BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

The Chairman

VIA FACSIMILE

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

3 November 2003

Subject: ED 5 Insurance Contracts

Dear Sir David

The Basel Committee on Banking Supervision welcomes the opportunity to provide comments on ED 5 Insurance Contracts ("ED 5").

Please find our detailed comments in the attached note. The note has been prepared by the Committee's Accounting Task Force, chaired by Prof. Arnold Schilder, and approved by the Basel Committee. The development of our comments was coordinated by the Task Force's *ad hoc* subgroup on accounting issues in bank-headed financial services conglomerates. This group is chaired by Donna Bovolaneas, Senior Director, Office of the Superintendent of Financial Institutions Canada.

The Basel Committee trusts you will find its comments useful and constructive.

If you have any questions regarding our comments, please feel free to contact, Prof Schilder (+31 20 524 3360), Ms. Bovolaneas (+1 416 954 6464) or Mr. Bengt A. Mettinger at the Basel Committee Secretariat (+41 61 280 9278).

Yours sincerely,

Jaime Caruana

Enclosure

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Basel Committee's Comments on IASB Exposure Draft ED 5 Insurance Contracts

Introduction

A large number of banking groups include insurance entities and require an overall supervisory assessment of the combined group's financial position and risk profile. Accordingly, we have reviewed ED 5 with a bank-headed conglomerate view in mind. As such, we have focused on areas where opportunity for accounting or capital arbitrage could exist and where the interaction of IAS 39 and ED 5 could undermine the quality of either the bank's financial statements or those of the consolidated group.

We are of the view that in substance similar contracts should be accounted for the same way, regardless of differences in legal form, to enhance comparability and consistency within and among financial services entities.

We also support the concept of a phased-in IASB insurance project as we appreciate the need for a harmonized standard for insurance contracts and agree that, at minimum, interim improvements to disclosure and certain accounting practices are required.

While we recognize the need for an interim solution for 2005, we would also urge the Board to complete phase II as soon as practicable as we do not believe that phase I, particularly in its current form, constitutes an acceptable standard for long-term use. Our primary concern in this regard is the risk of unduly delaying the elimination of those remaining accounting inconsistencies among countries and entities that reduce the comparability and reliability of financial reporting by conglomerates. However, as our more detailed comments will demonstrate, we have also identified certain aspects of phase I that, taken together with other IFRS that affect issuers of insurance contracts, may lead to undesirable financial reporting outcomes beyond the effects of existing national GAAP differences.

Nevertheless, we also appreciate the complexities and challenges of developing and implementing a comprehensive model for accounting for insurance contracts and recognize that from a conceptual and practical perspective the project to develop the optimum phase II solution may not be capable of delivery by 1 January 2007. We would therefore strongly encourage the IASB to take the time it needs to carefully consider those more complex aspects of the phase II model that prompted the mid-2002 decision to adopt a phased-in approach. This is highly preferable to delivering a sub-optimal solution by the original deadline. These aspects may or may not be unique to the business of insurance and every effort should be made to achieve harmonized "financial services" solutions wherever possible. We also urge the Board to remain open-minded as it examines these issues, to ensure that the final accounting model leads to the best and most meaningful financial information. Finally, we would recommend that the Board develop a detailed plan or "road map", for publication alongside the final phase I standard, setting out its plan for delivering the phase II standard within a reasonable timeframe.

Our comments will focus on those few aspects of phase I that we believe are obstacles to achieving a reasonable, if not fully comparable, financial reporting outcome in the near term. Our primary concerns are discussed below in section 1 and our answers to the specific questions posed in ED 5 are provided in section 2.

