Andrea Pryde
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International Accounting Standards Board
30 Cannon Street, London EC4M 6XH

United Kingdom

22 October, 2004

Dear Ms. Pryde,

Exposure Draft 7 Financial Instruments: Disclosures ("ED 7")

We are responding to your invitation to comment on the above exposure draft (the “draft IFRS”). We welcome the Board’s decision to revise and enhance financial instruments disclosures and appreciate the opportunity to comment.

We support the draft IFRS and believe that it represents an improvement in IFRS disclosure requirements. High-quality disclosure standards assist a company’s key stakeholders in better understanding operating performance and in making more informed business and investment decisions. The draft IFRS makes a number of changes to existing disclosure requirements that are welcome, e.g., the draft IFRS would ease the contractual maturity information, terms and conditions of insurance contracts, and effective interest rate disclosure requirements, all of which are proving difficult to collect. However, the timing of the draft IFRS causes considerable uncertainty. As an example, we have found that contractual maturity information is of little or no use to management and implementing systems and processes for its collection is expensive. Early-adopting the draft IFRS for the year-end 2005 financial statements would solve that problem; however, there is no guarantee that such provisions will survive into the final draft. Given the number (and significance) of recent changes to draft IFRS’s, we are reticent to “gamble” that certain proposed provisions will remain in the final standard. Moreover, there is no certainty as to whether the IFRS would then be approved by the EU in its entirety. Lastly, at this point in time it is difficult to assert that a company would be ready to early-adopt the final IFRS in its entirety, i.e., there may be other requirements that a company cannot comply with that would prevent it from early-adopting the standard.

Accordingly, we find ourselves in an difficult position on how to implement this draft IFRS in the current data collection process, which is in large based on IAS 32 and IFRS 4 requirements and well underway for 2005 IFRS financial statements. We recognise that there will always be uncertainty in determining which provisions of an exposure draft will survive into the final standard. However, providing additional transitional rules, e.g., the ability to early-adopt certain provisions and not others, may help companies to react late in the process of collecting information for the 2005 IFRS financial statements and avoid, as much as is possible, the cost of collecting disclosure information that will be no longer be required in 2007.

Regarding risk management disclosures, we applaud the approach to adapt to each entity's approach to manage risks. However, the draft IFRS is more prescriptive than IAS 32 as it makes sensitivity analyses wider in scope than just interest rate risk and it makes sensitivity analyses a requirement. We believe that sensitivity analyses can be informative to the users of the financial statements but a number of issues require additional consideration. Since there are a number of limitations surrounding sensitivity analysis calculations (discussed further in response to questions 3 and 8), we believe it is inappropriate to extend the scope of the sensitivity analyse from the IAS 32 requirements.

Secondly, we are very concerned with the proposal to extend the draft IFRS quantitative market risk disclosures to insurance contracts. Predicting the impacts on insurance contracts from changes in risk variables is a complex topic. While risk is managed internally, capital and risk management are based on very different recognition and measurement principles than those applied in the financial statements. Requiring the publication of the sensitivity analyses of IFRS net income and equity contradicts the IASB approach of allowing each company to disclose risk information that is consistent with how risk is managed internally. Moreover, the draft IFRS goes beyond US regulation, specifically the SEC's market risk disclosures, which do not require the inclusion of insurance contracts in sensitivity analyses. Our proposal would be that the sensitivity analyses proposed in the draft IFRS should not be extended to insurance until the phase 2 proposals are established and understood.

Lastly, in light of the issues above, we strongly believe that sensitivity analyses do not belong in the financial statements. We are concerned that the inclusion of such risk disclosures within the financial statements would give the measures undue weight in the eyes of the investor. Furthermore, it would be very difficult and expensive to audit.

If you have any questions in relation to this letter, we would be happy to discuss these issues further.

Yours faithfully,

Joseph Streppel,
Chief Financial Officer, Aegon
On behalf of the following companies:

- AXA SA
- Aviva plc
- Assicurazioni Generali S.P.A
- Fortis
- Hannover Rückverischerungs-AG
- ING Groep N.V.
- Legal & General Group plc
- Old Mutual plc
- Prudential plc
- The Standard Life Assurance Company
- Scottish Widows Group
- Skandia
- Swiss Life Group
- Swiss Reinsurance Company
- Zurich Financial Services

ED 7 Financial Instruments: Disclosures

Responses to detailed questions

Question 1 – Disclosures relating to the significance of financial instruments to financial position and performance.

