SOCIETE GENERALE

29 October 2003

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

Re: Exposure Draft ED 5 Insurance Contracts

Dear Sir David,

We are pleased to provide our comments on the above exposure draft.

General comments

Interaction of ED 5 and IASs 32 and 39

ED5 addresses accounting for certain financial instruments issued by insurers in the context of their first-time application of IAS/IFRS, ‘notably for financial contracts with a discretionary participation feature. We understand that those contracts were scoped into ED 5 due to the fact that discretionary participation features are (a) for the most part specific to contracts issued by insurers (b) common to insurance contracts and investment contracts alike and (c) not fully addressed by the current text of IAS 39.

However, we think that as all financial instruments should be within the scope of IAS 32 and IAS 39, in fact these two Standards should be amended to permit specific treatment for financial instruments with a discretionary participation feature and to allow both measurement principles, amortised cost or fair value for these contracts.

Pending these amendments to IAS 32 & 39, we believe that existing local accounting policies should continue to apply to all financial instruments issued by insurers, consistently with ED5's approach for financial contracts with a discretionary participation feature and insurance contracts.

Additionally, we believe it is necessary to rename the Exposure Draft, for clarification purposes, as follows: *<< ED 5 Insurance Contracts and Financial Instruments with a Discretionary Participating Feature>>.*

Effectively, in so far as the Exposure Draft treats both of these types of contracts, it would be more appropriate to reflect this fact in the title and so:

(i) avoid confusion in the scope of application of the Standard [i.e. it covers both contracts. Thus, wherever 'insurance contracts' are referred to, the reference should include 'financial instruments with a discretionary participating feature];

(ii) emphasise the fact that ED5 temporarily treats issues that should be addressed by the proposed amendments to IAS 39, Financial Instruments: Recognition and Measurement.

Asset and liability mismatch

We would also like to highlight, in our general comments, our concern regarding the asset/liability mismatch which would result from the application of IAS/IFRS to insurance entities (this is addressed specifically and in more detail in our answer to question 13). Since insurance contract liabilities will continue to be accounted for under local GAAP and as a result of the temporary inclusion of certain financial contracts in ED 5 as noted above, this will result in an asset/liability mismatch. Contracts issued by insurers will be accounted for at an amount close to amortised cost whereas assets held by insurers will be in the scope of IAS 39 and accounted for at the most part at fair value.

This mismatch will lead to an artificial volatility in an insurer's own equity which could be misleading to the users of financial statements, e.g. financial analysts tracking movements in equity.

For this reason, we believe that the current version of IAS 39 and the proposed amendments to this Standard should be amended to allow for a specific additional category of assets in which assets backing contracts issued by insurers [insurance contracts and financial contracts] can be classified and measured at cost in order to ensure that there is no measurement mismatch between assets and liabilities.

Implementation time and pressure on systems and operations

We would like to stress how little time insurance entities will have to put this Standard into practice. Published as an Exposure Draft at the end of July 2003, the definitive version of the Standard is expected in the first quarter of 2004 for application as of 1 January 2005. This leaves hardly any time at all for insurance entities to adapt their information systems accordingly.

We believe that ED5 should benefit from the same optional exemption as IASs 32 and 39 in terms of comparative figures for 2004.

An additional point is that we have concerns regarding the perenniality of any IT changes insurers would have to make for Phase I of the insurance project. Although it is the Board's intention that the accounting for liabilities should not change significantly before Phase II of the project is concluded, application of Phase I will require significant systems changes that may well prove to be temporary.

Moreover, the adaptations necessary for Phase I only focus on limited aspects of the measurement of liabilities. This would result in certain cases in applying two sets of accounting standards (local (GAAP and IAS/IFRS accounting principles) to the same contract.

Conceptual inconsistency

We have questions on conceptual grounds on the guidance in the Basis of Conclusions, which places a floor on the fair value measurement of financial contracts issued by insurers (see our response to question 13). An economic view of how insurers pool risks (e.g. mortality or lapse rate) results in a fair value for a portfolio of contracts which is not necessarily equal to the sum of all of the fair value of the individual financial contracts.

