

Michelle Sansom  
Accounting Standards Board  
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Dear Michelle

#### **INSURANCE ACCOUNTING STAFF PAPER – MIND THE UK GAAP**

Lloyd's welcomes the opportunity to comment on the proposals contained in the above document, which we have reviewed in the context of the broader Accounting Standards Board's (ASB) consultation on the Future of UK GAAP.

#### **Background regarding 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 2011 was £23.5bn and the total net resources of the Society and its members exceeded £19bn 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 were 88 syndicates registered to underwrite insurance at Lloyd's in 2011. 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 were 57 agents managing active syndicates in 2011. 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.

The Corporation of Lloyd's oversees the market, setting standards, approving business plans, providing services to support its activity and managing the Lloyd's Central Fund.

Lloyd's syndicates prepare their accounts in accordance with UK GAAP. The annual accounts of each Lloyd's syndicate are aggregated into Lloyd's Aggregate Accounts in

accordance with the Insurance Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008. The accounts of the Corporation of Lloyd's and its subsidiaries, including Lloyd's Central Fund, are prepared using IFRS. Finally, Lloyd's prepares the Pro Forma Financial Statements so that the financial results of Lloyd's and its members taken together and their net assets can be compared with general insurance companies.

### **ASB's consultation**

Our responses to the questions in the paper are set out in the appendix to this letter.

In summary we share ASB's view that in the longer term, IFRS4 Phase II should be adopted into UK GAAP, once the final version has been issued by IASB and adopted for use in the EU. However, this standard should not be incorporated uncritically into FRS102 (ie UK GAAP) without a proper assessment of the position of UK insurers. Any such assessment should be undertaken with the objective of ensuring proportionate financial reporting. In the meantime, we favour the retention of the ABI SORP requirements within UK GAAP as this would mean that insurance undertakings will not currently incur any additional costs in relation to insurance accounting until such time as IFRS4 Phase II is implemented.

Should you wish to contact us about any comments please feel free to do so.

Yours sincerely



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Lloyd's Market Finance

### 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 IFRS4 Phase II into UK GAAP, when issued by the IASB and adopted for use in the EU?

#### Lloyd's comments

**Yes it should, once the final version has been issued by IASB and adopted for use in the EU. However, this standard should not be incorporated uncritically into FRS102 (ie UK GAAP) without a proper assessment of the position of UK insurers. Any such assessment should be undertaken with the objective of ensuring proportionate financial reporting.**

### 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?

#### Lloyd's comments

**Yes, we agree that all aspects of the problem have been identified.**

- (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?

#### Lloyd's comments

**We prefer the option, "Embed the relevant rules of FSA's Realistic Capital regime into UK GAAP", which would effectively retain the current requirements set out in the ABI SORP. We are not in support of the other solutions because of the reasons stated below:**

#### ***Incorporate Current IFRS 4***

**Incorporating the current IFRS 4 requirements would mean that insurance companies could grandfather their existing accounting practices as well as having an option to update those accounting policies that would lead to their financial statements being more relevant. This approach could result in insurance companies implementing accounting changes requirements twice, ie implement current IFRS4 and later IFRS4 Phase II once this is available. In addition, it could lead to reduction in comparability of financial statements.**

***Incorporate IFRS4 Phase II as it is available***

This project is still ongoing and the requirements are still not finalised. Incorporating the latest position may lead to additional costs as the final standard may end up being different from the version incorporated into FRS102, thus resulting in insurers having to implement accounting changes twice.

***Incorporate Solvency II into UK GAAP***

Solvency II is balance sheet focussed as this is aimed at protecting the policy holder unlike accounting standards which are aimed at providing useful information to investors and other users of financial statements. There are a number of key differences between IFRS4 Phase II as currently proposed and Solvency II. For example, recognition of 'day 1' profit is allowed under Solvency II; and contracts are recognised on a bound basis under Solvency II while this is on an inception basis under IFRS4 Phase II. In these cases the Solvency II treatment, although valid for regulatory purposes, is not appropriate for financial reporting. In addition, the final version of the IFRS4 Phase II may be quite different from Solvency II. This again would result in insurers having to implement significant accounting changes twice.

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

***Lloyd's comments***

We prefer to keep the status quo until such time as the long term solution, to incorporate IFRS4 Phase II into UK GAAP, can be implemented. This would mean that insurance undertakings will not currently incur any additional costs in relation to insurance accounting until such time as IFRS4 Phase II is implemented.

- (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).

***Lloyd's comments***

As noted in the main letter, Lloyd's syndicates, and Lloyd's when preparing the Aggregate Accounts and Pro Forma Financial Statements, currently apply UK GAAP in the preparation of financial statements. We consider that the impact of any change under our preferred solution would be minimal. However, the impact of the other options proposed by the Accounting Standards Board would be substantial, with significant costs being incurred to meet changes in the reporting requirements. We do not consider that this

**would be worth it in terms of potential benefits to users of the accounts recognising that there would need to be further changes once the final version of IFRS4 Phase II is implemented.**