The draft IFRS incorporates disclosures at present contained in IAS 32 *Financial Instruments: Disclosure and Presentation* so that all disclosures about financial instruments are located in one Standard. It also proposes to add the following disclosure requirements:

(a) financial assets and financial liabilities by classification (see paragraphs 10 and BC13).
(b) information about any allowance account (see paragraphs 17 and BC14).

(c) income statement amounts by classification (see paragraphs 21(a), BC15 and BC16).

(d) fee income and expense (see paragraphs 21(d) and BC17).

Are these proposals appropriate? If not, why not? What alternative disclosures would you propose?

Answer
We agree that all disclosures regarding financial instruments should be located in one Standard. We also agree with the proposed additional disclosures above, as they are important in understanding the exposure of financial institutions to financial instruments. However, clarification is needed for paragraph 21 (d) *"fee income and expense (other than amounts included in determining the effective interest rate) arising on financial assets and financial liabilities, and from trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans and other institutions"*. Would this include IAS 18 deferred costs and deferred revenue amortisation?

In addition, we believe the usefulness of further defining the income statement amounts by classification, as per point c above, is not entirely clear. We believe there would be sufficient information within the balance sheet and footnote disclosures.

Question 2 - Disclosure of the fair value of collateral and other credit enhancements

For an entity's exposure to credit risk, the draft IFRS proposes to require disclosure of the fair value of collateral pledged as security and other credit enhancements unless impracticable (see paragraphs 39, 40, BC27 and BC28).

Is this proposal appropriate? If not, why not? What, if any, alternative disclosures would you propose to meet the stated objective?

Answer
We disagree with the requirements to disclose the fair value of collateral pledged as security. We believe the effort and detail required to comply with these requirements is disproportionate to the value to users of the financial statements. For example, it will be necessary to breakdown mortgage portfolios by loan-to-value ratios and geography. Moreover, the collateral fair value disclosures could be unreliable as the estimated value becomes less reliable over time.

We do however support disclosures about collateral where there is default or a high risk of default. As for all other cases, we believe that a qualitative description of the entity's policies for obtaining collateral pledged as security would be sufficient.

We believe further clarification regarding the scope would be helpful, specifically are insurance contracts (within IFRS 4) subject to the credit risk disclosures proposed within ED 7?

Question 3 - Disclosure of a sensitivity analysis

For an entity that has an exposure to market risk arising from financial instruments, the draft IFRS proposes to require disclosure of a sensitivity analysis (see paragraphs 43, 44 and BC36 - BC39).

Is the proposed disclosure of a sensitivity analysis practicable for all entities?

If not, why not and what, if any, alternative disclosures of market risk would you propose to meet the stated objective of enabling users to evaluate the nature and extent of market risk?

Answer
We do not agree that the proposed sensitivity analysis disclosures are "relatively easy to understand and calculate" (BC 36 (b)).

We believe sensitivity analyses could be performed; however, the quality of the information would lack the necessary level of reliability for users to evaluate the nature and extent of risks underwritten. Sensitivity analyses have many calculation limitations, for example, such calculations would likely ignore decisions and actions that management would take in response to changes in risk variables.

Further, sensitivity analyses should be excluded from the financial statements. If included in an operational review, the analysis should be limited to significant market risks and a qualitative assessment of management's sensitivity analyses. As an alternative to the disclosures proposed, the qualitative assessment could provide information regarding the lines of business, exposures to risks and life span of risks and thus enable users to evaluate the nature and extent of market risk.

In addition we are concerned that the proposal to use a single factor analysis basis for sensitivity information is inappropriate. This will not take account of the interaction of differing risks and therefore may give the impression that potential volatility is higher than it really is. In practice the interaction is complex and often risk factors offset to reduce volatility. As currently drafted the disclosures make no allowance for the impact on volatility of management intervention to mitigate the effect of movements in individual risk factors.

In addition, there are a number of areas that require clarification which are discussed further below at Question 8.

Question 4 - Capital disclosures

The draft IFRS proposes disclosure of information that enables users of an entity's financial statements to evaluate the nature and extent of its capital. This includes a proposed requirement to disclose qualitative information about the entity's objectives, policies and processes for managing capital; quantitative data about what the entity regards as capital; whether during the period it complied with any capital targets set by management and any externally imposed capital requirements; and if it has not complied, the consequences of such non-compliance (see paragraphs 46-48 and BC45 - BC54).

Is this proposal appropriate? If not, why not? Should it be limited to only externally imposed capital requirements? What, if any, alternative disclosures would you propose?