Financial guarantees

As we do not believe that subsequent measurement at fair value is appropriate for these financial guarantees, we think their inclusion in the scope of ED *5* is inappropriate particularly as Phase II of the insurance contracts project could introduce subsequent measurement at fair value for insurance contracts.

Additionally, the accounting for financial guarantees was already addressed by IAS 39. We understood that the final version of that Standard will indicate that:
issued financial guarantees, that are scoped out of IAS 39 because the beneficiary of the guarantee is only compensated if it is in fact exposed to or has incurred a loss, should be recognised initially at fair value and subsequently measured at the higher of the initial fair value and the value determined according to IAS 37; and other guarantees in the scope of IAS 39 are accounted for at fair value with changes in fair value recognised on profit and loss.

Appendix 1 sets out our answers to the questions raised in the draft Standard.

If you have any queries regarding our comments, please do not hesitate to contact me at

33 (1) 42 1449 86 or Mr. DAMOTTE at 33 (1) 42 140410.

Sincerely,

Ms Véronique de la Bachelerie
Group Accounting Manager

Appendix 1
Comments on ED 5—Insurance contracts

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 that it holds, except for specified contracts covered by others IFRS. The IFRS would not apply to accounting by policyholders (paragraphs 2-4 of the draft IFRS and paragraphs BC40 - BC 51 of the basis of 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 (paragraph BC 9 and BC 109 BC 114). 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 - BC 117).

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?

We do not believe that the scope exclusions/inclusions of the Exposure Draft provide appropriate answers for specific assets or liabilities.

- Firstly, we do not believe that the Exposure Draft provides an appropriate response as to how to account for assets held to back both insurance contracts and financial contracts with a discretionary participation feature (point (a) (i)). These assets fall either within the scope of IAS 39 or IAS 40.

  According to IAS 39, these assets would be accounted for mainly at fair value in which case there will be an accounting mismatch for Phase I between assets and liabilities which will continue to be measured under local GAAP at an amount comparable to amortised cost. We find it necessary therefore to have a specific category within IAS 39 that will permit consistent measurement of assets backing both insurance and financial contracts issued by insurers.

  We acknowledge that this specific topic (creation of an additional asset category for insurance assets) was discussed by the Board, as detailed in the Basis for Conclusions, paragraphs BC 109-114. However given the significance of the impact of the resulting asset/liability mismatch on our balance sheet, we urge the Board to reconsider (for Phase I) its position and to consider our proposed solutions as detailed below.

- For non-financial assets backing insurance and financial contracts issued by insurers we believe that there would be also a mismatch issue in the event that the Group elects to account for investment property at cost and it consolidates real estate funds backing unit-linked liabilities, the latter being valued at the underlining property market values. This problem would be exacerbated if the Board decides in Phase II of the project that insurance liabilities should be measured at fair value. We therefore believe that either an option to fair value, similar to the one introduced into IAS 39 in the June 2002 proposed amendments to that Standard, should be introduced into IAS 40 for investment properties or an additional 'assets held to back liabilities issued by insurers' category (see below) should be introduced so that an accounting measurement mismatch between insurance entities' assets and liabilities is avoided.

- For financial assets we would support the creation of a specific category of assets which back insurance liabilities and financial instruments with a discretionary participation feature, the measurement basis of which is identical to that applied to insurance liabilities which will continue to be accounted for under national GAAP (as expounded in our answer to question 13). This category does not exist today in IAS 39.

In conclusion, as long as the mismatch issue is not resolved we believe that assets held to back both insurance contracts and financial instruments with a discretionary participation feature should continue to be accounted for under local GAAP, i.e. until Phase II of the project is implemented.

▪ Secondly we agree that financial contracts that are not insurance contracts but are issued by an entity that also issues insurance contracts are to be included in the scope of IAS 39 (financial contracts with or without a discretionary participation feature).

