LLOYD'S

Financial Reporting Council
5th floor, Aldwych House
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24 October 2013

Your reference
Our reference

Dear Sirs

FRED49 (Draft FRS103) 'Insurance Contracts' – response of the Society of Lloyd's

Lloyd's welcomes the publication by the Financial Reporting Council (FRC) of FRED49 (Draft FRS103) 'Insurance Contracts', and appreciates the opportunity to contribute to this important development in accounting.

Lloyd's

We consider that it might be helpful to provide some background regarding Lloyd's. Lloyd's is not an insurance company. It is a Society of members, both corporate and individual, which underwrite insurance in syndicates. Total gross written premium income for Lloyd's in 2012 was £25.5bn and the total net resources of the Society and its members exceeded £20bn at the end of that year.

Lloyd's syndicates can comprise one single corporate member or any number of corporate and individual members, underwriting severally for their own account. There are currently 90 syndicates registered to underwrite insurance at Lloyd's. Each syndicate is managed by a managing agent. Managing agents manage the underwriting of insurance business on behalf of the member(s) of the syndicate, which receive profit or bear losses in proportion to their share in the syndicate for each underwriting year of account. There are 57 agents managing active syndicates. In addition, there are a number of inactive or 'run-off' syndicates, in respect of which financial statements must be prepared, until closure of the syndicate.

Each syndicate is organised into underwriting years of account. An underwriting year of account is subscribed to by one or more members, and is held open for a minimum of three years to conduct insurance business. The underwriting year is closed, and the final result

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determined, by a process called reinsurance to close (RITC) whereby the liabilities of the underwriting year of account are transferred to a later underwriting year of account of the same syndicate or another syndicate, in consideration of a payment by the ceding syndicate (the RITC premium).

In accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008, managing agents must prepare syndicate annual accounts under UK GAAP. Similarly, the Lloyd's Aggregate Accounts prepared by the Society of Lloyd's, which are an aggregation of the syndicate annual accounts, must also be prepared on this basis.

Developments in accounting requirements for insurance contracts

Lloyd's has been following closely the work that the FRC has undertaken with respect to reforming UK GAAP. We consider that the work that the FRC has successfully achieved in this respect, primarily the implementation of FRS102 'The Financial Reporting Standard in the United Kingdom and the Republic of Ireland', provides a succinct and streamlined set of accounting requirements for those entities which report under UK GAAP.

We also agree that the specialised nature of insurance justifies the development of a separate standard, FRS103, which should form an integral part of the 'new UK GAAP', and be implemented at the same time as and be consistent with the principles of FRS102.

We consider that the approach that the FRC has taken with respect to drafting FRS103, that is to base it on the existing IFRS4 'Insurance Contracts', but to supplement it with guidance taken from the current ABI SORP on 'Accounting for Insurance Business', as well as FRS27, to be sensible and appropriate. We also note FRC's intention that FRS103 as currently drafted is likely to be in place for a relatively short period pending developments on Solvency II and the IASB's 'Insurance Contracts' project. We therefore appreciate and support FRC's view that FRS103 will allow insurers to continue with their current accounting policies, whilst permitting improvements in line with FRS103.

We note that draft FRS103 contains disclosure requirements which will be new to UK GAAP preparers, having been taken from IFRS4. Whilst we consider that the additional disclosures are not onerous, we take the view that the requirements in respect of capital disclosure for both non-life and life insurance should be applied on a principles basis rather than on a prescriptive basis. In addition, the requirements should be applied on a proportionate basis reflecting the complexity of the risks presented by the insurer and its structure. For instance, we would expect the disclosures in respect of a Lloyd's life syndicate, which simply underwrites term life business and where policyholders are protected by Lloyd's overall chain of security, to be simpler than for a major life assurer writing multiple types of life assurance with investment products (see Question 6).

We also note that the provisions of FRS102 in relation to accounting for foreign exchange will reduce the options for the treatment of this under UK GAAP. We consider that this will create greater consistency in this area although for some entities, including some Lloyd's syndicates, this will require the restatement of 2014 comparatives given adoption of FRS102 in 2015.

Responses to questions set out in the FRED

Lloyd's responses to the specific questions set out in the FRED are attached as Appendix 1 to this letter.

I hope that the above and attached is of assistance but please do not hesitate to contact either myself or George Maina (George.maina@lloyds.com) should you have any queries or wish to discuss further.

Yours faithfully

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Appendix 1

Responses to FRC's questions set out in FRED49 'Insurance Contracts'

Question 1

Question

Do you support the introduction of draft FRS103, based on IFRS4 and incorporating many of the requirements of FRS27 Life Assurance and elements of the ABI SORP? Does it achieve its aim of allowing entities, generally, to continue with their existing accounting policies for insurance contracts? If not, why not?

