ANNEX 2

Implications for the European Directives

In carrying on the analysis of the implication of IAS/IFRS introduction for prudential supervision, CEIOPS also pointed out any possible changes to the EU financial reporting and Prudential Directives that may be needed or desirable. This analysis which shall be brought to the attention of the Commission Services is presented below.

In general, amendments to Directives are very time-consuming and for practicality reasons must therefore be avoided to the greatest extent possible. In certain cases, however, the introduction of IAS/IFRS as well as related prudential filters may call for amendments to Directives.

The purpose of such an analysis is not to propose further changes to the Prudential Directives at this point in time, as the matters are currently discussed in a profound way within the Solvency II project. Instead, the analysis is only focussed on the possible need for Member States to introduce prudential filters that are in line with the minimum harmonisation approach used in the Directives. Full use of all options under IAS/IFRS may require changes to Directives. CEIOPS assesses that these adjustments are better done in the framework of Solvency II and Phase 2 of the IASB accounting project.

All eleven issues mentioned above in part IV have been analysed from this aspect. Both historical cost and market value approaches have been considered.

Definition of insurance contracts

Neither financial reporting nor Prudential Directives currently define ‘insurance’. Most jurisdictions consider requiring that all contracts previously included as insurance should keep that classification during Phase 1. Two parallel classification systems may cause problems, but changes to the Directives do not seem necessary at this stage. This issue however could be analysed within the EU Solvency II project.

Valuation of financial assets

Supervisors need to define what prudential filters are necessary concerning financial assets, provided that these are within the Prudential Directives.

The IASB has outlined certain accounting methods to address the mismatch between the insurance assets and insurance liabilities (for example shadow accounting and change of discount rate). Caution must be taken that these are exercised in a way that is in conformity with the Directives.

Financial derivatives

In principle no changes to the Directives seem necessary. If a prudential filter for cash flow hedges is introduced, this must be constructed in a way that the provisions in the Directives are respected.

Valuation of property

As both the Directives and applicable IAS leave a choice between market values or historical valuation, no changes to the Directives are needed.

Valuation of insurance liabilities

Financial reporting rules do not override specific supervisory valuations rules contained in the Prudential Directives. This is particularly important for the valuation options contained in IFRS 4. These rules take precedence over the Insurance Accounts Directive (IAD), but the specific provisions in the Third Generation Insurance Directives apply.

Undertakings wanting to use the same set of accounts should only choose such options that are within the Prudential Directives. There are certain options outlined in IFRS 4 that may be exercised in a way contrary to prudential rules. A full use of all options may therefore require changes to the Directives, but this is an item under discussion within the EU Solvency II project.

It has been agreed not to advocate changes to Prudential Directives at this stage, as Solvency II work is already underway. CEIOPS believes that the current Prudential Directives provide sufficient flexibility to allow the intended level of communality between financial and supervisory statements.

Equalisation provisions

There are some links between the IAD and the Third Generation Non-Life Directive (92/49/EEC).

Article 18 of the latter Directive requires the establishment of equalisation *reserves*, but the Insurance Accounts Directive uses the notion equalisation *provisions*. In the IAD, the equalisation provisions are furthermore listed under the heading “technical provisions”. This is the only place in the Directives where it is explicitly said that equalisation provisions are a part of technical provisions.

In practice, equalisation amounts are generally regarded as provisions in the EU and are normally covered by assets like other technical provisions.

Following its deliberations there may be a need for smaller changes to the Prudential Directives as well as the IAD. Possibly the following adjustments would be needed:

- Clarification in the Prudential Directive that “equalisation reserve” is a technical provision.
- Deletion of the caption “equalisation provision” in the IAD and creation of a new sub-caption “equalisation reserve”

Valuation of financial liabilities

There may be a need for certain prudential amendments following the introduction of IAS/IFRS. CEIOPS believes that these could be done within the borderlines of the current Directives. If the full Fair Value Option had been retained, a full choice by companies may not have been possible due to the prudential directives.

Intangible assets

No need for changes to the Directives.

Discretionary participation features

No need for changes to the Directives.

Valuation of subsidiaries

No need for changes to the Directives.

Pension plan

No need for changes to the Directives.