However, due to the fact that certain financial contracts will be in the scope of ED *5* and other financial contracts will be in the scope of IASs 32 and 39, we are of the opinion that *all* contracts issued by an insurance entity should be exempted from the application of IASs 32 and 39 during Phase I of the insurance contracts' project. Indeed to have some financial contracts accounted for in accordance with IFRS/IAS and other financial contracts accounted for under local GAAP seems inconsistent to us and unhelpful to the users of the financial statements. It is for this reason that all financial contracts issued by insurers should temporarily continue to be accounted for in accordance with local accounting rules.

By way of illustration of the difficulties of application of IAS 39 to financial contracts issued by insurers, we believe that we face multiple problems and, notably we do not know how to measure unit-linked contracts as we are unsure whether the fair value measurement principles are sufficiently defined and would provide appropriate accounting treatment for these contracts. For example, uncertainties remain regarding how fees relating to unit linked contracts should be accounted for. Indeed the Basis for Conclusions (BC117(g)) indicates that costs of servicing should be taken into account when determining the fair value of the financial liability issued by an insurer when these fees are significant and other market participants would face comparable costs.. We are unsure whether this is consistent with the way IAS 39 defines fair value. So far we understand that future servicing costs had to be excluded.

In respect of the Exposure Draft's proposal that weather derivatives should be brought within the scope of IAS 39 unless they meet the proposed definition of an insurance contract (point (b)), we do not have any specific comments. Please refer to our comment letter on IAS 32 and 39 for our comments on the scope of IAS 39 in respect of derivatives.

Question 2: definition of an insurance contract

The draft IRFS defines an insurance contract as a << contract under which one party (the insurer) accepts significant 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 BCJO - 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 16 example 1, appropriate? If not, what changes would you suggest, and why?

We find the definition of an insurance contract to be appropriate but the Implementation Guidance too restrictive.

For example, based on this definition, we do not concur with the conclusion in Example 1.4 of the Implementation Guidance that a pure endowment policy is not an insurance contract. We consider that the present value of future cash flows arising from a pure endowment policy would be substantially modified in the occurrence of the insured event (survival) and the insured party would, as in the case of a life-contingent annuity, be adversely affected if they do not have an insurance policy covering them against survival risk. We consider, in consequence, that a pure endowment policy would meet the insurance contract definition.

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 affair 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 index; and***

(ii) ***an option to surrender a financial instrument which is not an insurance contract***

(paragraphs 5 and 6 of that draft IFRS, paragraphs BC 37 and BC 118 — BC123 of the basis of conclusions and IG example 2in the draft implementation guidance).

Are the proposed exemptions from the requirements in IAS 39for 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 paragraphs BC123 of the basis of conclusions). Is it appropriate to exempt these embedded derivatives from fair value measurement in phase 1 of this project? How would you define the embedded derivatives that should be subject to fair value measurement in phase 1?***

(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 1654 -IG58of the 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?***

We agree that the proposed exemptions from the requirements in IAS 39 for some embedded derivatives are appropriate (we agree with the proposal not to separate out embedded derivatives which themselves meet the definition of an insurance contract). However, we are in favour of an extension of this scope exclusion to all embedded derivatives in insurance contracts and financial contracts issued by an insurer for Phase I for the following reasons:

- The separation of the embedded derivatives from their host contract would entail extensive changes to information systems, which is not consistent with the expressed objectives of Phase I.

- At this juncture, we do not have at our disposal sufficient guidance to be able to calculate the fair value of these embedded derivatives, some of which will be defined in Phase II of the project on insurance contracts, such that 'fair value' is determined consistently from one insurance entity to another.

- The separation criteria retained for Phase I may well be called into question when Phase II is finalised or the burden of separating the embedded derivative may appear pointless when Phase II is completed because the host contract is accounted for at fair value for example.

- This separation will result in some contracts being partially accounted for under IAS 39 (embedded derivative) and partially accounted for in accordance with local GAAP (host contract).

