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Secrétariat
Général

Fédération
des Experts
Comptables
Européens

Rue de la Loi 83
1040 Bruxelles
Tél. 32 (0) 2 285 40 85
Fax: 32 (0) 2 231 11 12
E-mail: secretariat@fee.be

CL132

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street, 1st floor
GB - LONDON EC4M 6XH

Email: commentletters@iasb.org.uk

Dear Sir David,

Re: Exposure Draft ED 5 – Insurance contracts

FEE (Fédération des Experts Comptables Européens – European Federation of Accountants) is pleased to submit its comments on the IASB Exposure Draft ED 5 on *Insurance Contracts*.

FEE as a founding organisation of EFRAG has also contributed to the EFRAG commenting process by submitting our views on their preliminary comments. This response should be read in conjunction with the response submitted by the EFRAG. Where we are in agreement with the EFRAG comments we refer to these comments, where we are in disagreement our own views are put forward. In addition we raise some additional comments.

We support the need for an interim standard, as exposed in ED5, to be in place in time for the 2005 implementation date for the use of International Financial Reporting Standards for listed companies in Europe, in the absence of a comprehensive final standard ("phase II"). We support the recommendation of EFRAG that a well developed and debated phase II standard is introduced as soon as is practicable.

Our answers to the questions raised in ED5 are set out in detail in the attached appendix. However, we have some more general concerns over the interaction of ED5 with other IASB projects. The Board is looking to move accounting for insurance contracts, in common with many other areas of financial reporting, onto a fair value model. We are concerned that the concept of "fair value" is not clearly understood or consistently applied and would recommend that further development is made of this model before it is more fully introduced. We are also concerned at the volume of change facing insurers in a relatively short period of time, with Insurance Contracts Phase I in 2005, the proposed Performance Reporting standard in 2006 and Insurance Contracts Phase II in 2007. We have expanded upon these concerns in our attached appendix.

We would be pleased to discuss any aspect of this letter with you.

Yours sincerely,

David Devlin
President

APPENDIX

Q1 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?

(i) We agree with the EFRAG position that there is a significant mismatch issue requiring the attention of the Board before phase 1 is finalised. We have particular concerns that the measurement of assets at fair value while liabilities are measured at cost under local GAAP might allow a mismatch. We are concerned that this might lead to a significant understatement of liabilities under local GAAP when interest rates are significantly lower than when the contracts were written. One possibility could be that the Phase I standard requires interest rates to be unlocked through a strengthened loss recognition test, as elaborated in our response to Question 4 (b)(ii).

Another possibility to deal with the mismatch issue under phase 1 would be to require interest rates to be unlocked in the measurement of liabilities. We note that this unlocking of interest rates does not represent the fair value of insurance liabilities and does not fully resolve the problem of mismatch. We recognise that there would be a number of practical problems in requiring unlocking of interest rates in many jurisdictions and are concerned that the reliability of such information might be difficult to determine. The key issues (e.g. risk adjustments, determination of interest rate, development of models for long term interest rates) are not yet solved and subject to phase 2 this possibility being not practicable for phase 1.

(ii) We agree with the inclusion of financial instruments that contain a participation feature in ED5.

However we note that the requirement of paragraph 25 that the issuer shall recognise a liability measured at no less than the measurement that IAS 39 would apply to the fixed element will result in a change of the accounting for this product which will lead to inconsistencies between insurance contracts and investment contracts with participation feature in phase 1 and which require system changes, that may need to be reversed once a consistent basis for both kinds of contracts is developed within phase 2.

A special issue of concern is the treatment of surrender values under the conclusion drawn in IAS 39, on which we comment in the context of question 13.

We agree that, subject to retaining the exemption granted for participating business, investment contracts issued by insurance companies should be accounted for under IAS 39.

(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?**

We agree that weather derivatives should be brought within the scope of IAS 39 unless they meet the definition of an insurance contract.

Q2 Question 2 – Definition of 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?

We agree with EFRAG that the definition of an insurance contract is generally appropriate.

However, the definition of "significant insurance risk" appears inconsistent between paragraphs B21, where it is phrased in terms of net cash flows, and B23, where it is phrased in terms of the difference between the payment on death and payment on surrender, which is a gross cash flow measure. Also, B22 introduce the term 'trivial' as guidance to identify non-significant insurance risk. Significance is a well understood accounting term, while triviality is not well defined or understood in this context. There is a risk that this could lead to different interpretation. We would recommend that references to triviality are removed from ED5 and that insurance risk is defined in terms of significance.

