

Accounting Standards Board Consultation Paper: 'The future of UK GAAP'

Lloyd's welcomes the opportunity to comment on Accounting Standards Board's (ASB) consultation paper, '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. These syndicates can comprise one single corporate member or any number of corporate and individual members, underwriting severally for their own account. There are over 80 syndicates registered to underwrite insurance at Lloyd's in 2010. Each syndicate is managed by a managing agent. Managing agents write 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 over 50 managing agents managing active syndicates in 2010. In addition, there are a number of inactive or 'run-off' syndicates also managed by managing agents, 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 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).

Each member is required to provide capital to support its underwriting at Lloyd's. The capital requirement is calculated by syndicates on a risk based methodology in accordance with the FSA's Individual Capital Adequacy (ICA) requirements. The ICAs are increased from the FSA's minimum requirement (by an uplift of 35% in 2010) to provide an extra buffer to support Lloyd's financial strength and rating. This increased amount is known as the Economic Capital Assessment (ECA). Capital is provided by members in line with the ECA of the syndicates to which they subscribe to support their underwriting. This capital is known as funds at Lloyd's (FAL).

The Society of Lloyd's comprises the Corporation of Lloyd's and its subsidiaries, and the Lloyd's New Central Fund. Among other things, the New Central Fund exists to meet, at the discretion of the Council of Lloyd's, valid policyholder claims where these cannot be met from syndicate or member assets.

The managing agent, in respect of each syndicate, is required to prepare syndicate annual accounts (which show the transactions for all underwriting years of account of a syndicate in aggregate) and, subject to certain exceptions, syndicate underwriting year accounts (which show the transactions by underwriting year of account) in accordance with UK GAAP. The Society itself prepares its own financial statements (consolidating the financial position of the Corporation of Lloyd's and Central Fund) under IFRS. The Society also prepares an aggregation of the syndicate annual accounts under UK GAAP and a pro forma set of financial statements (also under UK GAAP) which are an aggregation of syndicate annual accounts, members' FAL and the financial statements of the Society of Lloyd's.

Total gross written premiums for the market were nearly £18bn in 2008. The total assets of the market as at 31 December 2008 were in excess of £67bn.

Responses to the questions from the ASB re its policy proposal

1. Which definition of Public Accountability do you prefer: the Board's proposal (paragraph 2.3) or the current legal definitions (paragraph 2.5)? Please state the reasons for your preference. If you do not agree with either definition, please explain why not and your proposed alternative would be?

The Board's proposal is preferred to the legal definition as it is more appropriate for the need to reflect the substance of 'public accountability'.

However, we do have some concerns regarding the Board's definition of public accountability. We believe that the definition is too high level and does not provide sufficient clarity as to which entities would be caught by the definition and which entities would fall outside it.

We propose that the Board should revisit its definition of public accountability and be more specific.

2. Do you agree that all entities that are publicly accountable should be included in Tier 1? If not, why not?

As noted in our answer to question 1, we believe that the definition is very high level and more clarity is required. However, if the definition is clarified and amended as appropriate, we agree that all entities that are publicly accountable should be included in Tier 1.

However within the group of 'publicly accountable entities', there will be occasions where it will be appropriate for the disclosure requirements to be modified where such disclosures would not be of material benefit to users of the accounts of the entity concerned, compared with the effort required to make the disclosures, or would not be relevant or potentially misleading. Accordingly ASB should, when finalising its requirements, make provision for such arrangements.

3. Do you agree with the Board's proposals that wholly-owned subsidiaries that are publicly accountable should apply EU adopted IFRS? If not, why not?

Yes. Publicly accountable entities owe their first responsibility of accountability to the public (users of the financial statements). Hence regardless of their ownership status, wholly-owned subsidiaries should ensure that they make adequate disclosures in their financial statements. The application of the EU adopted IFRS will ensure this required transparency and accountability is achieved.

4. Do you still consider that wholly-owned subsidiaries that are publicly accountable should be allowed reduced disclosures? If so, it would be helpful if you could highlight such disclosure reductions as well as explaining the rationale for these reductions.

No, see comments in 3 above.

5. Do you agree with the Board's proposal that the IFRS for SMEs should be used by 'Tier 2' entities?

Yes. IFRS for SMEs require fewer disclosures compared to the EU adopted IFRS. Tier 2 entities do not have any public accountability; hence they would not need to prepare extensive disclosures which would not be useful to the reader of the financial statements. In some cases, these entities would be wholly-owned subsidiaries and users of these accounts would not require these extensive disclosures required by EU adopted IFRS since these disclosures are also presented in the consolidated financial statements.