From an operational perspective, we lack sufficiently detailed guidance for the treatment of embedded derivatives in the insurance business as compared to the banking context, which benefited from a greater period of reflection as to how to implement these requirements.

As we do not support the separation of embedded derivatives for Phase I, we do not have any further comments in respect of points (b), (c) or (d).

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 BCS2 - BCS8 of the basis for conclusions).

Is it appropriate to grant this exemption from the criteria in paragraph 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 would:

(i) eliminate catastrophe and equalisation provisions,
(ii) require a loss recognition test if no such test exists under 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 BCS8 - BC7S of the basis for conclusion).

Are these proposals appropriate? If not, what changes would you propose and why?

No, we do not believe that these proposals are fully appropriate.

▪ Firstly although we support the temporary exemption from application of IAS 8 for insurance contracts and financial contracts with a discretionary participating feature (point (a)), we do not support the suppression of this exemption as of 1 January

2007. Indeed, in the event that Phase II of the Standard has not been finished by this date, it would be necessary to adapt information systems once for Phase I, only to have to then possibly re-adapt them when Phase II has been completed. This would also lead to significant variability in the content of the financial statements provided to analysts, contrary to the expressed objectives of the IASB.

This is the reason why we support the continued exemption from the application of IAS 8 for as long as Phase II of the Standard on insurance contracts has not been finalised.

- Secondly although we are aware that catastrophe and equalisation provisions do not meet the IFRS liability recognition criteria (point (b) (i)), we would like to thaw your attention to the fact that these provisions are recognised under French GAAP which allows for recognition at an amount determined by reference to time cycles. This mechanism takes into account low frequency high severity risks. The elimination of these provisions, under IFRS, will result in the loss of information on these liabilities.

- Additionally, as a result of the European directive, French regulatory rules already allow for loss recognition tests (point (b) (ii)). In our opinion it will not be necessary to carry out supplementary tests.

- Regarding the derecognition of insurance liabilities, we believe that the Exposure Draft is insufficiently detailed and as a consequence we are not in a position to provide comments.

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 BC 76 - 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?

We do not think that these proposals are appropriate. At this juncture, we estimate that there is still too much uncertainty in respect of Phase II of the project on insurance contracts to be able to conclude on point (a).

Regarding point (b), we understand from paragraph 35 of the draft Standard that the Board proposes that, on application of Phase II (once completed) reclassification of assets will only be permitted into the category of financial assets that are measured at fair value, with changes in fair value recognised in profit or loss. We understand that this permitted reclassification aims to avoid a mismatch between assets and liabilities in Phase II of the insurance contracts project. We agree with the principle of ensuring that there is no mismatch between assets and liabilities, but whichever measurement basis is introduced in Phase II for insurance contract liabilities, reclassification of assets should not be limited solely to reclassification into the fair value category. If, on application of Phase II insurance entities continue to have financial contract liabilities accounted for at amortised cost, reclassification of assets into the amortised cost asset categories will be necessary to avoid an asset/liability mismatch.

Question 6: Unbundling

The draft IFRS proposes that an insurer should unbundle (i.e. account separately for) deposit components of some insurance contracts, to avoid the omission of assets and liabilities from the balance sheet (paragraphs 7 and 8 of the draft IFRS, 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?***

(a) No, we do not think that unbundling is appropriate and feasible in all cases although we concur with the Board that the unbundling issue may be useful only for certain specified packaged contracts. At this stage, we think unbundling is only appropriate in the context of financial reinsurance contracts.

We believe that, unbundling would require substantial information systems changes and would introduce significant complexity to the accounting treatment.

As a result we would support limited application during Phase I of unbundling to financial reinsurance contracts, which will be in the scope of IAS 39 and we recommend that further unbundling be postponed until after Phase II of the insurance contract project is finalised when we will have at our disposal more elements to be able (i) to identify which elements should be unbundled in the new Phase II context and (ii) when to apply unbundling.

(b) We do not think unbundling should be required in other cases.

(c) See (a) above.