The intention of B21 appears to be to capture unlikely catastrophic events, with a low probability of occurring but high potential liability. It is appropriate that these fall within the definition of an insurance contract. We suggest that the IASB does reconsider its decision to reject the notion of defining the significance of insurance risk by comparing the present values of the adverse outcomes as a proportion of the expected present value of all outcomes.

We expect that this would lead to clarification over whether the following examples qualify as insurance contracts:

- Example 1: Life insurance contract with 1% cash flow difference between the surrender value and the death benefit, where the insurer is operating on a 5% profit margin. This cash flow difference might be considered significant when measured on a net basis.
- Example 2: Life insurance contract where the surrender value on maturity is 101% exceeding the death benefit of 90%. IG Example 1 1.4 appears to exclude this type of contracts as a pure endowment, but there is a significant cash flow difference involved and the insurable event is the added costs of living a long life.

We consider that the requirement for a contractual link between the adverse event and payments as laid down in para. B14 is too restrictive. It is difficult for example to establish a direct link between insurable losses and payments under weather derivatives but adverse weather conditions tend to increase insurance claims in general. This is also true of certain other types of insurance, such as life insurance where there is no direct link between the adverse event and the financial loss to the policyholder. We consider that the requirement for there to be a direct contractual link between the adverse event and the financial loss suffered to qualify as an insurance contract is overly restrictive and that the test should be whether there is a reasonable expectation of some indemnification to policyholders.

ED 5 requires that significant insurance risk is transferred and that this is considered on a contract basis. An insurer may bundle a large number of individual contracts for cession to a reinsurer in a way, that by bundling the contracts together because of diversification/pooling effects for the reinsurance contract the degree of risk transfer may become insignificant. For consistency reasons between gross and reinsurance business we ask for clarification that transfer of insurance risk in a quota share reinsurance contract is presumed to be significant if this is the case for the underlying direct insurance contracts.

Q3 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?

We agree with the EFRAG response. In principle, we agree that separately measuring embedded derivatives from underlying insurance contracts is reasonable, subject to the exemptions provided.

We are concerned, however, that the proposals in ED5 would require separate measurement of embedded derivatives on more types of contract than is intended or necessary under Phase I. Developing systems to separately measure embedded derivatives would require considerable time and effort given the complexity of many insurance products. We consider the effort involved in separately measuring embedded derivatives would be disproportionate to any benefits in relevance and reliability for an interim solution.

We would however expect that any derivative embedded in an insurance contract is taken into account in the loss recognition test.

Unit linked contracts provide a good example of the problems caused by the approach in ED5. Payments to policyholders are linked to the performance of an index, apparently meeting the definition of an embedded derivative. We do not consider that separate measurement of such an embedded derivative would enhance the relevance and reliability of the financial statements, given that the value of the assets used to back such contracts tend to closely match the liabilities, creating an effective hedge. We would recommend that embedded derivatives in insurance contracts are exempted from the requirements of IAS 39 where the assets backing those contracts are strongly linked to the liabilities.

Also, in paragraph 6 of ED 5, we recommend that the rule to not separate a policyholder's option to surrender an insurance contract for a fixed amount should also include surrender options in life insurance contracts where the surrender value is determined by the retrospective value of the insurance contract, i.e. as the premium with the addition of any bonus (interest) and deduction of costs, risk premiums and a surrender charge. We agree in principle with the proposals to require the separation of put options or cash surrender options based on equity or commodity prices. However, the working "if the surrender value varies in response to the change in an equity or commodity price or index" is not clear. Neither the guidance nor the Basis for Conclusions is clear on the principle that underlies the requirement. We believe this principle should be explained in more detail in the Basis for Conclusions and the difference between example 2.13 and 2.15 in the Implementation guidance should be explained.

Q4 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?

We agree with the EFRAG response. It is more important that the Phase II standard is of a high quality than that it meets any timetable. We are concerned over the intention of including the sunset clause and that it may put unnecessary pressure on the Board to adhere to a strict timetable rather than focussing upon ensuring that Phase II provides the most relevant and reliable solutions. If a properly developed, discussed and field tested Phase II standard is not in place by 2007, the Board should extend the sunset clause accordingly.