Section 1: Primary Concerns

Asymmetrical Measurement of Assets and Liabilities

The implementation of IAS 39 for financial assets and liabilities and the implementation of phase I for insurance assets and liabilities may lead to asymmetrical measurement outcomes in most jurisdictions due to the interaction between IAS 39 and ED 5. This results from phase I measurement of insurance liabilities using current national practices, which in many cases involve a form of amortised cost, and the use of IAS 39 for the assets backing the insurance liabilities that to a large extent will likely be measured using the available-for-sale category. Most insurers will be precluded from significant use of the held-to-maturity category because changing experience on the liability side may require periodic rebalancing of the specific assets held to back the liabilities. Our understanding is that even minor adjustments of this nature would taint the held-to-maturity category and cause the entire group to be reclassified. This asymmetrical measurement may lead to volatility in one or both of the income statement and capital that is not reflective of the underlying business economics. Given that there remains some uncertainty about the completion of phase II in time for 2007, allowing asymmetrical accounting results to remain in phase I could create an unacceptable degree of risk to the reputation and relevance of overall accounting results produced by a financial conglomerate with significant insurance operations.

Any "artificial" volatility caused by the asymmetrical measurement of insurance liabilities and the supporting assets will necessarily need to be explained and disclosed in some manner by entities. We have two concerns in this regard. First, these entities will need to have additional resources available to provide this disclosure and explanations. Second and more important, the resulting explanation will imply that the accounting model is somehow flawed.

We acknowledge that the asymmetrical measurement issue already exists in the United States insurance accounting model. However, as a result of the mismatch in the measurement of assets and insurance liabilities in US GAAP, we understand that various users of US GAAP financial statements make adjustments to them in order to determine what they believe are more useful financial measures. In our view, the objective of GAAP should be to produce financial information that meets the needs of a broad range of users without requiring such adjustments.

We do not agree with the statement in paragraph BC112 that "creating new exemptions from IAS 39 in this area is not the best way to meet the common needs of users (including insurance supervisors) of an insurers' general purpose financial statements" as the volatility caused by a mixed measurement model has consequences for all users. Equity volatility may affect regulatory capital but it may also affect the needs of other users, for example, rating agencies that consider equity when evaluating a company's rating. Furthermore, depending on some countries' existing approach to measuring liabilities under current national standards, there is potential for volatility to extend to reported income.

As many existing accounting models for insurance rely on symmetry of asset and liability measurement to reflect the closely managed relationships established between insurance liability portfolios and the assets selected to back them, we encourage the IASB to consider a solution in phase I that maintains this symmetry for accounting purposes. Many concessions have already been made in phase I and we recognize why these were necessary. However, we believe that some further selective enhancements to the phase I model are both desirable and necessary to stabilize its operation and make its results more useful and reliable.

We do not think that permitting special treatment of assets backing insurance liabilities would be the most appropriate answer in a final standard and do not wish to imply any support for this as a longer-term specific solution for insurance enterprises. However, we would observe that the IASB's current proposals may give rise to phase I results that are less meaningful than results prior to phase I. This would be contrary to the general direction of international standards and to one of the key objectives of phase I itself (achieving improvements in current accounting practices).

We note that for entities that issue insurance contracts there is no available equivalent in phase I to the IAS 39 cash flow hedging or the recently proposed fair value macrohedging approach for portfolios valued on a cost basis that might help to alleviate asymmetry issues created within the overall interim model for insurance activities. For this reason, and although the IASB has chosen not to pursue an approach that would alleviate asymmetrical measurement issues in phase I, we strongly encourage the Board to consider the following proposal.

The fundamental objective of this proposal is to achieve relaxation – for phase I only – of the held-to-maturity criteria for debt instruments in very specific circumstances. However, in light of the Board's concerns about either loosening the existing criteria for the held-to-maturity classification or introducing a further asset category within IAS 39, we would suggest amending ED 5 to create a new category of assets with relaxed held-to-maturity criteria. This classification would be available for assets held to back insurance liabilities, but preparers would not be precluded from applying the classification requirements of IAS 39. The suggestion for two classification options ensures that jurisdictions already applying a form of IAS 39 accounting for assets backing insurance liabilities will not face a special, additional transitional exercise in order to achieve IASB compliance during phase I. This provision would not be carried forward into phase II.

