C h a i r m a n

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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
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Dear Sir David,

Exposure Draft ED7 Financial Instruments: Disclosures

The IAIS is an international organisation comprising of insurance supervisors from more than 120 countries. One of its main objectives is to promote the development of well-regulated insurance markets. As this includes the implementation of high quality financial reporting standards, the IAIS has a keen interest in the work of the IASB.

The following comments relate to the Exposure Draft ED7 Financial Instruments: Disclosures, issued in July 2004.

General comments

As with most disclosure requirements, it should succinctly provide the information required by the users without it being so detailed that the clear message is lost, or so high level that key items are concealed by aggregation. When certain disclosure requirements which are appropriate in one area (e.g. in relation to financial risk) are translated to other areas (e.g. insurance risk), one should consider carefully whether they are indeed appropriate.

Specific comments

On **Question 2** (disclosure of fair value of collateral and credit enhancements), we believe that disclosure of the fair value of the collateral would, in most instances, be impracticable. For example, it may not be reasonable to expect the holder of a mortgage to disclose the fair value of the property being mortgaged in addition to the value of the mortgage asset itself.

On **Question 3** (disclosure of sensitivity analysis), we would like to see that the minimum disclosure is not limited to the risk sensitivity as at the reporting date, but also includes intra-period high, median and low risk sensitivity if they differ significantly from that at the reporting date. We believe that this could facilitate a better understanding of an entity's risk exposure.

On **Question 4** (capital disclosure), we would like to point out a discrepancy between paragraph 47a(ii) of ED7, which requires detailed disclosure about externally imposed capital requirements and its management, and paragraph BC53 of the Basis for Conclusions, which indicates that the Board decided to impose a disclosure requirement only about whether the entity complied with any externally issued capital requirements during the period and, if not, the consequences of non-compliance. We would therefore ask that the IASB confirm its intention regarding this issue.

Capital disclosure is an issue that causes some concern to insurance regulators. We recognise the benefit of insurers disclosing their general philosophy on capital management and we do not oppose the disclosure about whether or not insurers have complied with regulatory capital requirements. However, we would oppose disclosure requirements that could have the potential to impede regulators' imposition of entity-specific capital requirements. We also believe that the IASB should exercise some caution in regard to disclosure of internal capital targets by insurers.

Paragraphs 47(d) and (e) of ED 7 require disclosure of whether an entity has complied with the capital targets set by management and any externally imposed capital requirements, not just at the reporting date, but also during the reporting period. We have concerns that disclosure of minor breaches of compliance during the reporting period which have since been remedied may be misleading to users of accounts, and have a disproportionate effect on market and policyholder behaviour. There is also a danger that the information in the year end accounts will be taken out of context of the specific issues that gave rise to the breach earlier in the year, particularly if the issue has already been resolved.

We would also like to highlight that the second Illustrative Example (IE 2) in the Implementation Guidance is misleading. The example illustrates disclosure of an event where a breach of an entity-specific capital requirement has occurred, but has also been resolved within the time frame specified by the regulator. This example does not reflect the arguments set out in BC52, and is also at odds with the common understanding that a breach of compliance is not present where agreed measures are in place to remedy that breach. We would recommend that IE2 be recast to provide an example of disclosure of non-compliance with an applicable industry-wide minimum capital standard, which has material consequences at the reporting date.

On **Question 5** (effective date and transition), we would like to highlight that, given that the impact of the changes proposed under ED7 is not due until 2007, and most firms are currently very focused on the first time implementation of the IFRS4, some may be caught by surprise when these additional changes do come into force on 1 January 2007.

On **Question 7** (consequential amendment to IFRS4),

- the change from requiring disclosure that "helps users to understand" future cash flows from insurance contracts to disclosures that "enable users … to evaluate" such future cash flows seems excessive. The ability to "evaluate" future insurance cash flows is likely to be beyond the abilities of most users, regardless of the level of disclosure.
- while it is possible to quantify this in terms such as a 1% change in claim cost or related variable in a sensitivity analysis, it is likely to be of limited use in analysing an insurance business if such information is not put into the context of the business mix and interrelation between risks.
- risk management should be thought of as a holistic process that includes, but is not limited to, financial and insurance risks. Disclosures in relation to insurance should focus on specific insurance issues, such as underwriting, premium setting, pooling and reinsurance. Issues such as organisational structures and risk management generally should be disclosed elsewhere.
- given that the IFRS 4 accounting requirements for insurance contracts are temporary, we believe that any additional, interim change should be avoided before phase II has

been completed, as it could cause additional concerns regarding comparability and relevance of financial information.

On **Question 8**, we suggest that, as the Implementation Guidance is not part of the IFRS and is therefore not a reporting requirement, there may be benefit in relocating certain paragraphs currently within the Implementation Guidance within the main IFRS text. This would be particularly helpful where the guidance currently illustrates formats for disclosure, as, for example, in IG23 and IG37. Inclusion of such text within the main IFRS would have the advantage of introducing consistency of reporting formats between entities.

On **Question 10** (other comments),

- paragraph 12 (a) should not refer to “contractual” payments. It is not appropriate for trusts and discretionary payments that may, however, have been included in the value of the liability.
- paragraph 12 (c) should allow liabilities to be “adjusted” rather than “decreased”. Pure endowment contracts are financial instruments and may receive annual premiums that increase the liability.
- the process described in paragraph 12, and that is partly envisaged in paragraph 31, is similar to the “analysis of surplus” methodology commonly used by insurers, which provides a critical check on the assumptions used to evaluate future cash flows. Such an analysis need not be particularly detailed. It simply needs to partition profit into the following components:
    - Expected profit from release of margins or unwinding of the discount rate
    - Experience profit from actual experience being different from assumptions
    - Impact of assumption changes
    - Investment earnings on retained profits.

If there is any way in which the IAIS can assist the Board further, please do not hesitate to contact Mr Luc Cardinal at the IAIS Secretariat (tel: +41 61 280 8119; fax: +41 61 280 9151, email: luc.cardinal@bis.org).

Yours sincerely

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