(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?

i) We agree with the comments in the EFRAG response.

ii) We are concerned that the current drafting of the loss recognition test does not make sufficiently clear the basis of determining the discount rates which can be used to measure the liability when calculated using cash flow models. Under some local GAAP, assets purchased to match liabilities are carried at a form of "cost", either amortised or subject to impairment tests. The contracts are tested under local impairment tests by reference to the book carrying values of the assets.

Some have begun to interpret paragraph 11 to 13 inappropriately. If the liability is not adjusted to reflect the change to a market based valuation model for assets (as required by IAS 39), there is a tendency in lower interest rate environments for assets to be yielding interest at rates substantially lower than those locked into the valuation basis for liabilities. It may be necessary to adjust the valuation of liabilities carried on a local GAAP basis if the loss recognition test does not acknowledge that the value of the related assets under IAS already recognises the gain which represents the impact of the change in market interest rates. A similar issue arises for "available for sale" assets where gains are recognised in equity.

We recommend that the intentions of the Board under paragraphs 11 to 13 are clarified.

(iii) We agree with the EFRAG response. Whereas we do agree in principle with the derecognition criteria to be applied, we would like to point out that – and the wording of ED 5 demonstrate this – the difference between derecognition and decrease of provisions is not always clear. We therefore do suggest that also derecognition is left to current accounting practice provided that any liability is recognized unless the obligation is discharged, cancelled or expired.

<u>Q5 Changes in accounting policies</u>

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?

We agree with the comments in the EFRAG response. In certain circumstances a change from an existing accounting system to another consistent accounting system in its totality can result in an improvement due to change in the underlying objective (e.g. from a rather tax driven accounting system to an investor information related accounting system, like US GAAP). We would like the IASB to consider whether in rare circumstances a change would be acceptable even if not all of the criteria in ED 5.16 are matched (e.g. US GAAP prescribes an undertakings individual discount rate rather than a market discount rate).

Q6 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?

We agree in principle with the EFRAG response. We would encourage further research into unbundling as part of the development of the Phase II standard with particular focus on presentational issues.

Q7 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 for Conclusions).

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

We agree with the EFRAG response.

We agree that it is necessary to include a solution for the particular issue of retroactive reinsurance. Any solution should be limited to prevent accounting abuse by the use of retro contracts, however. We would expect that any reinsurance contracts not providing adequate transfer of risk would be excluded from the definition of an insurance contract and dealt with in that way.

The current impairment test for reinsurance assets appears to be based around the IAS 36 test. This would require a discounting of reinsurance assets, regardless whether the related gross provisions are discounted or not. We consider that a better impairment test for reinsurance assets would be an IAS 39 impairment test, treating the assets as financial receivables, focusing on the default risk. We consider this a more suitable test as it includes indicators.

An accounting treatment of reinsurance assets regardless from the treatment of related gross amounts would lead to inconsistencies between strongly related items. The gross amounts usually include the degree of prudence which is not used to the extent that reinsurance is taken. If despite of these reinsurance assets by themselves are measured on a prudent basis, prudence is increased in total instead of being adequately reduced. We suggest that a more appropriate approach to dealing with reinsurance would be to permit the retention of local GAAP for Phase I, but with the added requirement of an impairment test for possible defaults based upon the IAS 39 test.

Q8 Insurance contracts acquired in a business combination or portfolio transfer

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?

We agree with the conclusions reached by EFRAG. See also our comments on fair value under Question 10.

Q9 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?

We agree with the EFRAG response.

We believe that the mismatch problem for participating business would be addressed partially if phase I allows a liability to be created for future appropriations to policyholders. Past behaviour in respect of allocations of profits between policyholders and shareholders can create constructive obligations. It would be appropriate to recognise such obligations as liabilities. We would normally expect a split in the unallocated surplus between liabilities and equity but, in the absence of a split or where there is uncertainty, we would expect balances to be recognised as liabilities. We would support setting the burden of proof in favour of liabilities. The unallocated surplus should only be recognised as equity where and to the extent that there is evidence to support shareholders' rights to that surplus.

We note that by this, the mismatch issue is difficult to be resolved in phase 1. It is questionable whether and the extent to which increases or decreases in value of assets can be compensated. The participation feature introduces a specific relationship between assets and liabilities. The effect on liabilities of an increase or a decrease of the assets depends on some elements as variability introduced by the participation feature, surrender penalties, tax matters and other specific conditions of the contract that affect policyholders' behaviour, a question to be treated in phase 2.

