International Accounting Standards Board
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Exposure Draft 5 of the IASB - Response from the Danish Insurance Association

Dear Peter Clark

In the Danish Insurance Association (DIA) we have studied the Exposure Draft 5 (ED 5) on insurance contracts with great interest. We support the IASB in trying to establish a coherent accounting standard for insurance contracts. In this respect, we acknowledge that ED 5 is only an interim standard to be further developed in phase II.

We would like to comment on certain aspects of ED 5. We have, however, limited our comments to a few, particularly important issues. We have played an active role in the work of the Comité Européen des Assurances (CEA), and hence, we would like to state initially our support to the response which the CEA has prepared. In the following we only comment further on those issues which has in particular attracted our attention.

Our comments are concentrated on life insurance business. However, concerning non-life, we would like to explicitly state our support to the CEA concerns in relation to catastrophe and equalisation provisions in non-life.

Question 1 – Scope

In particular, in relation to question 1 a ii) we would like to point to the need for a pragmatic approach when drawing the distinction between insurance contracts and financial instruments in the interim period (phase I).

Unit linked contracts

On the Danish market, unit linked contracts do not represent one specific product, but rather a range of different products, all containing elements of insurance contracts. Danish life insurance companies can not legally offer unit linked contracts without insurance risk. Some products have features resembling with-profits contracts (contracts with participating features) and others do not.

In our view, this range of products must be accounted for in the same way. We would therefore urge that unit linked contracts in general should fall under the scope of ED 5.

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Employee benefit plans

According to ED 5, the IFRS shall not apply to employers' assets and liabilities under employee benefit plans and retirement benefit obligations, which are to be covered by IAS 19. In the Danish case, however, there is no reason to exclude such benefit plans from ED 5. In Denmark, these plans are governed by the same rules, legislation and supervisory guidance and control as any other benefit and retirement plans the insurance company enters into with its third part customer.

Insurance contracts with employers must also be taken fully into account when presenting a true and fair picture of costs, profit and loss etc. and is part of the statutory rules governing the distribution of profit between policyholders and shareholders equity.

In many benefit plans the employer contributes with x% of the employees salary, and the employee contributes with y% of his/hers salary. Consequently it would be necessary to separate the contracts in accordance with the contributions.

We request that it should be possible to include such plans under the scope of ED 5 in order to present a true and fair picture of the accounts of the year in question.

Question 2 – Definition of an Insurance Contract

It is not an easy task to develop a clear and consistent definition of insurance contracts, which will ensure a clear dividing line between those contracts which are clearly insurance and those which are not. The CEA has remarked on this issue. The problems pointed out by the CEA in our view reinforce the need for a pragmatic approach, i.e. referring to our comments to question 1 above.

Question 6 – Unbundling

We would like to stress that for the interim period in phase I due attention must be paid to the need to introduce as few changes as possible into the existing accounting procedures. We therefore support very much the CEA comments on this issue.

Question 9 – Discretionary participation features

Also on this issue we are in line with the CEA and support the temporary exemption for contracts with discretionary participating features (with-profits contracts) as an interim measure until Phase II is implemented.

Question 13 – Other comments

a) Fair Values

In Denmark, we have - as you are aware - introduced fair values into life insurance in recent years. In 2002 it was optional for life insurance companies to apply fair values to the liabilities, while it is a requirement for 2003 and the years to come. All assets are measured at fair (market) values.
The process which led to the introduction of fair values in life insurance was not easy. Actually, the process was initiated in 1998 when the government set up a committee which was given the task of developing a framework for measuring liabilities at fair value. It is fair

to say that all involved parties, including the insurance industry were somewhat hesitant towards this task, because the very notion of fair values for the liabilities was hard to interpret. However, the mandate given by the government left no room for questioning whether the task was to be solved.

During the work of the committee it became clear that fair values could be introduced. The specific method chosen in Denmark is a close result of the structure of the Danish market, where emphasis to a large extent is on with-profits contracts, containing a guaranteed yield.

One of the important changes brought about by the Danish version of fair value accounting is that differences in the rate of the guaranteed yield is reflected in the measurement of liabilities. The higher the guaranteed yield, the more risk is associated with those contracts, which shows up in the accounts. This is a major achievement.

