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**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. 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?

- (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?

**Lloyd's comments**

- (a) *We agree that the scope is appropriate.*
- (b) *We agree with the proposal for weather derivatives. In general, products which do not meet the definition of an insurance contract should be excluded from the scope of the draft IFRS.*

**Question 2 – Definition of an insurance contract**

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?

### **Lloyd's comments**

*The proposed definition is broadly satisfactory having regard to the clarification and elaboration in Appendix B. However, as it does involve a certain element of subjective judgement, particularly as to what is (or is not) "significant", clear guidance will be essential in order to avoid a number of differing and inconsistent interpretations.*

### **Question 3 – Embedded derivatives**

- (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?

### **Lloyd's comments**

- (a) *The proposed exemptions from the requirements in IAS39 for some embedded derivatives are generally appropriate*

- (b) *We have no specific comment.*
- (c) *We have no specific comment.*
- (d) *We are not aware of any other embedded derivatives which should be exempted from the requirements in IAS 39.*

#### **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.

(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?

- (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?

#### **Lloyd's comments**

- (a) *The exemption from IAS 8 is appropriate in the context of the two phase project. There is however a difficulty with the time limit as it is dependent upon the completion of phase II of the project in accordance with the current timetable. There should be sufficiently flexibility to extend the period during which the exclusion applies to take account of any slippage in the phase II timetable.*
- (b) *These proposals are appropriate.*

## 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?

### **Lloyd's comments**

*We believe that the proposals in (a) and (b) are appropriate.*

## 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?

### **Lloyd's comments**

- (a) *We believe that unbundling is inappropriate in cases where the deposit component forms an integral part of the insurance contract. Also it may not be feasible to unbundle because of the scale and cost of system changes required.*
- (b) *Unbundling may be appropriate for any component of a contract that falls outside of the definition of an insurance contract (e.g. financial reinsurance contracts).*
- (c) *No, it is not clear when unbundling should occur.*

## 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?

**Lloyd's comments**

*It is not clear from paragraph 18(d) of the proposed IFRS whether all of a reinsurance asset can be recognised to match the related inwards liability or whether the "profit" (i.e. total recovery less premium paid) on the reinsurance contract can only be recognised on a straight line basis over the period of the reinsurance contract. This paragraph needs to be clarified. We strongly believe that all of the reinsurance asset should be recognised at any time in the period of the contract as long as it matches the related inwards liability.*

*Our view is that to avoid potential inconsistency in the treatment of insurance and reinsurance, and changes now which may have to be reversed or otherwise be inappropriate as a result of phase II, all aspects of reinsurance accounting should be deferred and covered under 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?

**Lloyd's comments**

*We have no specific comments on these proposals.*

**Question 9 – Discretionary participation features**

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?

**Lloyd's comments**

*We have no specific comments on these proposals.*

**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?

**Lloyd's comments**

*It does not seem appropriate to introduce fair value disclosure requirements for insurance assets and liabilities in Phase I when the methodology for calculating fair value of insurance liabilities has not been agreed and prescribed or any guidance provided.*

*It would be more appropriate to require fair value disclosures once the introduction of fair value accounting, including guidance on the methodology to be used, has been published.*

**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?

**Lloyd's comments**

- (a) *Broadly we support the requirement for other disclosures as outlined in ED5 as long as they are relevant, appropriate and properly balanced against the needs of users and the benefits that will be gained from such disclosures.*
- (b) *The approach is largely sensible. However because of the element of subjectivity and judgement required in addressing these high level requirements, this may result in different interpretations which would lead to a lack of comparability by users.*
- (c) *We agree with the proposed transitional relief.*

**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?

**Lloyd's comments**

*We agree that it is appropriate that IAS 39 should apply to a financial guarantee given in connection with the transfer of non-financial assets or liabilities.*

**Question 13 – Other comments**

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

**Lloyd's comments**

*We have no other comments.*