Question 7: reinsurance purchased

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 of conclusions).
Are these proposals appropriate? Should any changes be made to these proposals? If so, what changes and why?

We do not think that this is appropriate, except for financial reinsurance contracts.

We disagree with making changes, during Phase I, to the accounting for reinsurance contracts (other than financial reinsurance contracts) for we believe it may result in different accounting treatment for insurance contracts and reinsurance contracts.

As a consequence, in order to keep consistent accounting principles, local accounting rules should be retained for reinsurance contracts, except for financial reinsurance contracts.

In short, we advocate limiting the proposals regarding purchased reinsurance to financial reinsurance during Phase I and waiting until Phase II is completed to address other types of reinsurance.

Question 8: insurance contracts acquired in a business combination or portfolio transfer

IAS 22 business combinations requires an entity to measure at fair value assets and liabilities assumed in a business combination and ED3 business combination proposes to continue that long-standing requirement However, they would permit, but not require, an expanded presentation that splits the fair value of acquired insurance contracts into two components:

- ***(a) liabilities 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 repeats business that are not pan 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 - B C101 of the basis of conclusions).

Are these proposals appropriate? If not, what changes would you suggest and why?

Yes, we believe that these proposals are appropriate. However, we suggest that they should be extended to financial contracts issued by an insurance company, to the extent that the fair value valuation methods for these contracts will only be clarified subsequently.

For Phase I we support like-for-like treatment for insurance contracts and financial contracts issued by an insurer.

We note that 1AS22 (and ED3) does not appear to permit entities that recognise an asset on their balance sheet for the value of the in-force business to include this asset in determining the goodwill. We would recommend that ED3 be amended to specifically refer to this type of asset in the determination of goodwill in a business combination otherwise the acquirer would not be following the accounting policies of the acquiree. Moreover, we think that the "Present Value of Insurance in Force" has to be amortised according to the already realised benefits. It is necessary that the recognised amount of the asset have to be taken into consideration in course of the loss recognition test.

Question 9: Discretionary participation feature

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 of conclusions). The board intends to address these features in more depth in phase 2 of this project

Are these proposals appropriate? If not, what changes would you suggest for phase 1 of this project and why?

No, we do not believe that all of these proposals are appropriate.

We reject the limited accounting treatment proposed by the Board for contracts with a discretionary participation feature for Phase I for the following reasons:

- The recognition of the liability required by paragraph 25 in respect of a financial instrument that is not an insurance contract and contains both a discretionary participation feature and a fixed element poses implementation problems. The Exposure Draft states that the "issuer shall recognised a liability measured at no less than the measurement that IAS 39 would apply to the fixed element" and that "the issuer need not determine the IAS 39 measurement of the fixed element if the total reported liability is clearly higher." A definition of the 'fixed element' and clarification of 'clearly higher' is equally necessary to be able to apply this paragraph. For it could lead to different interpretations by insurers.

In particular should this value of the fixed element include the value of the option to surrender? If so,

- the calculation of the value of the option to surrender these financial contracts with discretionary participation features could only be performed taking into account the participation feature, the accounting treatment of which will only be examined by the Board in Phase II of this project.

Therefore, we advocate that financial instrument with a discretionary feature should be accounted for, like insurance contracts with a discretionary feature, i.e. using local existing accounting principles without any additional testing required.

We are in agreement with the classification of unallocated surplus as either a liability or equity which leaves each insurance entity the freedom to determine how to split the unallocated surplus into liability and equity components.

Appendix 1
Comments on ED 5— Insurance contracts

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 of 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?

No, we believe that this disclosure is inappropriate. We do not support disclosure in the notes to the financial statements of the fair value of insurance contracts as of 31 December 2006, as long as there is no a clear definition of fair value in the insurance context. In the absence of such a definition, we believe that 'fair values' may vary significantly from one insurance entity to another.

In addition, the methods used by insurance entities to determine fair value for 31 December 2006 may be changed as a result of the completion of Phase II of the insurance contracts project. This could lead to onerous, successive information system modifications.