Especially in the situation of an increase of interest rates the resulting temporary decrease in the value of the assets can only be partially compensated by "shadow accounting" to the extend that the losses can be charged against future policyholder participation, provided that this is permitted in analogy to IAS 12 at all. Firstly, this approach could be too restrictive with consideration to the prior elements. Secondly, the loss in the assets ought to be already partially taken in account in the loss recognition test of the contracts, existing in local GAAP.

Q10 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?*]*

We agree with the EFRAG response.

The term "fair value" is not well developed or well defined in respect of insurance contracts. As such, it is difficult for preparers of financial statements to measure and for auditors to audit the required disclosures. Until a well understood measure of fair value for insurance contracts has been developed and agreed, we do not consider that any disclosure would meet the criteria of relevance and reliability. We therefore recommend that fair value disclosures are deferred until phase II of the project.

Since the determination of fair values for financial instruments that contain a participation feature, faces nearly the same problem as for insurance contracts, we believe that a consistent approach should be taken and therefore these instruments should be scoped out from the requirements of IAS 32 to disclose fair value but instead fall under the regime for insurance contracts with this respect also.

In more general terms, we are concerned that the concept of "fair value" is not currently well defined and consistently used in International Accounting Standards. We would recommend that the Board undertakes a project to develop a set of principles to underpin the fair value concept to ensure its consistent application and that the term is well understood by preparers, auditors and, most importantly users of financial statements.

Q11 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?

We agree with the comments in the EFRAG response.

Q12 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 (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?

We agree with the comments in the EFRAG response.

Q13 Other comments

Do you have any other comments on the draft IFRS and draft Implementation Guidance?

Investments contracts

We find that more guidance is required on how to apply IAS 39 for investment contracts (contracts that do not transfer enough risk to quality as insurance contracts).

Surrender Values vs Fair Values

A transfer of the conclusions drawn in IAS 39 for financial instruments would require insurers to value insurance liabilities with a demand feature at a minimum value of the surrender value irrespective of expected surrender patterns. This appears to confuse surrender values with fair values. Fair values are an estimate of the price that would be agreed by two knowledgeable unrelated participants. This is not the same as a surrender value. Market participants might take on the risk of a portfolio of life contracts for less than the surrender values of those contracts in the expectation that not all contracts will be surrendered.

In our opinion, including a demand floor of the surrender values for measuring liabilities creates an imbalance. By its nature, a fair value approach should consider expected values, including expected surrender patterns in this context. We therefore suggest that insurance liabilities should be valued on a portfolio basis.

Performance Reporting

We are concerned that the combination of the ED5, future changes in Phase II and the proposed changes to the income statement format under the IASB Performance Reporting project will be onerous for preparers and confusing to users of insurance company financial statements, potentially at the expense of quality. Taken together, the current proposals would imply major changes to the financial statements of insurance companies in three consecutive years, with a Phase I in 2005, the proposed performance reporting standard in 2006 and Phase II in 2007. This contradicts the Board's intention of avoiding several changes in accounting methods by segregating the Insurance Project into two phases. It is important to also take into account the various other changes currently faced by insurers, to their capital requirements under Solvency I and Solvency II, and other regulatory reporting issues. There is a danger that, not only will financial reporting become confusing in the interim, but that mistakes may be made by preparers, auditors or regulators as a result of the volume of change.

The performance reporting proposals appear premature. We would prefer that measurement issues are dealt with by the Phase II standard before presentation issues are tackled. In general terms, we consider that measurement issues are more significant than presentation issues and suggest that these are properly addressed across the range of International Accounting Standards by the Board before it introduces major presentational changes, such as the proposed performance reporting project.

The current income statement formats are well established, understood and broadly consistent across territories. An alternative and acceptable solution to the issue of performance reporting for insurance companies might be to have some form of segmental reporting by activity and business model under the existing income statement format. This would allow the proposed income statement to communicate financial performance provide more useful information by classifying income consistently with the business is managed.

Systems Changes

A related issue to the volume of change facing the insurance industry is a concern that insurers are not required to introduce costly system changes which are superseded by the Phase II requirements. The phase I proposals might require significant systems changes without knowing what the final phase II model and system requirements will be. Phase I will require significant changes for many insurers, particularly those currently measuring investments at amortised cost. It is important that any systems changes necessary for phase I are consistent with the direction of phase II to avoid unnecessary changes. Early exposure of well developed phase II proposals would assist insurers in developing suitable new systems.