Answer

We support the sentiment to provide the user of the financial statements information about capital requirements and potential exposures due to these capital requirements, and we believe these should:

a) focus primarily on externally imposed capital requirements
b) require management to disclose significant risks based on their internal review of objectives, policies and processes (i.e. exception based)
c) be cognizant of commercial sensitivities

We are concerned that the proposed disclosure requirements would require insurers to reveal proprietary information that either has the potential to be used by other insurers to gain a competitive advantage or could be misread by readers and thus have unintended adverse consequences to the company. In order to give readers adequate insight and a meaningful overview of an insurer's capital management, we believe that under the proposed Project guidelines, the insurer would have to disclose information regarding their underwriting assessment criteria as well as guidance from rating agencies or regulators that a company is attempting to adhere to. Such insights are not necessarily intended for public consumption, and have the potential to be taken out of context.

Many insurers manage capital as part of the underwriting process by establishing a capital model and return on capital criteria to assess new business. Because capital management and proprietary underwriting assessments are often intertwined, most insurers consider information regarding capital management to be proprietary. For a sophisticated underwriter, risk-adjusted return on capital can be the primary factor in how they assess risk and determine pricing adequacy. To the extent any aspect of this management tool becomes public, peer companies could potentially use this information to win competitive bids and attract customers.

We believe an approach that would respect commercial sensitivities while requiring exception based internally assessed risks disclosures would satisfy the users' needs to understand risk exposures from capital requirements.

With respect to analysis performed by rating agencies or regulators, the disclosure of capital targets not currently made public by either the company, rating agencies, or regulators could result in adverse business consequences for a company; the very consequences that the rating agency or regulator is attempting to avoid with their recommendations to management. Currently, insurance rating agencies and regulators perform comprehensive reviews of insurers to determine the capital adequacy or the solvency position of an insurer. These reviews, including internal management capital assessments, are typically based on a multitude of factors and therefore, any attempt to simplify such analyses through disclosure of one or a few factors, such as a particular capital target, is subject to undue emphasis and scrutiny – either positively or negatively – by a user of the financial statements.

We recommend avoiding financial statement disclosure requirements involving internal capital management process, and focus financial statement disclosure requirements on independent and objective information at the balance sheet date, such as commitments, uncertainties, and regulatory capital levels used to monitor a company and the implications of non-compliance. A company should be allowed to disclose internal capital management information but should not be required to do so.

In summary, while we believe management should be responsible for its capital adequacy and solvency position and should disclose significant risk exposures, we believe that the task of opining on insurers' capital adequacy is best handled by professional independent rating agencies and insurance regulators whose primary function is to judge capital adequacy and solvency. Not only are insurance solvency requirements applied inconsistently internationally, they are also applied inconsistently across Europe as the European Directive is implemented by local authorities in various ways. We believe it is inappropriate to implement disclosure requirements based on information prepared for local regulators. Lastly, this issue may be best addressed in a separate standard as we do not believe that it is part of the scope of 'ED 7 – Disclosures: Financial Instruments'.

Note: there appears to be a discrepancy between ED7 and the Basis for Conclusions. Paragraph 47a(i) of ED7 which requires an entity subject to externally imposed capital requirements to disclose the nature of those requirements and how those requirements are incorporated into the management of capital. Paragraph BC53 of the Basis for Conclusions clearly indicates that the Board decided not to require disclosures of externally imposed capital requirements, but to only require disclosures about whether the entity complied with any externally issued capital requirements during the period and, if not, the consequences of non-compliance. It is requested that the IASB confirm the intention of the capital disclosure requirements.

Question 5 - Effective date and transition

The proposed effective date is for periods beginning on or after 1 January 2007 with earlier adoption encouraged (see paragraphs 49 and BC62 - BC67).

Entities adopting IFRSs and the draft IFRS for the first time before 1 January 2006 would be exempt from providing comparative disclosures for the draft IFRS in the first year of adoption (see Appendix B, paragraph B9).

Are the proposed effective date and transition requirements appropriate? If not, why not? What alternative would you propose?

Answer

We believe the effective date is reasonable; however, as discussed in the introduction considerable uncertainty has been created with regards to timing of implementation of the provisions of the draft IFRS before its effective date. Accordingly, we recommend providing additional transitional rules, e.g., the ability to early-adopt certain provisions and not others, that may help companies avoid the cost of collecting IFRS disclosure information that will be no longer be required in 2007 at the latest.

