Sir Bryan Carsberg
IASC Secretary-General
166 Fleet Street
London EC4A 2DY
United Kingdom

Re: Comments on the IASC Issues Paper on Insurance

Dear Sir Bryan,

I have the pleasure to send you, herewith enclosed, ISVAP's comments on IASC Issues Paper on Insurance.

ISVAP (Istituto di Vigilanza sulle Assicurazioni Private e di Interesse Collettivo) is the Italian authority responsible for supervision over insurance and reinsurance companies. The provisions regulating its activity assign ISVAP not only powers concerning prudential supervision and consumers protection, but also specific competences in accounting matters. More precisely art. 6 of legislative decree Nº 173 of 26th May 1997 has vested ISVAP with powers regarding:

a) integrations, revisions, explanatory and enforcement instructions on the annual accounts and consolidated accounts of supervised insurance and reinsurance undertakings;
b) supplementary or more detailed information as well as the documents required for the performance of its statutory duties;
c) the chart of accounts that supervised insurance and reinsurance undertakings must adopt.

Therefore the Issues Paper by the IASC Steering Committee on Insurance is in our opinion a very important document, which is being examined and discussed in detail both at a national level and, together with the other Member States' supervisory authorities, in the competent fora of the European Union, OECD and IAIS.

ISVAP has therefore welcome IASC's invitation to make its contribution to the Issues Paper.

Moreover, as already stated in the competent fora, ISVAP agrees on the objectives to improve the comparability of financial statements of insurers from different countries and, more in general, to raise information standards in favour of all users. In this scenario ISVAP is aware that the establishment of a single set of accounting principles uniformly adopted represents an essential tool for the creation of efficient financial and capital markets, both at a European and at a global level, and believes that this aim is consistent with that of market stability.

However, and this is of paramount importance for the authority responsible for insurance supervision, the pursuit of this goal must absolutely not leave out the need to take into due consideration the specific features of insurance and the primary need to protect policyholders.

In fact not only do financial statements provide information to investors, they also constitute the main documentary basis for measuring an undertaking's assets, liabilities and economic trend for legal, fiscal and supervisory purposes.

The technical features of insurance business (e.g. inverted financial cycle, uncertainty about the assessment of costs and long-term activity), together with the need to protect the confidence between the insurer and the insured make it necessary to apply a special accounting model and valuation criteria, which allow to maintain the undertaking's solvency conditions over time.

ISVAP's comments to the Issues Paper have been made expressly with a view to pursuing the above-mentioned purposes. These remarks, worked out on the basis of the experience gained in the field of supervision and accounting regulation and enforcement, may be further developed when drawing up the draft accounting standard, i.e. once its basic guidelines are defined more in detail.

Annex I focuses on some of the basic issues; Annex II examines the specific remarks to some Issues and Sub-issues.

Once again I underline our interest to give a contribution to the future discussions on the draft IASC Accounting Standard on insurance. Of course I remain at your disposal for any further information you may need.

Kind regards

the President
(Giovanni Manghetti)

ANNEX I

ISVAP GENERAL COMMENTS ON SOME ASPECTS OF THE IASC ISSUES PAPER ON INSURANCE ACCOUNTING STANDARD

1. Scope

We agree with the approach by the Steering Committee on Insurance (SC) on the information scope of accounting, according to which information must be general and intended for investors, policyholders, creditors, supervisors and anyone who is interested to know the financial situation and the economic performance of the undertaking.

However, we must underline that the tentative conclusions drawn by the SC seem to favour information for investors rather than that necessary for the other users. As regards some aspects, the SC does not always duly take into account the peculiar characteristics of uncertainty of the insurance operation and inversion of its production cycle, which require a prudential approach different from that applicable to other enterprises. In this regard the need to inform the market must combine with other general interests linked to the survival of the undertaking and protected by public supervision.

2. Insurance contracts and insurance enterprises

With regard to the basic issue of the object of the accounting standard, we believe that the adoption of an accounting approach of the institutional type, centred on the insurance enterprise and not on contracts, better serves the purpose to represent the insurance transaction. As a matter of fact it allows to consider the whole insurance process – acceptance of the risk, offsetting of risks in space and time, management of the resources collected from policyholders, settlement and payment of commitments – in a coherent way that takes the specific features of this operation into account.
On the other hand, operations which seem to have no bearing on the procedure (such as those connected with the investment of the enterprise's own funds) should take account of the management framework in which they are performed – having considered the peculiarity of the insurance operation.
This approach is consistent with the regulatory framework to which, at least in the EU countries, the exercise of insurance business belongs: the insurance enterprise is licensed to carry on insurance business in compliance with specific regulations which envisage a sole business purpose. The insurance enterprise as such therefore represents the sole entity to which the insurance operation must be referred.
Nonetheless this does not exclude that the standards envisaged for an insurance enterprise follow the same guidelines as those envisaged in general, and that – if it is not necessary – they do not wander from them.

3. Reference Accounting Model

As is well known, the main elements peculiar to the insurance activity are:

- the inversion of the financial cycle: premium income – which is certain – precedes the outlays arising under contractual obligations – which are uncertain as to the *an* and/or the *quantum* and the when;
- the consequent need to handle the uncertainty in the assessment of income (when the contract is issued) and the costs of insurance benefits (after the contract is issued and also after its term);
- the long-term activity which is reflected on the determination of the tariff (based on a multi-annual statistical analysis) as well as on the quantification of technical commitments (which most of the times implies a long-term perspective).

