FINANSTILSYNET

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MINISTRY OF ECONOMIC AND
BUSINESS AFFAIRS

Dear Peter Clark,

The Danish Financial Supervisory Authority (Danish FSA) welcomes the opportunity to comment on IASB's Exposure Draft on Insurance Contracts (ED 5). The Danish FSA is a member of the IAIS and we therefore refer to the comment letter sent by the IAIS. Due to the fact that we would like to draw the IASB's attention to certain issues that we find are of particular importance we have decided to send this comment letter. We will therefore in the following not reply to all the issues raised in ED 5 but just draw your attention to certain issues.

The Danish FSA is a fully integrated supervisory authority responsible for the supervision of all financial enterprises including insurers and it also serves as securities supervisor in Denmark. The Danish FSA has the power to issue accounting rules for all financial enterprises under its supervision.

The rules for public financial reporting constitute a main pillar in the strategy of the Danish FSA for ensuring sound functioning of financial markets and for motivating sound business practices in the financial sector.

Given that the exposure draft is an interim standard the Danish FSA supports it. We do, however, place great emphasis on the fact that the adoption of a phase 1 standard on insurance contracts does not delay the work on a phase 2 standard, which should be completed as soon as possible.

In the Danish financial sector we have a long tradition of measuring financial assets at fair value. Regarding life insurance we have recently introduced a full fair value model with all investments (financial assets and property) and insurance liabilities measured at fair value. From this perspective we regard the fair value option included in the forthcoming improved IAS 39 as very important and we would certainly regard it as a step backwards if we were forced to use the "mixed model" contained in the present IAS 39.

The Danish FSA acknowledges that in theory artificial volatility could arise in accounting results or in equity because of the interaction between the rules of measuring financial assets in IAS 39 and existing practices of measuring liabilities in certain jurisdictions. The Danish FSA emphasizes that a “solution” to this mismatch problem must be directed towards cases where it can be proven that the problem exists in reality and not by introducing new measurement rules for financial assets in insurance entities in general.

Temporary exclusions from criteria in IAS 8

In view of the fact that one of the aims of ED 5 is to avoid major changes in accounting practices that may need to be reversed in phase 2 the exclusions suggested in paragraph 9 which are referred to in question 4a seem necessary.

For the same reason it does not seem justified that the exclusions are only made temporary. The clause that the exemption should only be in force until 1 January 2007 is only relevant in the case that phase 2 is not in place by that date. Consequently, this sunset clause could imply – contrarily to the aim of phase 1 – that accounting practices have to be changed once 1 January 2007 and then again when phase 2 is in place.

The Danish FSA is therefore of the opinion that the exemption from the criteria in IAS 8 should be in force for the whole phase 1 period.

As regards question 4b the Danish FSA believes that the proposals (i), (ii) and (iii) are appropriate. However, the Danish FSA is of the opinion that it is not appropriate that the wording of 10 (a) in the ED 5 only relates to catastrophe provisions and equalisation provisions for "future insurance contracts". Furthermore, the provisions which the ED 5 aims at precluding should be more precisely described in the standard in order to prevent practices of "equalisation provisioning" under other names and maybe with slightly different purposes to be continued. It is therefore suggested that 10 (a) is worded as follows:

"shall not recognise as a liability catastrophe provisions, equalisation provisions or any other provisions specifically set up to cover future claims beyond the provisions set up to cover expected claims under existing contracts."

Discretionary participation features

The Danish FSA supports the requirement to account for unallocated surplus as either a liability or equity and the prohibition of an item in between.

According to the proposed amendments to IAS 39 it will be mandatory to recognise a gain or a loss on an available-for-sale financial asset directly in equity. In order to ensure that the entities do not use this rule to avoid a proper allocation of gains and losses between liabilities and equity it is suggested that the following paragraph is included in the insurance standard:

"Financial assets which performance contributes to the determination of the rights of beneficiaries under participation contracts can not be classified as available-for-sale assets. If such assets are not held-to-maturity assets or originated loans and receivables they have to be designated as financial asset held for trading with changes in fair value recognised in profit or loss."

The meaning of the paragraphs 24 (c) and 24 (d) seem unclear. It looks as if the content already follows from other paragraphs in the ED.

Owner-occupied property

From the basis for conclusions BC114 we understand that the issue of owner-occupied property has been deliberated on in relation to the insurance project. It is our understanding that properties owned by the insurers and occupied by the companies themselves have to be treated in accordance with IAS 16 and not IAS 40 as is the case with investment property.

In general - it is difficult to understand the logic behind a solution implying that the measurement of properties depends on who is working in the buildings, but we understand that this is a consequence of past decisions and that we have to live with this solution for some time both for insurers and for other companies. We hope that the rules will soon be changed so that all real property can be measured at fair values with changes taken to income statement at least in entities having investment in real property as part of their activities.

The specific and more serious problem for insurers in this respect relates to life insurers issuing participation contracts. The properties owned by such a company are - at least in Denmark - part of the investments in which policyholders participate in the risks and returns.

According to IAS 16 property has to be measured either at its cost or at its fair value. Evidently, if the cost option is chosen no increase in the value will appear and consequently policy holders will not get a share in any possible increase in the value, unless the piece of property is sold. Therefore, if you want to ensure that policy holders receive their share of the current return (including increases in the value) this option can not be chosen.

The allowed alternative treatment in IAS 16 implies that the property is remeasured periodically at fair value. According to this optional treatment increases in the value should be credited directly to equity. However, according to the life insurance contracts policy holders are entitled to a fair share of the increase in the value. If the liability toward policy holders is increased corresponding to their share of the increase in the value of the property, you will get an expense in the income statement without the corresponding income. In other words, choosing this option, the income statement will be distorted. The same goes for the balance sheet as an increase in the value of the property should be credited to equity although only a minor part of it belongs to the owners of the company.

Yours sincerely,

Flemming Petersen