As a result, we support the postponing of fair value disclosure of insurance contracts until Phase II is complete.

We equally advocate postponement of the disclosure of fair value of financial contracts until then for the same reasons.

Question 11: other disclosures

(a) ***the exposure draft proposes requirements for disclosures about the amounts an 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 of 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 extend, 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 applies the proposed IFRS (paragraphs 34, BC134 and BC135)
Should any changes be made to this transitional relief? If so, what changes and why?

Generally this approach seems appropriate. However, we are concerned that:

- the level of detail required in the Implementation Guidance is excessive. However we understand that the Basis for Conclusions and the Implementation Guidance are not prescriptive and are only for illustrative purposes.

- certain disclosures required are confidential in nature, for example:
  - techniques and models used by management to manage insurance risks underwritten:
    - selection and approval of risks to be insured
    - methods used to assess and monitor risk exposure and internal valuation methods:
      - e.g. sensitivity analysis and stress-testing
    - ALM methodology

- some disclosures required either by the Draft Standard or the Implementation Guidance are not relevant, for example:

  - an analysis of the recognised insurance liabilities, and reinsurance assets, by the period in which the net cash inflows and outflows are estimated to occur (less than one year, for each year between year one and year five, later than five years)
  - the average effective interest rate implicit in the measurement of insurance liabilities for each period described in the bullet point above
  - the amount of insurance liabilities and insurance assets denominated in foreign currencies

Furthermore, at its July 2003 meeting the Board tentatively agreed for IAS 32 "that disclosure of sensitivity of a fair value estimated using a valuation technique to all variation assumptions not supported by observable market prices is not requested. Rather, the sensitivity disclosure is required only if the fair value is sensitive to a particular assumption, a range of reasonable alternatives for that assumption would produce a materially different result, and that assumption is not supported by observable market values." We would strongly support that the Board adopts the same approach for ED5.

Appendix 1
Comments on ED 5—Insurance contracts

Question 12:financial guarantees by the transferor of a non financial asset or liability

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 (paragraph 4(e) of the draft IFRS, C5 of appendix C of the draft IFRS and BC41 - BC46 of the basis of 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?

IAS 39 currently addresses the accounting treatment of guarantees given in connection with the transfer of financial assets or liabilities. As we understand that subsequent measurement for guarantees given in connection with the transfer of non financial assets or liabilities is not defined yet, we are unable to provide a specific answer to this question.

For financial guarantees other than those given or received on the transfer of assets or liabilities:

- We believe that this subject is already addressed by IAS 39 and should be considered in relation with current amendments to IAS 39 which are not yet published. As a result of which it is difficult for us to comment on since we do not know what the final drafting of the Standard will be.

- To date, we understand that the final version of IAS 39 will indicate that issued financial guarantees that are scoped out of the Standard because the beneficiary of the guarantee is only compensated if they are in fact exposed to or have incurred a loss, should be recognised initially at fair value and subsequently measured at the higher of the initial fair value and the value determined according to IAS 37 (on the contrary other issued guarantees would be in the scope of [AS 39 and are accounted for at fair value with changes in faire value recognised in profit or loss).

- As a consequence, we do not understand why ED5 includes these guarantees within its scope. If such a scope was confirmed, we would be unsure whether the two Standards ([AS 39 and ED *5)* would be fully consistent in respect of financial guarantees according to which the beneficiary of the guarantee is only compensated if it is in fact exposed to or has incurred a loss. ED *5* does not precisely indicate what the accounting treatments should be for issued financial guarantees within its scope, except for the loss recognition test (paragraphs 11-13 of the draft Standard and BC 46 (c)). Consequently it would not be clear whether issued financial guarantees scoped out of IAS 39 and in the scope of ED 5 should be initially measured at fair value or not.

- Finally we believe that subsequent measurement at fair value is inappropriate for these financial guarantees, which is likely to be the measurement applied in Phase II of the project on insurance contracts.