Response

We support the introduction of draft FRS103. We appreciate the underlying approach of basing it on the current IFRS4, consistent with the approach used in FRS102 to base this on IFRS for SMEs. We consider, however, that there is valuable guidance contained within the ABI SORP and welcome the inclusion of this guidance in draft FRS103. We also appreciate that the requirements of FRS27 continue to be relevant for life insurance accounting and thus should also be incorporated in the draft standard.

We also concur with the FRC that entities generally will be able to continue with their existing accounting policies. We do note, however, that basing the draft standard on IFRS4 will result in additional disclosure requirements being applied to entities reporting under UK GAAP, specifically in respect of:

- reconciliations of changes in insurance liabilities, reinsurance assets and any related deferred acquisition costs;
- claims development triangulations at whole account level (see Question 5); and
- qualitative information about objectives, policies and processes for managing capital as well as a summary of capital managed (see Question 6).

Question 2

Question

Draft FRS103 paragraph 2.3 includes the 'improvement' options from IFRS4 (ie permitting entities to change accounting policies for insurance contracts in certain circumstances). Do you agree with the inclusion of these options in the draft FRS? If not, why not?

Response

We note the inclusion of the 'improvement' options, taken from IFRS4, in draft FRS103, and are content that this provision is available.

Question 3

Question

Draft FRS103 paragraph 1.5 requires new entrants to apply the same requirements as existing preparers in setting a benchmark for their accounting policies, but they are also permitted to utilise the improvement option where justified, in finalising their initial accounting policies.

Is there sufficient clarity on the application of the draft FRS by new entrants? If not, how should this be improved?

Response

This provision appears to apply the same requirements to new entrants, in terms of establishing accounting policies consistent with a base framework, and the implementation of improvements to these, as is set for existing entities. We therefore consider this approach to be reasonable.

Question 4

Question

Draft FRS103 includes paragraphs from IFRS4 on future investment margins. Paragraph 2.8 notes that an insurer need not change its accounting policies to eliminate future investment margins, however there is a rebuttable presumption that an insurer's financial statements will become less relevant and reliable if an accounting policy is introduced that reflects future investment margins in the measurement of insurance contracts (unless those margins affect contractual payments). Paragraph 2.9 describes how an insurer might overcome the rebuttable presumption.

Do you agree with the rebuttable presumption? If not, please describe your preferred measurement basis for insurance contracts and whether or not you would permit insurers to continue with their existing accounting policies in this area for the time being?

Response

This matter primarily concerns life assurance with related investment products, which is not underwritten at Lloyd's. We accordingly make no comment.

Question 5

Question

Draft FRS103 paragraph 4.7(c) (iii) has adopted the IFRS4 requirement for claims development disclosures. Is the data for these disclosures readily available to preparers?

Response

We consider that the information needed to report the claims development information as set out in this paragraph should be readily available to preparers, given that it is required at a high level only.

Question 6

Question

The requirement to provide capital disclosures is now contained in paragraph 34.31 of FRS102 and Section 3 of the draft Implementation Guidance provides only guidance on how those disclosures might be made by insurers with long-term insurance business, rather than mandating a particular presentation.

Do you believe this approach is appropriate in the context of applying draft FRS103 with FRS102? Will it have an impact on the usefulness of the disclosures to users of financial statements?

Response

We support that the approach set out in this paragraph of FRS102, which applies principles to be complied with in respect of both life insurers, and for the first time, non-life insurers using UK GAAP, in respect of capital disclosures.

We believe that the requirements should be applied on a principles basis rather than applying a prescriptive approach to disclosure. In addition, the requirements should be applied on a proportionate basis reflecting the complexity of the risks presented by the insurer and its structure. For example, we would expect the disclosures in respect of a Lloyd's life syndicate, which simply underwrites term life business and where policyholders are protected by Lloyd's overall chain of security, to be simpler than for a major life assurer writing multiple types of life assurance with investment products.

Question 7

Question

Do you think the guidance on providing capital disclosures, set out in Section 3 of the draft Implementation Guidance, should also be applicable to other financial institutions applying FRS102, such as banking entities?

Response

We have no comment to make on this question.

Question 8

Question

Draft FRS103, as with other accounting standards, is written in the context of a company and the relevant legal requirements. Appendix IV recognises that draft FRS103 applies to other entities, including mutual insurers established under the Friendly Societies Act 1992. Are there any requirements of the draft standard or accompanying draft Implementation Guidance that you consider require amendment in order to be applied by insurers other than companies?

Response

We consider that the principles of the draft FRS103 should be adhered to by all UK GAAP reporters conducting insurance business. As noted in our general comments above, Lloyd's syndicates prepare their annual accounts in accordance with UK GAAP as a requirement of the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008. However the approach to disclosure should be applied on a relevant and proportionate basis taking into account the complexity and structure of the insurer. For instance, the approach to be required in respect of capital disclosures (see Question 6), should reflect this.

Question 9

Question

Do you agree with the proposed effective date? If not, what alternative date would you propose, and why?

Response

We believe that the effective date of draft FRS103 should be aligned with that of FRS102 and thus support the proposal to apply it for accounting periods beginning on or after 1 January 2015.