6. Do you agree with the Board's proposal that the IFRS for SMEs should be adopted wholesale and not amended? If not, why not? It would be helpful if you could provide specific examples of any amendments that should be made, as well as the reason for recommending these amendments.

Yes.

7. Do you agree with the Board's proposal that large Non-Publicly Accountable Entities should be permitted to adopt IFRS for SMEs? Or do you agree that large entities should be required to use EU adopted IFRS? Please give reasons for your view.

Yes, we agree that large Non-Publicly Accountable Entities should be permitted to adopt IFRS for SMEs. This is because we believe that the level of disclosures made by entities should be determined by the level of accountability and not the size.

8. Do you agree with the Board that the FRSSE should remain in force for the foreseeable future?

N/A

9. Do you agree that the FRSSE could be replaced by the IFRS for SMEs after an appropriate transition period, following the issuance of the IFRS for SMEs?

N/A

10. Do you agree with the Board's current views on the future role of SORPs? If not, why not?

Yes. SORPs are there to fill the gap left by the accounting standards and they also provide more clarity. These SORPs should be reviewed and only those that cover areas/issues not covered by IFRS should be retained. This could include accounting requirements specific to insurers.

11. Do you agree with the Board's proposal to develop a public benefit entity standard as part of its plans for the future of UK GAAP? If not, how should (converged) UK GAAP address public benefit entity issues?

N/A

12. If you do agree with the proposal to develop a public benefit entity standard, should the standard cover all the requirements for preparing true and fair view accounts or should it cover only those issues where IFRS or the IFRS for SMEs needs to be supplemented for the public benefit entity sector?

N/A

13. Do you agree the issues listed in the above table are distinctive for the public benefit entity sector and should therefore be covered in a public benefit entity standard? What other issues might the proposed standard include?

N/A

14. The Board accepts there may be a continuing need for guidance to supplement a public benefit entity standard in sectors such as charities, housing and education. Where this is the case, do you think the Board should provide a Statement confirming the guidance is consistent with UK GAAP, including the public benefit entity standard?

N/A

15. If you are an entity whose basis of preparing financial statements will change under these proposals, what are the likely effects of applying those new requirements? Please indicate both benefits and costs and other effects as appropriate. If you are a user of financial statements (such as an investor or creditor) what positive and negative effects do you anticipate from the implementation of the proposals set out in this paper?

There are a number of benefits and costs associated with the adoption of either EU adopted IFRS or IFRS for SMEs.

Benefits

- Comparability of financial information with those of similar entities in other territories.
- Consistency of reporting (including convergence of accounting policies)
 - (i) Syndicates/corporate members with a EU publicly listed parent or members of other international groups already produce IFRS data for inclusion in the consolidated accounts under IFRS
 - (ii) US entities may be producing consolidated IFRS accounts from 2014 (with transition from 2012), hence syndicates with US parents may be required to provide IFRS compliant information.
 - (iii) The economic balance sheet (except technical provisions) within the Solvency II framework is predicated on an IFRS Balance Sheet.

Costs

- Entities may require significant additional resources to produce the necessary information for the increased and extensive financial statement disclosures under IFRS reporting.
- Entities with parents incorporated in jurisdictions that will not have adopted IFRS may have to produce two set of numbers.
- If the implementation of IFRS is done before the finalisation and adoption of IFRS Insurance Contracts Phase II, it could lead to additional costs relating to a 'double' conversion.

Other - IFRS Insurance contracts project – Phase II

There continues to be uncertainty over the timing of IFRS Phase II. We understand that an exposure draft is planned to be issued in May 2010 and the publication of a final standard in 2011, with possible implementation from 2012. However this project has been the subject of considerable delay and we consider that there is potential for further delay due to the expected level of debate regarding this matter and the broadening of the project to involve FASB.

16. What are your views on the proposed adoption dates?

We consider that mandatory implementation for financial periods starting in 2012 is ambitious. We propose that the adoption is put on hold until IFRS Phase II and IFRS 9 are finalised. Hence, we recommend that the adoption date be revised to 2013 or 2014 as this would enable the timing to be synchronised. However entities should be permitted voluntary adoption in 2012.