Question 6 - Location of disclosures of risks arising from financial instruments

The disclosure of risks arising from financial instruments proposed by the draft IFRS would be part of the financial statements prepared in accordance with International Financial Reporting Standards (see paragraph BC41). Some believe that disclosures about risks should not be part of financial statements prepared in accordance with IFRSs; rather they should be part of the information provided by management outside the financial statements.

Do you agree that the disclosures proposed by the draft IFRS should be part of the financial statements? If not, why not?

Answer

In addition to the issues raised in answer to question 3, above, we are concerned that the inclusion of risk disclosures within the financial statements would give the measures undue weight in the eyes of the investor.

To the extent we are performing sensitivity analyses on the market risks we have underwritten or the assumptions we have used in the calculation of our estimated balances, these calculations represent a hypothetical alternative value to the balances actually reported in our financial statements. We believe that if these values are to be reported, they should be shown outside of the financial statements to ensure the investor does not give these hypothetical values undue weight.

With respect to the other disclosure requirements, such as the qualitative and quantitative risk disclosures, in some cases the Board notes that the disclosures result in “information that has more predictive value”. The risk is that the investor will also attempt to make predictions based on this information because it is contained within the financial statements. Again, to ensure that undue weight is not given to this type of information which may or may not provide accurate predictive value it should be reported outside the financial statements.

Furthermore, it would be very difficult and expensive to audit. While we can understand that the IASB has no official power over information not in the financial statements, that should not be a basis to require inappropriate information within the financial statements. The draft IFRS again goes beyond US regulations which do not require similar information in the financial statements.

Question 7 - Consequential amendments to IFRS 4

Paragraph B10 of Appendix B proposes amendments to the risk disclosures in IFRS 4 *Insurance Contracts* to make them consistent with the requirements proposed in the draft IFRS. The requirements in IFRS 4 were based on disclosure requirements in IAS 32 that would be amended by the draft IFRS. The Board's reasons for proposing these amendments are set out in paragraphs BC57 - BC61.

Do you agree that the risk disclosures in IFRS 4 should be amended to make them consistent with the requirements proposed in the draft IFRS? If not, why not and what amendments would you make pending the outcome of phase II of the Board's Insurance project?

Answer

We feel strongly that it is premature to include insurance contracts in the draft IFRS's sensitivity analyses. We refer to the issues raised in the introduction to this letter.

Since the draft IFRS requires its sensitivity analyses to be based on IFRS net income and equity, this will lead to additional sets of risk information being prepared. How will the two inconsistent sets of figures be reconciled or even published together without creating considerable confusion for the users of the financial statements?

In addition, we would note that insurers' risk capital models have not been subject to audit and the processes surrounding them have not been designed with audits in mind. The FSA in the UK has acknowledged the time required for internal processes and methods to evolve and intends to review the development of Pillar 2 assessments of individual firms under the FSA's new risk based capital framework over a period of at least two years.

We are of the opinion that the disclosure requirements for financial instruments and insurance contracts should be as consistent as possible, but wish to stress that there are differences between financial instruments (including those with discretionary participation features) and insurance contracts that need to be taken into account. Our view would be that the changes proposed to IAS 32 should not be extended to insurance until the phase 2 proposals are established and understood.

Other IFRS 4-related points we would raise include:

- Paragraph 29 (b) states that certain fair value information is not required to be disclosed for "a discretionary participation feature (as described in IFRS 4 *Insurance Contracts*) contained in a financial asset or financial liability if the fair values of that feature cannot be measured reliably." We believe that this paragraph should be clarified to state the exclusion extends to the entire contract and not just the discretionary participation feature.

- Paragraph B 10 of the draft IFRS makes the following revisions to IFRS 4, paragraph 38: "An insurer shall disclose information that ~~helps~~ enables users of its financial statements to ~~understand~~ evaluate the amount, timing and uncertainty of future cash flows from insurance contracts." This appears to strengthen the disclosure requirements without justification which we do not believe it is appropriate.

Question 8 - Implementation Guidance

The draft Implementation Guidance accompanying the draft IFRS suggests possible ways to apply the risk disclosure requirements in paragraphs 32-45 (see paragraphs BC19, BC20 and BC42 - BC44).

Is the Implementation Guidance sufficient? If not, what additional guidance would you propose?