In the absence of enforceable conditions and limitations for use, this solution could create accounting arbitrage opportunities for conglomerates. We therefore believe that the suggested solution should be supported by the development of appropriate and enforceable conditions to prevent a conglomerate from using this option in order to manage financial results.

Concerning the application of IAS 39, we would also note the cautions previously expressed by the Basel Committee on the use of the fair value option in its October 2002 comment letter on the revisions to IAS 39.

Financial Guarantees

We understand the reasoning behind the IASB's proposal to include certain bank guarantees within the scope of ED 5. These products seem to contain significant insurance risk, in contrast to other credit derivatives that deal with other forms of financial risk. Also, the IASB is demonstrating its commitment to requiring products with different legal forms but the same economic substance to be accounted for in the same manner. However, we are not convinced at this time that certain bank guarantees and credit insurance products are in fact fully interchangeable or share sufficiently common facts and circumstances to be considered similar and require consistent accounting treatment.

For example, while it may be true that in each product the contract compensates a party if a future uncertain event adversely affects the policyholder or other beneficiary, the underlying reason for the uncertain event occurring can be quite different for credit insurance compared to a guarantee. In the case of a credit insurance product, the trigger is typically an adverse event that occurs to the debtor, for example death or disability, while under a guarantee the trigger is usually a credit related event such as failure to deliver specified contractual cash flows that results in default. As a consequence, the issuer of typical credit insurance products would be underwriting and managing quite different risks compared to those assumed by the issuer of a guarantee.

Accordingly, we believe that credit insurance and certain financial guarantee products contain elements of both credit risk and insurance risk, but that further consideration needs to be given to the most appropriate treatment based on the dominant risk to the issuer. While we support the continued study of these two products, we are concerned that proceeding with the proposed scope of phase I runs the risk that certain financial guarantees will be found to contain no or insignificant insurance risk compared to another type of dominant risk. If so, the phase I scope decision for financial guarantees might need to be reversed. It is also possible that certain credit insurance products could be found to contain significant credit risk, greater than the insurance risk in the contract. For these reasons, we would strongly recommend that for phase I the IASB restore the original scope proposal it set out in paragraph 1(f) of the revisions to IAS 39, which requires the application of IAS 37 to certain financial guarantee contracts for remeasurement purposes. For the same reasons, we would also support leaving credit insurance contracts within the scope of ED 5 until a final resolution for both types of products can be reached in phase II.

Sunset Clause

ED 5 exempts an insurer from applying revised IAS 8 paragraphs 5 and 6 that deal with the selection of accounting policies until 1 January 2007. The intent of the Board is to have phase II completed by this date. However, if phase II is not ready, entities will need to apply IAS 8 paragraphs 5 and 6 and, in some cases, change their accounting policies to comply with these principles.

We noted earlier that the IASB should strive to complete phase II expeditiously as phase I is not suitable for long-term use. However, we recognize the risk that phase II may take longer to complete than anticipated and that issuers of insurance contracts may be required to apply IAS 8 paragraphs 5 and 6 commencing 1 January 2007 without adequate guidance. This may lead to practices that are even more divergent than at the moment. It also could be very impractical and expensive for entities to change accounting policies more than once in a short period of time.

We would therefore recommend that the sunset clause be revised to exempt insurance contracts from the application of IAS 8 paragraphs 5 and 6 until phase II is implemented.

Disclosure of Fair Value of Insurance Liabilities and Insurance Assets

We agree that fair value disclosure is relevant and useful information for users of financial statements, but the requirement to disclose the fair value of insurance assets and liabilities by 31 December 2006 may be problematic.

In this regard, we are concerned that the IASB has not yet determined how these fair values are to be calculated and that this uncertainty may lead to fair value disclosures that are unreliable and inconsistently measured among insurance entities. It also will require entities to develop fair value models and systems for insurance liabilities and insurance assets that may not be appropriate in phase II, causing duplication of work effort and expense. While it may be true that some insurers already produce fair value information for internal use, the determinations of fair value are likely to vary considerably in practice and the processes are likely not designed for external disclosure purposes.