As a consequence we ask the Board to reconsider the inclusion within the scope of ED5 of issued financial guarantees that compensate the beneficiary only if they are in fact exposed to or have incurred a loss.

Furthermore we believe that we currently have no indication on how financial guarantees received should be accounted for.

Question 13: other comments

Do you have any other comments on the draft IFRS and draft implementation guidance?

We do not have additional comments to make but would like to expand on our comments on the following areas of the draft Standard:

1- the asset/liability mismatch arising from the different valuation principles applied to assets and liabilities of insurance entities;

2 - fair value measurement of contracts issued by an insurer at no less than surrender value;

1 - The asset/liability mismatch arising from different asset measurement principles

During Phase I, insurance contracts and financial contracts with a discretionary participation feature will continue to be accounted for under national GAAP. Their measurement basis under national GAAP will be close to amortised cost. Assets will be for the most part accounted for at fair value.

In so far as the rules for the accounting for assets differs from one country to the next (some countries already account for their assets at fair value), during Phase I, we will see accounting differences arise due to the fact that, for countries that already measure their assets at fair value, there are mechanisms (e.g. "shadow accounting") for the maintaining of the equilibrium of the balance sheet. These rules do not always exist for countries accounting for their assets at historical cost.

In addition there are some complex issues to address to allow for symmetry of measurement when the asset portfolio which backs contracts issued by insurers is measured at fair value and there is an unrealised loss on the assets.

For Phase I of the insurance contracts' project the insurer has complete freedom of choice in determining how unallocated surplus is allocated between equity and liability.

This allocation is dependent however on the nature of any discretionary participation features in the insurer's insurance and financial contract liabilities, as well as on the expected behaviour of policy-holders.

In the case of an unallocated surplus, it is a question of apportioning a surplus between the policy-holders and the shareholders. In the ease of an unallocated deficit (asset portfolio overall has fallen in value below cost), the problem of allocation becomes more difficult and a systematic symmetrical approach appears inadequate. Given the nature of the contracts, it is hard to envisage that the entity's liabilities in respect its policy-holders can be offset to the amount of the total loss. On the contrary, should the entire loss be borne by the insurance company when in fact, in practice, a share of this loss is actually borne by the policy-holder by means of a future reduction in the level of the discretionary participation to which they are entitled?

It all depends on policyholders' behaviour. Should they keep their contract for a certain period of time [which is a realistic assumption as yields on contracts issued by French insurers may well be not significantly below the market interest rates], the potential loss would be mainly theirs. On the contrary, if we suppose that they all surrender immediately, the loss would be totally incurred by the insurer.. It is therefore indispensable that insurance entities have more precise guidance on how to account for policyholders' behaviour [which in turn is correlated with the discretionary feature] so as comparability between the financial statements of insurance entities is assured.

However this guidance will not be available for Phase I since the accounting treatment for contracts with a discretionary participation feature is a subject that will only be addressed during Phase II of the insurance contracts' project (BC 6(e) (ii))

Moreover, we do not know how to manage the following mismatches which will result from the consolidation of real estate funds and other types of investment funds:

- a real estate fund can be an asset which in fact backs simultaneously both unit-linked contracts (financial contracts valued at the fair value of the underlying units) and other contracts which will continue to be accounted for under local GAAP during Phase I of the project at a value similar to amortised cost. Depending on the investment property measurement model opted for the real estate fund, a mismatch between assets/liabilities results either in respect of the unit-linked contracts or the other contracts which the fund backs.

- In addition to this problem, there is the question of how to account for transfers of such assets from/to the management category "assets held to cover unit-linked liabilities" to/from the management category "assets held to cover the insurance & financial liabilities) as a result of surrenders or underwritings, i.e. the same assets will not always continue to back the same liabilities of the insurer. These transfers will compound the mismatch problem, particularly if assets can not be reclassified after initial recognition.

  In fact, it will no longer be possible to change the initial accounting treatment of the financial asset (possibilities for reclassification highly restricted by IAS 39) or the investment property such, this initial accounting treatment being based on the initial backed liability. The measurement basis of the asset will then remain the same (amortised cost or fair value) whereas the re-measurement basis of the backed liability may have changed as a result of the transfers.

