Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

31 July 2009

Dear Sir David,

We are taking this opportunity to comment on your Exposure Draft – *Derecognition* (the "exposure draft" or "ED"). This letter has been drafted by the European Insurance CFO Forum, which is a body representing the views of 20 of Europe's largest insurance companies.

We understand the Board's objective in considering this area in order to address inappropriate off-balance sheet accounting, particularly in the light of the current financial crisis. However, we do not believe that this is a significant issue for insurers under current IFRS requirements. It appears, however, that by addressing this issue in the manner set out in the ED the IASB may have created some significant unintended consequences.

As major investors, insurers utilise securities lending, repos and similar transactions to a significant degree and we believe that the current requirements appropriately reflect the economic substance of these transactions. There is a real likelihood, however, that the changes proposed in the ED will result in different accounting for such transactions, specifically by requiring derecognition of assets subject to such arrangements. We do not support such developments and question why the IASB feel the need to address such areas which have no underlying problems. The current wording could have real economic consequences as insurers and other large securities lenders may refrain from entering into these types of transactions.

In our view, a principles based approach should be followed for the treatment of repos and other similar financial transactions under which a sale of a financial asset is entered into contemporaneously with an agreement to repurchase the same asset at a fixed price or a sale price plus a lender's return. In this regard it may be appropriate to build on US GAAP which defines effective control over financial assets in SFAS 166 paragraph 9(c)(1) to include those under an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity. Ultimately it is important to indicate that control is not relinquished when a repurchase obligation or option remains in force.

In addition to the issue set out above we have significant concerns that the proposals could be interpreted in such a way that may lead to the derecognition of a significant proportion of many insurers' investment portfolios, removing decision-useful information and potentially creating mismatches with associated liabilities. We have discussed these concerns with relevant IASB

staff members and there do appear to be some potential unintended consequences of the proposals which may create this situation.

Based on our understanding, confirmed with your staff, the sale of units in an insurance fund might be considered to constitute a "transfer", as the insurer has contracted to pass on to the policyholder the economic benefits of the underlying linked investments. The insurer is deemed as having no continuing involvement with the ED specifically stating that holding the financial asset in a “fiduciary or agency relationship” does not constitute continuing involvement. Accordingly, the insurer's relationship with its policyholders could be considered to be a “fiduciary or agency” relationship and hence would result in derecognition even though the legal ownership of the assets has not transferred, cash flows are not passed on and in bankruptcy the policyholders do not generally have a specific or direct claim on the assets (i.e. they are not lien-holders and rank equally with other creditors).

We are fully supportive of the concept that assets held by an insurer under a true agency relationship should not be recognised on the insurer’s balance sheet. However, we believe that it is very important to distinguish such assets from those that are held in a fiduciary capacity. For these purposes we are utilising the meaning of agency and fiduciary relationships as established under UK law but it is the principle we are attempting to illustrate rather than the juristic differences in law and it is important that the proposals can be applied throughout all different jurisdictions.. Our understanding is that in law an asset that is subject to an agency arrangement is owned by the principal. Thus the principal will benefit/suffer all the returns from that asset and the agent will receive only a fee commensurate with their role as an agent. Thus an agent may have power over the asset (delegated by the principal) but will not benefit/suffer the returns.

An agent is generally required by law or regulation to act in the best interests of the principal, often referred to as in a fiduciary capacity; however assets can be held in a fiduciary capacity without necessarily being the subject of an agency relationship. The key difference being who in fact actually owns the underlying asset. For example an asset held by an insurer for the benefit of a policyholder can be held in a fiduciary capacity, meaning that the insurer will contract with the policyholder to pass on benefits that are measured according to the performance of the asset. The legal ownership of the assets however can rest with the insurer such that in the event of bankruptcy for example the policyholder would not have a specific or direct claim on the underlying asset. Similarly the liability to the policyholder would remain according to the terms of the contract even if the underlying assets were no longer held by the insurer. How this distinction operates in practice is further explained below.

Many insurers, in addition to providing unit linked insurance and investment contracts, also operate asset management operations offering unit trusts to customers and hence we are able to illustrate this distinction by reference to these two types of products provided to customers. In this regard a unit linked savings contract is very different from a unit trust. A customer buying a unit in a unit trust is acquiring a share in an underlying entity that, in itself, holds assets. The fair value of that share may vary depending on the value of the underlying assets but the customer directly owns that share. Under this scenario the asset manager is acting as an agent for the customer in relation to the underlying assets.

Conversely, in a unit linked insurance or investment contract the customer has a contract with an insurance company which provides certain benefits (perhaps including a life assurance element or some tax advantages). The fact that the policy is issued by the insurer is directly relevant to the features provided (for example, tax advantages). The policy itself may be valued by reference to a pool of ring fenced assets but the insurer is not acting as agent for the policyholder to own a share of those assets, it is merely the case that the return to the policyholder varies in accordance with the return on those assets and the insurer is acting in a fiduciary capacity in respect of the assets held.

The lack of a clear distinction in the ED between fiduciary and agency relationships means that applying the derecognition principles to assets backing insurance and investment products in this way could result in many assets held by insurers in a fiduciary capacity being derecognised and much valuable information being lost from the balance sheet. This would not reflect the economic substance of our underlying business. Furthermore a key part of an insurer's business is to manage policyholders' funds; how well this is achieved is useful information in predicting future success as a business. It would not be helpful to users if this information was lost as a consequence of holding these assets off balance sheet. We also note that it is not clear from the ED whether the related liability would be derecognised if financial assets backing insurance and investment products were derecognised,

It is also not completely clear whether there are any ramifications for participating contracts, which have many similarities to linked contracts and differ from jurisdiction to jurisdiction. This would warrant further review.

It should be noted, in this regard, that the proposed ED appears to create a difference from US GAAP. In the event an insurer goes bankrupt in most jurisdictions the linked assets form part of the general pool of assets to meet any obligations (i.e. linked policyholders do not have a direct claim on the linked assets). The proposed US GAAP amendments to SFAS140 are similar to the IASB's ED, but crucially include the requirement that transferred financial assets have been isolated from the transferor, any of its consolidated affiliates and its creditors, even in bankruptcy. The approach proposed in the IASB's ED does not require such a test. We have not investigated this matter fully but if the ED was consistent with US GAAP proposals, it could well resolve the issue above. We would encourage the IASB to consider this matter in conjunction with the FASB.

We do not believe that, in formulating the ED, the IASB set out to remove such a significant element of an insurer's business from the balance sheet. If this is the case then we would welcome amendment to the proposals to prevent such unintended consequences. If the implications set out above were the objective of the board then we would stress the need to reconsider that objective in the light of loss of decision-useful information, increased complexity and potential accounting mismatches.

If you have any queries or questions that you would like to raise in relation to the matters raised in this letter, please feel free to contact me.

Yours sincerely,

Philip G Scott
Chairman – European Insurance CFO Forum