We would therefore suggest that the requirement to disclose the fair value of insurance liabilities be delayed until the IASB has specified how fair values should be determined. In the absence of quantitative fair value information, the disclosure requirements in ED 5 regarding the amount, timing and uncertainty of cash flows will give the users of financial statements some qualitative information on the nature and risks associated with insurance liabilities.

Section 2: Responses to Questions in Exposure Draft

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 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?

(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?

Question 1 - Response

(a) We agree that ED 5 should apply to insurance and reinsurance contracts and not to insurance entities as this allows for similar contracts to be accounted for in a similar way regardless of legal form. We also agree that financial instruments that do not meet the definition of insurance contracts, in practice investment contracts, should be accounted for under the appropriate IFRS regardless of the legal form of the issuing entity.

However, as discussed in section 1, we do not agree that assets held to back insurance contacts should be scoped out of ED 5. Until the asymmetrical measurement issues are addressed through the measurement principles in phase II, we do not believe it is appropriate to allow for what will likely be volatility in the income statement and capital that is not reflective of the underlying economics of insurance contracts.

(b) We agree that weather derivatives should be brought into IAS 39 unless the weather derivative meets the definition of an insurance contract.

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?

Question 2 - Response

We generally agree with the proposed IFRS definition of an insurance contract set out in ED 5 and read in conjunction with the related guidance. (However, please refer to our comments on financial guarantees in section 1.) The concept of significant insurance risk helps to insure that contracts that have the legal form of insurance but in substance carry little insurance risk are accounted for under the appropriate IFRS allowing for greater consistency in accounting treatment among similar instruments. We support the decision to err on the side of prudence to minimize the potential for reversals in phase II. We do, however, recognize that there may be some practical issues for preparers in making consistent judgements about whether a contract contains "significant" insurance risk, especially where contracts fall close to the line, and there may be differing treatment in application among issuers. In some jurisdictions, the careful determination of whether significant insurance risk exists will require significant time and effort and possible system changes since many of their products seem to offer small amounts of insurance risk. There is a risk in these cases that these judgements could face reversal in phase II.

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?

Question 3 - Response

(a)&(b) We agree with the concept that certain embedded derivatives should be separated from their host contract and measured at fair value. We do recognize the conceptual difficulties of separating certain embedded derivatives when the measurement of these contracts has not yet been resolved. Accordingly, we agree with the exemptions proposed in ED 5 for certain contracts from the requirements of IAS 39 until the finalization of phase II.

(c) We agree with the specific disclosures proposed in ED 5.

(d) We agree that no other embedded derivatives should be exempted from IAS 39.

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 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?

(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?

Question 4 – Response

(a) We agree that it is appropriate to exempt insurers from applying revised IAS 8 paragraphs 5 and 6 to insurance contracts since for practical purposes many national accounting practises that jurisdictions will be applying would not meet the requirements set out in paragraphs 5 and 6 of IAS 8. As discussed in our covering letter, we do have some concerns about the use of an expiration date. We agree that IAS 8 paragraphs 5 and 6 should apply to accounting for insurance contracts when phase II has been finalized and recognize the Board's commitment to completing phase II without delay. The existence of the sunset date signals this commitment, but we do have some concerns that this date may not be achievable. It is therefore important that preparers be clear concerning the Board's intention for insurance contract accounting in the interim period if phase II is not completed in time.

(b) We agree with the proposals in (i), (ii) and (iii).

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 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?

Question 5 - Response

(a) We agree with the requirement that an insurer must satisfy if it changes its accounting policies for insurance contracts. However, paragraph 16 states:

> "An insurer may continue to using existing accounting policies that involve the following, but a new accounting policy that involves any of them does not satisfy the requirements of paragraph 14"

This paragraph could imply that an entity may not adopt a new accounting policy for insurance contracts unless all of the items (a) – (e) have been addressed in the new policy. Our understanding is that any new policy that is an improvement from current policies and that does not introduce any *one* of the items (a) – (e) would be considered acceptable. We ask the Board to clarify our understanding on this issue.