Moreover, accounting at fair values has introduced more flexibility into investment decisions. The recent years' developments on financial markets has been easier for the companies to absorb because of the new, market-oriented accounting rules.

We therefore take a positive stance towards the introduction of fair values into life insurance. However, we must stress that our particular model is especially fitted for the type of products found on the Danish market. Other markets and products might need different models if fair values were to be introduced.

Moreover, while the accounting rules have been reached in agreement between the insurance industry and the supervisor, some of the legislation governing the accounting rules has given rise to severe problems. This concerns not least the delicate question of rules on the division of surplus between policyholders and shareholders. This question, of course, is a matter of utmost relevance for the measurement of the available solvency margin. On this issue, we are still debating the specific rules with the authorities.

Therefore, on the one hand we support the introduction of fair values into insurance. And we are encouraged by the fact that the ED 5 does not seem to hinder us from continuing to apply our new accounting rules to life insurance. On the other hand, the development of fair value accounting techniques at a European level must be flexible enough to respect differences in products found on the individual markets. If the IASB decides to take this approach in phase II, it will be an immense task. Of course, in the DIA we would be happy to share our experiences on this matter.

While supporting fair values, we must also stress that some markets have problems with the mismatch issue arising from assets being measured at fair values while liabilities are measured in a more traditional way.

Hence, we also urge that due consideration be taken to these markets. A solution must be found to alleviate the volatility in equity which these markets might experience as a result of ED 5 - however, such a solution should not impose changes to those markets which are already on a fair value standard.

b) Owner-occupied property

Owner occupied property investment are - in line with other investment assets - usually assets “earmarked” to ensure that the life insurance company will be able to repay policyholders savings, and the profit and loss are included in the profit and loss available for distribution to the policyholders. Owner occupied assets are under Danish GAP stated at fair value at the end of the year like other investment property and securities.

We would like to argue that for entities already using market values on the liability side, there should be an option to value owner-occupied property held by insurance companies at fair value (as in IAS 16, point 29), but with changes in fair values showing up in the profit and loss account.

c) Assets issued by the entity in question

Life insurance companies are required to invest their policyholders' savings in certain types of investment assets (shares, bonds, property etc.). In some cases the company decides on the composition of the investment portfolio, in other cases the policyholder is given the opportunity to decide. At all times Danish life insurance companies are required to hold investment assets corresponding to the company's life insurance provisions (commitments towards policyholders). Hence, some investment assets are allocated ("earmarked") to ensure that the life insurance company will be able to repay policyholders' savings.

Mortgage bonds issued by a group company and purchased by another (life insurance company) do not meet the definition of an asset and a liability when consolidated in consolidated financial statements of the parent company. In accordance with IAS, such holdings of bonds should therefore be eliminated. In the same manner own shares (treasury shares issued by the reporting entity) should be eliminated and return on shares would not be recognised in the income statement.

However, in our opinion elimination of "earmarked" investment assets held as security for policyholders' savings does not result in a true and fair view of the consolidated financial statements.

We have on the basis of the above reviewed the IAS standards and corresponding SIC´s. Our conclusion is that according to an analogous understanding of IAS 19 own shares and bonds that are not “non-transferable” can be defined as Plan Assets in Defined Benefit Plans.

Neither ED 5 nor IAS 39 (and SIC 16) covers the situation where returns of the Group’s own shares and bonds accrues to policyholders and serves as investment assets for the policyholder’s savings. Therefore, by analogy to IAS 19, we do not find elimination mandatory.

ED 5 should in our opinion incorporate the same excemption concerning assets issued by the entity in question as is the case in the note to IAS 19, appendix B. In our view, this is necessary in order for the accounts to present a true and fair picture of the underlying business development.

d) Effective date and transition

According to ED 5, an entity shall apply that IFRS from 1 January 2005 onwards. However, the standard will not be ready until spring 2004. Therefore we urge that the same transition rule as introduced into IAS 39 should be applied to ED. Hence, the amendments emanating from ED 5 should only be applied prospectively. Otherwise, costly administrative burdens will be forced upon the European insurance industry.

Sincerely yours

Steen Leth Jeppesen