

## CEIOPS

Committee of European Insurance and Occupational Pensions Supervisors

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Copenhagen 25 May 2004

Mr. Stig Enevoldsen  
Chairman of the Technical Experts Group  
EFRAG  
Avenue des Arts 41  
1040 Brussels

Dear Mr. Enevoldsen,

**Re: CEIOPS Comments on EFRAG Letter on Adoption of IFRS 4 *Insurance Contracts***

On behalf of CEIOPS, I am pleased to provide you with some comments about the EFRAG letter on the adoption of IFRS 4 *Insurance Contracts*.

The following comments regard the main areas of concern shared by EU Insurance Supervisors. According to the specific situation in each jurisdiction, some of them might provide additional comments in relation to issues particularly relevant to their own market and regulation.

It is worth underlining that insurance supervisors are key stakeholders in the IFRS rules making and endorsement process. First of all, even though supervisors have different ways of collecting relevant information, financial statements represent a significant source of information for the assessment of the undertaking's financial situation. Secondly, the reliability and relevance of the financial information available to users are the preconditions for promoting an efficient, fair and stable insurance market for the benefit and protection of policyholders. Finally, we are aware that the IAS standards are not aimed at supervisory purposes; nevertheless, the policy and methodologies used for drawing up public financial statements should, as far as possible, be compatible with prudential purposes as well, in order to easily reconcile public financial statements with the reporting system used in applying the supervisory regime.

For these reasons CEIOPS has committed to follow and contribute to the process and has established a specific Working Group for this purpose.

Generally speaking, insurance supervisors are in favour of the ongoing EU accounting strategy based on the introduction of high-quality international accounting standards. Appropriate accounting standards, consistently applied at the EU level, represent an essential condition in building a strong European financial market.

With specific reference to IFRS 4, insurance supervisors agree with EFRAG in recommending its adoption. IFRS 4 fulfils the urgent need to provide guidance on the accounting for insurance contracts from 2005 on. In particular, we do appreciate that IFRS 4, pending a satisfactory definition of all the aspects related to accounting for insurance contracts, allows insurers to maintain the application of the current accounting practices for measuring assets and liabilities originated from insurance contracts.

However, insurance supervisors have some concerns regarding the potential effects of the application of IFRS 4. In our opinion, in the lack of specific further guidance, the application of some provisions of IFRS 4 might undermine understandability and comparability of financial statements and decrease their reliability. The draft EFRAG letter is partially in line with the concerns of the supervisors.

In general terms, the supervisors' concerns are mainly due to the lack of clarity and comprehensiveness of some areas of the standard and to their inconsistency with other IAS/IFRSs' requirements. We are aware that those defects basically derive from the provisional nature of this standard but, at the same time, also considering the short time available before the first application of the standards, we can't deny that those defects could have serious implications for the insurance market, raising implementation uncertainties for undertakings and adding potential difficulties for supervisors as well in pursuing their supervisory goals.

In particular, we would like to mention the areas related to the "mismatch" issue, the treatment of contracts with discretionary participation features and the measurement of insurance liabilities.

#### *The mismatch issue*

Insurance supervisors share EFRAG's considerations on this subject. The potential asymmetry in the evaluation methods applied to assets and liabilities might undermine transparency and understandability of financial statements, by reflecting in the financial statements a volatility stemming from accounting policies and not from the economic reality. In the perspective of prudential supervision, in particular, this potential distortion might have a misleading impact on the users' interpretation of financial statements, thus posing significant problems, not only to undertakings, but also to supervisors in explaining any inconsistency between the accounting figures and the real economic conditions. On the basis of those arguments, indeed, the jurisdictions which are potentially more affected by this distortion had preferred a solution for reducing the mismatch based on the extension of the classification criteria for HTM financial instruments.

#### *Discretionary participation features*

The lack of clear guidance in the treatment of contracts with discretionary participation features might also, in some jurisdictions, undermine reliability and comparability of insurers' financial statements, especially where these contracts make up a significant part of the insurers' portfolio. In the supervisors' opinion, the definition of this kind of contracts and their accounting treatment require more specific guidance in order not to leave room for different interpretations of the same concepts.

### *Measurement of insurance liabilities*

The option to remeasure designated insurance liabilities to reflect current market interest rates, substantially aimed to help insurers in dealing with the mismatch issue, is also an area of concern for supervisors. The implementation of this option will permit an insurer to use different and not specified methods for the measurement of its insurance liabilities, thus allowing for accounting arbitrage (similar insurance liabilities to be measured in different ways). This option potentially decreases the comparability of insurers' financial statements, even within the same jurisdiction. Moreover, taking into account the significance and uncertainty in estimating insurance liabilities, the lack of guidance in the choice of methodology and assumptions might also hinder the measurement reliability, leaving room for potential manipulation of the amounts shown in the balance sheet.

In light of the above considerations, supervisors agree with EFRAG that the development of Phase II should be undertaken and defined as soon as possible in order to significantly improve the accounting treatment of insurance contracts: in this regard, CEIOPS is willing to cooperate with EFRAG to develop and suggest long-term accounting solutions enabling to solve the above-mentioned concerns.

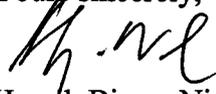
With regard to the first application of IFRS 4, supervisors are confident that appropriate presentation and disclosure, as underlined in the EFRAG letter, will mitigate the potential lack of understandability of insurers' financial statements.

However, in the supervisors' opinion, specific guidance on presentation and disclosure of the figures shown in the financial statements, with particular regard to the "mismatch" issue, would be essential during Phase I in order to enhance financial statements' transparency and comparability. Such guidance could hopefully be developed at international level, in line with any presentational solution to be identified for similar problems in the banking sector, such as hedge accounting for a portfolio hedge of interest rate risk. In this perspective, CEIOPS is available to work with EFRAG to discuss and develop with IASB any appropriate solutions for enhancing, in particular, the understandability of any mismatch exclusively due to accounting asymmetry.

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Should you wish to have any further clarification on CEIOPS's advice or to discuss the proposed issues more in-depth, please do not hesitate to contact Mr Alberto Corinti at the following e-mail address [alberto.corinti@isvap.it](mailto:alberto.corinti@isvap.it) or by phone at +39-06-42.133.489.

Yours sincerely,

  
Henrik Bjerre-Nielsen  
CEIOPS Chairman