only apply to goodwill on new acquisitions and the accounts would not need to be restated to apply this treatment retrospectively to earlier acquisitions. On balance we would prefer a single accounting treatment based on the historic rate, but we have no objection to the closing rate being used provided a "grandfathering" approach is adopted.

Fair value adjustments relate to the assets and liabilities of the acquired company and should therefore be translated at the closing rate.

5 FRED 25

5.1 ***(ASB(i)) Do you agree with the proposal to issue a new standard in the UK on related party disclosures, once the new IAS 24 is approved by the IASB?***

The new FRS should not become effective until 1 January 2005 and should be consistent in all respects with the corresponding IFRS.

5.2 ***(ASB (ii)) Do you believe the ASB should consider any transitional arrangements?***

Subject to our response to question 1, the answer is no.

5.3 ***(ASB (iii)) Do you believe that an accounting standard should require disclosure of the name of a controlling party and, if different, that of the ultimate controlling party? If the new IAS 24 does not require***

disclosure, do you believe that a new UK standard should require this disclosure as set out in paragraphs 13 A and 13B of the draft FRS?

We assume that the disclosure stipulated by paragraph 12 would apply only at the parent company and group level and that the disclosure already required by the UK Companies Act in relation to interests in subsidiaries would be sufficient to satisfy paragraph 12.

In relation to its parent companies, a subsidiary would be required to disclose no more than paragraph 13A requires. Paragraph 13A carries forward an existing provision of FRS 8 and is not therefore a cause for concern.

5.4 (ASB (iv)) Do you believe that an accounting standard should require disclosure of the names of transacting related parties?

No; unless the transactions were not on normal arm's length terms.

5.5 (ASB (v)) Should the definition of related parties specifically refer to shadow directors? Should it also refer to persons acting in concert?

Yes in both cases.

5.6 (ASB (vi) Do you believe that an accounting standard should specify that disclosure is required of material related party transactions and give more guidance on materiality in the context of such transactions?

Yes.

5.7 (ASB (vii)) Are there any other aspects of the draft standard that the ASB should request the IASB to review?

No.

5.8 (IASB(i)) Do you agree that the Standard should not require disclosure of management compensation, expense allowances and similar items paid in the ordinary course of an entity's operations?

Yes; in the UK directors emoluments etc. are already disclosed under requirements relating to corporate governance.

5.9 (IASB(ii)) Do you agree that the standard should not require disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or wholly-owned subsidiary that are made available or published with the consolidated financial statements for the group to which that entity belongs?

There is some ambiguity in the wording of paragraphs 3 and 4 of IAS 24. The implication of paragraph 4 is that intra-group related party transactions and balances that are eliminated on consolidation do not need to be disclosed in the group accounts. This is the correct treatment and the wording of paragraph 4 should follow paragraph 4(a) of the existing IAS 24 in making this more explicit.

Paragraph 4 also states that such disclosure should be made in the entity's separate financial statements unless the exemption in paragraph 3 applies. Paragraph 3 appears to say that the above disclosure need not be made in the individual financial statements of any of the group members provided these are published with the consolidated financial statements for the group in question. We would like confirmation that this is the correct interpretation as the wording of this paragraph is ambiguous, In particular it could be interpreted to mean that, where there is no disclosure in the consolidated accounts of related party items and balances that have been eliminated on consolidation, such disclosure should be made in the financial statements of both the parent company and the subsidiary concerned. In our view such disclosure would be unduly onerous and in any case is unnecessary as it is to be expected that transactions between members of the same group will take place on a regular basis, and insofar as subsidiaries are wholly owned, these have no net impact.

An exemption from disclosure for related party transactions carried out in the ordinary course of the entity's business should also be reintroduced.

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RESPONSE OF THE ASSOCIATION OF BRITISH INSURERS (ABI) to ASB FINANCIAL REPORTING EXPOSURE DRAFT 27 (EVENTS AFTER THE BALANCE SHEET DATE)

1 INTRODUCTION

1.1 The ABI represents some 430 insurers accounting for 96% of the business written in the UK by insurance companies.

1.2 We do not propose to comment generally on FRED 27 as its provisions, which are principally intended to bring the UK into line with international accounting standards, will in most cases have a limited impact. We have identified an issue however of potentially serious concern. This is explained below.

2 DIVIDENDS (PARAGRAPH 11)

2.1 The corollary of paragraph 11 is that parent companies will only be able to recognise dividends receivable from subsidiaries in the year that they are declared rather than, if different, in the accounting period to which they relate. This will reduce the distributable reserves, and hence the dividend-paying ability, of such parent companies in the first financial period affected by the proposals. In subsequent accounting periods, there will be a one-year postponement of the recognition of any uplift in final dividends receivable from one year to the next.

2.2 Some groups will be able to mitigate the effect by preparing, for example, interim or management accounts for the first nine months of the accounting period in which the change takes place and, after estimation of fourth quarter profits or losses, declaring dividends prior to the end of that period. While this would work for direct subsidiaries of a holding company it might not be practicable for subsidiaries further down the chain, because of the need to determine dividend paying capacity at each level. An alternative would be to produce additional financial statements for the parent company made up to a date after the year end by which time the subsidiaries have declared their final dividends. It should not be necessary to do this however to circumvent a restriction which we consider inappropriate for entities within the same group. Other mechanisms, eg group relief payments and flatter group structures, may also be available to mitigate the position but probably to a limited extent only.

2.3 A possible solution would be for the principle established in paragraph 11 not to apply to parent-subsidiary relationships. The control exercised by parent over its subsidiary will ensure a de facto obligation on the part of the subsidiary to pay a dividend in advance of the formal dividend declaration by the subsidiary.

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