The Corporate Reporting Users' Forum

Peter Clark
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30 Cannon St
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17th February, 2009

Dear Peter

We are a group of users of insurance company accounts who have recently begun to meet under the auspices of the Corporate Reporting Users' Forum (CRUF). We include individuals from both buy- and sell-side institutions. We are pleased to have the opportunity to comment on two aspects of insurance accounting currently under consideration by the IASB.

I. Profit on inception

None of the buy- and sell-side analysts present at any of our discussions upon the topic support the suggestion that net Day One profits after acquisition expenses should be reflected in primary statements.

Many of us consider that this would better mirror reporting in other industries, and in practice be both simpler to use for investors who look across multiple industries and easier to understand.

Those of us who see insurance contracts as essentially contracts to provide a service believe that reflecting profit as the service is delivered simply makes better economic sense.

Most of us recognise the usefulness of embedded value approaches, but we believe that the purpose of financial statements should be to allow the user as far as possible to understand the development of business activity over the period under review, and not to reflect a valuation of the business. We consider that supplemental disclosure – potentially in the notes to the accounts - reflecting an analysis of the profits expected to be earned from life insurance contracts is useful and should continue to be provided by companies.

Participants overwhelmingly support not causing a loss to be recognised on inception simply because of the acquisition costs incurred.

Some participants believe that insurers have provided a service in acquiring an insurance contract and so sufficient revenue should be recognised on inception of the contract to cover these costs.

The majority of us believe, however, that this is best achieved by the capitalisation of direct acquisition costs and their amortisation over the term of the contract, subject to periodic re-measurement. We believe this would have the following advantages:

- The concept and implementation of Deferred Acquisition Cost (DAC) methodology is well established and well understood by preparers and users globally.
- IFRS currently recognises analogous treatment for other commercial entities, for example the capitalisation of development costs by pharmaceutical companies
- Although not frequently enough to be regarded meaningfully as a negotiable financial instrument, the DAC asset can demonstrably be monetised, as for example in the L1 to L6 series of securitisations undertaken by Hannover Re between 1998 and 2006 and their imitators.

Participants recognised that DAC methodology would need to be more standardised and a robust principle developed to ensure that it is made more rigorous, in at least the following areas:

- Definition of the sales costs which are to be considered direct and subject to DAC treatment;
- Tighter guidelines for DAC amortisation.

II. Liability measurement: Fulfilment value or exit value?

Investment professionals look to the financial statements for information that can help them forecast expected cash flows – not for a hypothetical market price. As there is no sensible independent measurement of "exit value" (i.e. no traded market for insurance blocks), there is overwhelming support by participants in our discussions for insurance liabilities to be measured at fulfilment value and not exit value.

Many of us believe that valuation based on an exit value would require arbitrary and/or hypothetical inputs and assumptions. Recent experience with regard to structured credits leads us to believe that assumed markets are a poor basis for valuation.

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About the Corporate Reporting Users' Forum (CRUF)

The CRUF came together in 2005 as a discussion forum to help its participants in their approach to the debate on current and future corporate reporting requirements. In particular, participants are keen to have a fuller input into the deliberations of accounting standard setters such as the IASB. CRUF participants come from all around the world, including individuals from both buy- and sell-side institutions, and from both equity and fixed income markets.

The CRUF is a discussion forum. The chairmanship of the CRUF rotates at each meeting and different individuals take leadership in discussions on different topics and in the initial drafting of representations. It does not seek to achieve consensus views, though at times some or all of its participants will agree to make joint representations to standard setters or to the media. It would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative.

CRUF participants take part in discussions and joint representations as individuals, not as representatives of their employer organisations. The participants in the Forum that have specifically endorsed this response are listed below.

Trevor Petch
European Insurance Analyst
Insight Investment

James Quin
Director
Citigroup Investment Research

James Pearce
Senior Insurance Analyst
Cazenove Equities

Jed Wrigley
Portfolio Manager,
Director - Accounting & Valuation
Fidelity Investments

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Dr. Juergen Hawlitzky, CFA
Director
Senior Analyst European Insurance
RCM

Martin Ayres
UK Financials Analyst
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Maurizio Lualdi, MSc, ACII, CIP
Capital Research Global Investors

Nicholas Midgley
Equity Research Associate
Schroders

Paul Lee
Director
Hermes Investment Management Ltd

Richard Mathieson
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Stefan Schürmann
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