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Accounting Standards Board
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08 May 2012

Dear sirs

Insurance Accounting – Mind the GAAP

We are pleased to respond to the above paper. Our response reflects the activities of the RSA Group as a general insurer operating in 33 countries around the world. As a quoted company the Group's results are reported under IFRS, however we continue to use UK GAAP for our insurance and non insurance subsidiaries operating in the UK and the Republic of Ireland.

We are grateful that the ASB has identified the issues for insurers in making the proposed moves from existing UK GAAP to a new UK GAAP based upon IFRS and that it has dedicated considerable resource in ensuring that the specific challenges facing insurance companies have been addressed.

We support the ASB's view that UK GAAP as applied by insurers should ultimately move towards a solution that is closely linked to the IASB's Phase II standard on insurance contracts but the uncertainty over the timing of the conclusion of the Phase II standard means that this goal will not be achievable within the time constraints of the proposed transition.

In addition to the uncertainty on the IFRS front, the insurance industry is also facing the challenge of the emergence of the new regulatory reporting in the form of Solvency II. Whilst we acknowledge that there are key similarities between the measurement principles emerging under Solvency II and those likely to be adopted for Phase II, we do not however believe that the ASB should make changes to UK GAAP to align with Solvency II at this stage.

There are two main reasons for us not supporting this route. Firstly, we see the IASB's Phase II model as the ultimate solution for accounting for insurance business and do not believe that it helpful, to either preparers or to users, to have to make changes to the accounting bases twice within a (hopefully) relatively short period of time. Secondly, as a regulatory tool, Solvency II has a balance sheet focus and, consequently, has shortfalls in the presentation of financial performance. While this issue is probably solved far more easily for general insurers than for life companies, we do not believe that there is benefit in dedicating additional effort to resolve the performance statement problems at this time.

We therefore support the solution that requires the minimum changes to current UK GAAP and we believe that the method to achieve this will be to adopt (as far as possible) IFRS 4 into the new framework. This solution will not preclude companies who so wish, from adopting accounting policies aligning more closely with the measurement bases of either solvency II or of phase II where an entity concludes that the IFRS 4 conditions on making such changes to accounting policies are met.

We acknowledge that this may not achieve the convergence of accounting policies that the ASB may wish to achieve but to counter this we would argue that this would be no different to the situation existing under IFRS. Subject to the potential ability to make “IFRS 4 improvements” to the measurement basis of insurance contract liabilities, this solution should maintain the current level of comparability between UK insurers.

We attach our responses to the questions on which comments were invited in the appendix to this letter. These responses include the major observations noted above together with other issues where we have concerns with the proposals.

We trust that you will find our comments helpful in the development of the final standards and if you require any clarification of the issues raised in this response, please do not hesitate to contact me.

Yours faithfully

Doug Logan
Director, Group Technical Accounting

Insurance Accounting – Mind the GAAP
Responses to the questions upon which questions are invited

Long-term solution

7.4 Do you agree that the long-term solution for accounting for insurance by reporting entities in the UK (listed and unlisted) is to incorporate IFRS 4 Phase II into UK GAAP, when issued by the IASB and adopted for use in the EU?

We agree that the best solution for accounting for all items (including insurance contracts) under the revised UK GAAP will be to align with IFRS. We therefore endorse the ASB's proposals to align UK GAAP with the IASB's standard on insurance contracts as soon as its work on Phase II of IFRS 4 is completed. We believe that this will improve comparability across international borders.

For a Group such as RSA it will facilitate the preparation of the individual entity accounts to align the accounting policies with those adopted under IFRS at Group level.

Short-term solution

7.5 When providing comments on the short-term solutions please comment on:

(a) whether you agree that all aspects of the problem have been identified? If not, what is missing and how do you see it impacting the accounting for insurance contracts?

For UK general insurance companies, the short term accounting problems arising as a consequence of the regulatory changes are less acute than those faced by those companies writing life business. The issues on claims discounting for non life companies have already been identified by the ASB.

There is a potential problem for non life companies if the implementation of Solvency II is delayed beyond 1 January 2014, in respect of equalisation reserves. If Solvency 1 regulations continue beyond this date, then non life companies would be required to continue to hold such reserves in accordance with Companies Act balance sheet formats for insurance companies. Under the Companies Act these reserves are required to be recognised as liabilities (as a direct consequence of applying the underlying EU accounting directive).

This treatment would not be allowed under any of the solutions proposed by the ASB and consequently, if there is the delay in adopting solvency II, it would be necessary to apply the treatment currently described in paragraphs 125-126 of the ABI SORP. We believe that it would be helpful to recognise the Companies Act requirement in [draft] 100 in a similar manner as currently described in the SORP.

It should also be noted that while both the SORP and the Companies Act requirements refer only to equalisation reserves established in the UK or under EU directives, the underlying directive requires a liability to be recognised for such reserves *"set aside in compliance with legal or administrative requirements"* which appears to encompass a wider category of equalisation reserves (i.e. including those established in other overseas territories).