(b) We agree in principle with the proposal that when an insurer changes its policies for accounting for insurance contracts it can reclassify some or all of its financial assets into the category of financial assets that are measured at fair value, with changes in fair value recognized in profit and loss. We recognize that this permits insurers who currently use a form of fair value for the measurement of insurance liabilities to achieve measurement symmetry. We do, however, have significant concerns about the reliability of fair value measurement as discussed in our previous comment letters on the possible adoption of full fair value accounting and proposed amendments to IAS 32 and 39. For financial instruments without observable prices in active markets it may be difficult for companies to determine reliable fair values and for auditors to audit those estimates. We strongly encourage the IASB to prioritize work on fair value measurement to ensure that appropriate guidance is developed as soon as possible.

The fair value reliability issues aside, to increase the value of this option we suggest that the option be broadened to include when an insurer implements phase I even if the insurer does not change its accounting policy for insurance liabilities. This will allow those jurisdictions that may already have a "fair value" methodology for insurance liabilities to achieve a symmetrical accounting result. Additionally, when the level of insurance risk in a contract changes such that a contract that was initially an investment contract becomes an insurance contract the insurer should be able to exercise this option along with the change in the liability measurement in order to achieve a symmetrical measurement model.

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 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?

Question 6 – Response

(a) We support the principle that all material contractual obligations and contract rights should be recognized in the financial statements and that unbundling under ED 5 is intended to achieve this when possible under phase I. We believe unbundling of deposit components from insurance components is feasible in the cases described in IG5 and IG6.

(b) We do not believe that unbundling should be required in any other cases.

(c) We believe it is clear when unbundling is required.

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 for Conclusions).

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

Question 7 – Response

For practical reasons we agree with the proposals in phase I to limit the reporting of anomalies when an insurer buys reinsurance, although we note that the creation of deferred gains and their subsequent amortization is not entirely consistent with the asset-liability focus of the IASB framework.

We acknowledge that the complexities of reinsurance accounting will be dealt with in detail in phase II.

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 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?

Question 8 – Response

The proposals for insurance contracts acquired in a business combination or portfolio transfer are appropriate for use in phase I. We do note that in the absence of a clear definition of the fair value of insurance liabilities this proposal will be difficult to apply and there may be a lack of consistency in practice during the phase I period.

Question 9 - 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?

Question 9 – Response

We agree with the proposals related to discretionary participation features until phase II is implemented. We also agree that an issuer of products with discretionary participation features should classify the unallocated surplus as a liability or equity and not an intermediate category and we understand this issue will be dealt with in phase II.

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 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?

Question 10 – Response

As discussed in section 1, we agree that disclosing the fair value of insurance liabilities and assets is useful information for users of financial statements. However, unless the fair value information is reliable and comparable it will be of limited use to most readers of financial statements.

We are of the view that until fair value measurement principles have been determined by the IASB disclosure of fair values of insurance liabilities and assets is not appropriate.

Question 11 - 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?

Question 11 - Response

(a) We believe the proposed disclosures are appropriate and that no further disclosures are required.

(b) We recognize the Board's intention to keep standards principle-based. However, we believe the current guidance in the standard does not provide enough detail to be sufficient on a standalone basis. Since the implementation guidance does not form part of the standard and the guidance reads "discusses how an insurer *might* satisfy the disclosure requirements in the draft IFRS" there could be varying degrees of disclosure in practice.

(c) No changes to the transitional relief should be made.

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 (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?

Question 12 - Response

We agree that a financial guarantee resulting from the transfer of a non-financial asset or liability should be accounted for under IAS 39. However, as discussed in section 1, we do have concerns about how certain bank issued financial guarantees that meet the definition of an insurance contract are to be accounted for under phase I. Please refer to that discussion.

Question 13 - Other comments

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

Question 13 – Response

Included in section 1 are other comments on the draft IFRS and the draft Implementation Guidance.