Answer
Regarding sensitivity analyses, while we do not believe that each company must calculate sensitivities in precisely the same manner as risk profiles vary from company to company, we do believe broad high-level issues should be addressed before requiring the disclosures. However, we do not believe the Implementation Guidance is sufficient for application by financial institutions on certain matters and it would be helpful to provide additional clarity. For example, is "profit and loss" the profit and loss for the period being reported upon or forecasts of future period(s), which are not released into the public domain? Is the "reasonably possible change" an unusual occurrence whereby risk variables are assumed to return to their previous level or do they continue on into the future (and become the company's best estimate)? The answers to these detailed questions, among others, can dramatically change the results of the sensitivity analyses, especially when considering the impacts of investment and intangible asset impairment and liability adequacy. Until these issues are examined thoroughly, we recommend that the draft IFRS not require sensitivity analyses beyond the requirements of existing standards.

Question 9 - Differences from the Exposure Draft of Proposed Statement of Financial Accounting Standards *Fair Value Measurements* published by the US Financial Accounting Standards Board (FASB).

The FASB's Proposed Statement of Financial Accounting Standards *Fair Value Measurements*, which is open for public comment at the same time as this Exposure Draft, proposes guidance on how to measure fair value that would apply broadly to financial and non-financial assets and liabilities that are measured at fair value in accordance with other FASB pronouncements. That Exposure Draft proposes disclosure of information about the use of fair value in measuring assets and liabilities as follows:

(a) For assets and liabilities that are remeasured at fair value on a recurring (or ongoing) basis during the period (for example, trading securities)

> **(i) the fair value amounts at the end of the period, in total and as a percentage of total assets and liabilities,**
> **(ii) how those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market inputs were used), and**
> **(iii) the effect of the remeasurements on earnings for the period (unrealised gains or losses) relating to those assets and liabilities still held at the reporting date.**

(b) For assets and liabilities that are remeasured at fair value on a non-recurring (or periodic) basis during the period (for example, impaired assets), a description of

> **(i) the reason for remeasurements,**
> **(ii) the fair value amounts,**
> **(iii) how those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market inputs were used), and**
> **(iv) the effect of the remeasurements on earnings for the period relating to those assets and liabilities still held at the reporting date.**

Disclosures similar to (a)(ii) above are proposed in paragraph 31 of the draft IFRS (and are currently required by paragraph 92 of IAS 32) and disclosures similar to (a)(iii) are proposed in paragraph 21(a).

Do you agree that the requirements in the draft IFRS provide adequate disclosure of fair value compared with those proposed in the FASB's Exposure Draft? If not, why not, and what changes to the draft IFRS would you propose?

Answer
We agree that the requirements in this draft IFRS provide adequate disclosures of fair value.

Question 10 - Other comments

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

Answer
We have a number of additional comments:

- IG 62A of the draft IFRS requires insurance companies to comply with IAS 1 paragraph 51 and 52, i.e. all assets and liabilities in the balance sheet analysed into amounts expected to be recovered or settled in greater than and less than twelve months. This analysis, while pertinent to other industries in determining liquidity sources and needs, is not performed by insurers due to the longer nature of their liabilities and we do not believe that these requirements should be required for insurance companies.

- Paragraph 30 (b) of the draft IFRS requires disclosure of the carrying amount of financial liabilities. The unallocated surplus will therefore require allocation between investment and insurance contracts. While the total amount of unallocated surplus is known, by definition this has not been allocated further, including between investment and insurance contracts. We believe that such an allocation would be arbitrary at best and does not provide users of the financial statements with useful information.

- Paragraph 11 (a) requires the following disclosure for financial liabilities at fair value through profit and loss: "the amount of change in its fair value that is not attributable to changes in benchmark interest rate". We believe that disclosure would not be applicable for Unit-Linked investment contract liabilities due to the fact the underlying assets often include equity securities and/or real estate. Even though this point is not applicable to the EU-endorsed version of IFRS, we would appreciate clarification of this point in the final standard.

- Paragraph 21 (c) requires the disclosure of total interest expense (calculated using the effective interest method) for financial liabilities not at fair value through profit and loss. We believe that it should be clarified that this disclosure is not intended for investment contracts with discretionary participation features.

- Paragraph B 10 of the draft IFRS adds additional disclosure requirements to paragraph 39 (b) (iii) on concentrations of insurance risk. These requirements were previously in the Implementation Guidance of IFRS 4 which is "not part of the IFRS" and have now been incorporated into the IFRS. This appears to strengthen the disclosure requirements without justification which we do not believe it is appropriate.

- The Board's Basis for Conclusions discusses the need for comparatives during the transition period (particularly with regards to the risk disclosures), however given an entity's business, policies and procedures are likely to change over time we would question whether comparatives are always relevant. As the Board pointed out these disclosures tend to have a more "predictive value" therefore in some cases only the most recent risk and capital information is relevant.