These are some of the reasons why, for Phase I, we support the creation of a specific category of assets which back insurance & financial liabilities, the measurement basis of which is identical to that applied to the insurance liabilities under national GAAP.

2 - Fair value measurement of contracts issued by insurers at no less than surrender value

We have problems with what we perceive to be a conceptual inconsistency in the Basis of Conclusions. BC 117 notes that:

> "Some contracts subject to IAS 39 grant cancellation or renewal rights to the holder. Under IAS 39, an issuer measures these contracts at amortised cost. The cancellation or renewal rights are embedded derivatives and IAS 39 requires the issuer to measure them separately if they are not closely related to their host contract. Under the amendments to IAS 39 proposed in the Exposure Draft of June 2002, the issuer could elect to measure these contracts at fair value. The Board intends to clarify the following when it finalises the amendments to IAS 39:
> (a) The issuer of such a contract determines the amortised cost of its contractual liability on the basis of expected (i.e. probability-weighted) surrender patterns. This is consistent with the treatment of assets subject to prepayment risk under the Exposure Draft of June 2002."

However BC 117 (e) seems to contradict BC 117 (a) by asserting that:

> "(e) The fair value of a financial liability with a demand feature (e.g. an investment contract that the investor can cancel at any time) is not less than the amount payable on demand. This precludes a liability measurement based on expected surrender patterns (the measurement described in paragraph BC 117(d)) if the latter amount is less than the amount payable on demand..."

We see inconsistencies in these tentative conclusions of the Board: On the one hand, the amortised cost of financial instruments issued by insurers may be less than their surrender value, whereas, on the other hand, their fair value should be no less than that.

Paragraph BC 117 requires that the fair value of a financial liability with a demand feature be no less than the amount payable on demand.

We consider that this should not be also applied to a financial liability with an option to surrender, issued by an insurer, for the following reasons:

- We believe that contracts issued with an option to surrender are not strictly identical to financial liabilities with a demand feature. Furthermore we do not believe that this point has yet been sufficiently analysed by the Board. In addition, we feel that any response we make on this subject would be premature given that this is also an issue within the Exposure Draft on Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk.

  For example, we believe that there are some features that may differentiate insurance contracts issued with an option to surrender from financial contracts with a demand feature, such as participation features... We suggest therefore that the Board reconsiders more thoroughly this topic.

- If applied to contracts issued by insurers (which we are strongly opposed to), this limitation would be somehow premature given that it is Phase II of the insurance contracts project that will consider how to account for contracts with a discretionary participation feature clause and therefore financial contracts with this feature. At this juncture we understand that consideration of the accounting for these contracts has been put off until Phase II.

- The basis on which insurance companies calculate fair value may not comply with later decisions of the Board during Phase II of the project. This would increase significantly the changes necessary to information systems for fair value calculation.

- To set a floor for fair value of financial contracts issued by insurers at their surrender value ignores the characteristics of the insurance business in reality. It is not conceivable that all policy-holders will cancel their contract at the same time. At the very least, there are regulatory and fiscal constraints which render this improbable. Moreover, the calculation of fair value of contracts using stochastical calculations takes into account the effect of surrender clauses and more specifically the sensitivity of these to different simulated economic scenarios. This constitutes fair value measurement of the option to surrender. All possible behavioural patterns of policy holders are taken into account. Therefore the fair value can, in effect, be less than surrender value.

- We believe that this also contradicts the way entities usually manage their risks. Indeed they mutualise the risks they underwrite and manage them by means of statistical methods to estimate if and when there will be a claim on the risk underwritten and its magnitude. In this way the overall risk of an entity is less than the sum of the individual risks which make up their portfolio of contracts

We would like to see the Board reconsider the use of amount payable on surrender as the floor for the fair value of a financial instrument issued by an insurance entity. We would also like this to expand this request to insurance contracts issued by an insurance entity.