There is also a potential issue relating to the use of the financial statement formats set out in the Companies Act. We acknowledge that under [draft] FRS 102, the use of the Companies Act's formats replaces the formats within the IFRS for SMEs. However, there is no such provision for companies making use of the reduced disclosure requirements in [draft] FRS 101. We believe that it will be difficult for insurance companies to comply with both the requirements of IAS 1, and the "schedule 3" formats prescribed by the Companies Act. In particular, the "3 part" profit and loss account prescribed by the Companies Act does not appear to be consistent with the requirements of IAS 1. We believe that in [draft] FRS 100, the use of Companies Act's formats for entities applying [draft] FRS 101 should be explicitly allowed as an alternative to the adoption of the requirements of IAS 1.

(b) what is your preferred solution (whether one of those set out in section 6 above or not) for insurance accounting in the UK during the gap period?

Our strong preference for insurance accounting during the gap period is the use of option I – *Incorporate the current version of IFRS 4 into UK GAAP* amended as necessary to comply with the requirements of the Companies Act (see our response to 7.5(a) above).

(c) what is the your rationale for proposing that solution, including the balance of cost and benefits?

We believe that the adoption of IFRS 4 into UK GAAP will provide information that is (as far as possible) compliant with IFRS which, for RSA, is consistent with the accounting policies applied in the Group's consolidated accounts, and provide a cost effective solution for all preparers during the interim period.

We do not support the alternative solutions proposed for the following reasons:-

- Option II – *Embed the relevant rules of FSA's Realistic Capital Regime into UK GAAP*

  This option is relevant for insurance companies writing life business only and it is unclear as to what guidance (if any) would be applied for general insurance companies. Assuming that the retained ABI SORP was left unchanged for general insurance business, then in practical terms the outcome could be similar to that of adopting option I. However the ability to make improvements to the reporting available under IFRS 4 may not be present under this option and this could potentially lead to less relevant information being presented.

  There is also the practical concern that the ABI SORP would need to be updated and maintained. This could be burdensome as it may be difficult to find the adequate level of resource to devote to this task for what is, essentially, a short term solution.

- Option III - *Update FRS 27 and the ABI SORP for Solvency II requirements*

  We do not believe that it would be sensible to introduce a completely new basis of financial reporting for what would be an interim period pending the completion of the phase II project. The consequence of adopting this option would be that insurance companies would face the probability of having to make two changes to their accounting policies within a very short period of time.

  The ASB has made the observation that the solvency II requirements are designed to meet a different set of needs to those of financial reporting and in particular do not address the issues of performance reporting. We would expect that for general insurance contracts this could be resolved in a relatively straightforward manner but for long term contracts there is unlikely to be an easy fix. The IASB has been considering similar issues within the phase II project and even now, these matters remain unresolved.

  The same issues of resourcing the additional work to update the ABI SORP as described under option II above are likely become more acute under this proposal as the level of change arising from it would be far greater. In addition, the additional restrictions imposed by the Companies Act (as previously addressed in (a) above) would need to be resolved.

  We acknowledge that for some entities, there may be some appeal of aligning the financial reporting more closely with the reporting that will be needed for regulatory reporting. However, for these entities we believe that applying IFRS 4 under option I (and using the standard's provisions for making changes to accounting policies) would permit this closer alignment in any event.

- Option IV – *Incorporate IFRS 4 phase II into UK GAAP*

  We do not believe that this solution is an acceptable solution while the IASB is continuing its development of the new standard. As identified by the ASB, to incorporate "a pre–final version" of the Phase II standard would again run the risk that insurers would face additional changes to financial reporting when the final standard is adopted.

  The conflicts between the Phase II standard and the restrictions imposed by the Companies Act, would again need to be fully identified and resolved.

  We believe that it is unlikely that entities reporting under IFRS will be required to adopt the new Phase II standard as early as 2015. It would appear to be somewhat perverse that in 2015, a UK company could be faced with a potential choice of applying IFRS in its financial statements and applying the existing IFRS 4, or alternatively not applying IFRS but being required to apply the replacement IFRS 4.

  (d) what is the likely impact of any changes in accounting for insurance contracts under UK GAAP on the entity you have in mind. It would be helpful if your response clarifies the current position of the reporting entity you have in mind (listed, unlisted, reporting in accordance with IFRS/grandfathering/own accounting policies/UK GAAP/other).

The entities affected within the RSA group of companies would be the seven subsidiary insurance companies within the UK and the Republic of Ireland within the RSA group, one of which is a plc and all of which currently report under UK GAAP for their individual financial statements but under IFRS for Group reporting. Under the [draft] FRS 100 these companies would ideally report under IFRS while making use of the reduced disclosure framework permitted by [draft] FRS 101.

The adoption of the existing IFRS 4 into UK GAAP (option I) would enable these subsidiary companies to apply the same accounting policies as are used within the consolidated accounts of RSA Insurance Group plc. There may be some continuing differences in these accounting policies where the restrictions imposed by the Companies Act preclude absolute alignment, however these differences would be managed more easily than the additional differences that would be introduced by the other options; in particular those that would arise under option III and option IV.

The proposed solution of adopting option I would make the transition from current UK GAAP to UK GAAP under [draft] FRS 100 as straightforward as possible and, looking further ahead, would facilitate the progression to the new Phase II standard where the transition would be managed on a consistent basis at Group and at individual entity level.