Insurance accounting – mind the UK GAAP

The ABI's response to the ASB's discussion paper

Introduction

1. The ABI is the voice of insurance in the UK. It has over 300 members, accounting for some 90% of premiums to the UK insurance industry, which manages investments amounting to 26% of the UK's net worth.

2. The ABI is grateful to the Accounting Standards Board (ASB) for the opportunity to respond to its discussion paper, *Insurance accounting – mind the UK GAAP.*

ABI comments

3. We acknowledge the difficulties facing the ASB in seeking to determine the future of insurance accounting in the UK, and accordingly we welcome the ASB's initial consultation through a discussion paper.

   The long-term solution

4. We agree in principle with the ASB's proposal that the long-term solution is to incorporate IFRS 4 Phase 2 into UK GAAP. That is in line with the ASB's aim for UK GAAP to minimise inconsistencies with IFRS, especially for recognition and measurement, and it helps achieve the associated benefits. It avoids the challenges to developing a comprehensive alternative (and the associated cost) that the Phase 2 project itself has shown to be formidable. It maximises the coherence between the various standards to be applied by insurers, because of the IASB's underlying framework and standard development processes. And it allows users to make comparisons between insurers applying UK GAAP and those applying IFRS.

5. The scope for any amendments or clarifications to the Phase II standard for use in the draft FRS 102, or in the reduced disclosures proposed in draft FRS 101, will need to be assessed when the Phase II standard is finalised. At that stage, the ASB might need to consider again the position of smaller insurers that could find it burdensome to produce perhaps quite different figures for accounting and solvency purposes without significant compensating benefits.

   The gap period

6. We favour the inclusion of IFRS 4 into UK GAAP, as proposed by the ASB in its draft FRS 102. We emphasise the benefits of the grandfathering process in enabling existing practices to be retained, whilst allowing improvements. This approach is also consistent with the long-term solution and reduces the need to make significant changes in what may be quick succession.

7. We acknowledge that there may be some downsides to this approach. But we think they may be overplayed. For example, the application of the ABI SORP,

Accounting for Insurance Business, already ensures the application of FRS 26, and it achieves consistency of practice that grandfathering could continue. Although IFRS 4 permits improvements, we are not aware that this has caused a significant loss in comparability in UK listed companies' accounts since the adoption of full IFRS in 2005.

8. We consider the downsides to the three other options to be much more significant:

   - Embedding the relevant rules of FSA's Realistic Capital regime into UK GAAP is likely to achieve largely the same accounting result as incorporating IFRS 4 into UK GAAP, but at a much higher cost. Also, updates would be required to permit the improvements that the IFRS 4 route would allow as a matter of course;

   - Using Solvency II (which has not yet been finalised) as a basis would be to graft onto accounting requirements an approach that has quite different objectives. Accordingly, it neither ensures coherence with the requirements of other accounting standards nor is comprehensive enough - for example, in not covering profit recognition. Further, this option is likely to be the most difficult and costly to follow;

   - Incorporating Phase II into UK GAAP before the Phase II standard is finalised brings an unacceptable risk of successive changes. Further, we do not think it appropriate that insurers applying UK GAAP should have comply with a Phase II standard before listed insurers are obliged to do so.

9. We have not identified any other option that we would invite the ASB to consider further.

10. Lastly, we highlight the need to ensure the options to be developed take appropriate account of legal constraints. We understand from the European Commission that it intends to review the requirements of the Insurance Accounts Directive (IAD) when the IASB's Phase 2 project is complete. In the meantime, however, UK insurers using UK GAAP are of course subject to Companies Act requirements that are specific to insurers and are almost wholly derived from the IAD. The Regulations under Companies Act 2006 include some detailed requirements for presentation, measurement and disclosure in insurers' accounts.

11. We will be happy to help the ASB develop its proposals in the light of its consultation responses, taking into account the implications for the ABI SORP.

Association of British Insurers
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