These characteristics require the application of particularly prudent standards of measurement, which allow to maintain the solvency conditions over time and to represent results according to a long-term perspective. Therefore we believe it necessary to adopt *ad hoc* accounting models which eliminate the distortions deriving

from the financial disalignment of benefits and, at the same time, take account of the uncertainty typical of insurance assets and liabilities measurement.
The model used in Europe was worked out in view of these requirements. It can be classified as Deferral and Matching according to the categories defined by the SC. This system, under which the objective of the accounting of insurance contracts is to correlate costs and income, according to the principle of accrual, seems fully consistent with the representation of the insurance transaction.

By way of example, some consequences deriving from the application of this model can be summed up as follows:

- a share of premiums is deferred to the following financial year and recognised as income in the relevant contract period (provision for unearned premiums). In accordance with the peculiarities of the insurance activity and in particular with the fact that it is a contract providing a service, the deferral of a share of the premium is essential for the respect of the principle of accrual. Moreover it avoids that there are profits from shares of premiums for which the insurance cover and therefore the obligation on the insurer are still effective. The respect of the principle of prudence is anyhow guaranteed by the supplementary provisions envisaged in order to allow for unfavourable trends in claims (provision for unexpired risks – premium deficiency).
- Catastrophe and equalisation reserves have been envisaged. These reserves fulfil technical requirements, given that they are aimed to maintain stability in technical results and diversify the portfolio over time, in line with the long-term perspective linked to the procedure for the pricing of certain categories of risks.
  Catastrophe reserves guarantee the offsetting of the results over time by envisaging a specific provision to meet the commitments arising out of the occurrence of events with a low frequency but a very high economic impact.
  The setting up of equalisation reserves is particularly important for those portfolios where evidence has shown a very high volatility of technical results over time, for example for those risks that are affected by economic cycles, such as the risks in credit insurance.

In our opinion the *Asset and Liability Measurement* accounting model proposed by the SC does not serve, in principle, the purpose to represent the insurance transaction just as good. In fact this approach makes it more difficult to give a financial and economic reporting consistent with the long-term perspective of this business if we give adequate consideration to the prudential requirements on which the measurement of insurance assets and liabilities must necessarily be based.
In order to provide adequate information for financial statements users we also think that the ALM approach does not give a better presentation of an insurance enterprise's financial position if we consider the distorting effects connected to the high variability of economic results which would be produced by its application.
On the other hand a more thorough study of the two models' application details – both as regards recognition and measurement (mainly of liabilities) – could highlight aspects which would make the impact of the different approaches on accounting items not incompatible with each other.

4. Use of fair value in the measurement of insurance assets and liabilities

SC recognises that "*… at this time, it is often difficult to estimate the fair value of assets and liabilities created by insurance contracts on a reliable, objective and verifiable basis. Therefore, the Steering Committee intends to develop further guidelines to address estimation…".*

Although in the long run, SC proposes the adoption of fair value measurement for insurance assets and liabilities arising under insurance contracts and defines it as *… "the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction".*

We are rather perplexed about the methodological approach used; in fact the proposal is to extend to the insurance sector valuation models which are being revised and now partially applied with some difficulties to economic sectors which – at least from an accounting point of view – are less peculiar than the insurance sector.

At any rate here are some general remarks on the fair value principle, made on the basis of the elements given in the Issues paper.

As to assets it must be duly taken into account that the insurance process (including the investment of resources covering commitments) must be represented in a unitary and coherent way, keeping in mind the specific allocation of assets. A consequence of this should be the application of calibrated valuation methods, possibly different from those adopted for enterprises in general.

Moreover we would like to remind that both IAS 39 and the recent proposal to amend the IVth EC directive exclude the use of fair value for assets which shall be kept until their maturity, as well as for those whose fair value cannot be determined in a reliable way. In other words the application limits of a full fair valuation are still recognised; these limits are more evident in case of assets such as loans and properties, which play a major role in the financial statements of insurance enterprises. On the other hand if liabilities were valued at their fair value this would imply mismatches, which are incompatible with the objective of consistency in the valuation of assets and liabilities.

At any rate we think that the choices about assets valuation standards must derive from those made in relation to liabilities and, in particular, to technical reserves.

As to measuring insurance liabilities, it does not seem that the application of the fair value as defined by the SC makes it possible to determine an enterprise's commitments towards policyholder correctly. The purpose of measuring insurance liabilities is the quantification of future payments to be made by the insurer (e.g. premium reserve, mathematical reserve) as well as of the amount of debts caused by past events until their complete extinction (e.g. provision for claims outstanding). Therefore it is not appropriate to refer to an "exchange value" for their valuation.

As to the calculation of the commitment to be met we think that the best estimate of liabilities arising under insurance contracts can only be given by the company's managers and actuaries, who know the elements necessary for the valuation, although we recognise the need for guidelines which make it possible to limit the discretionary character of measurements, thus favouring financial statements' comparability.

Moreover, having considered that the exchange of insurance liabilities occurs only in very rare cases and on the basis of information not available to all operators we can say that there is no reference market and consequently no reference objective exchange value. On the basis of the same considerations we do not understand, for instance, how the risk adjustment mentioned by the SC can be determined by following the market's indications in the same way as the value of a listed share.

Moreover, the absence of a reference market undermines the role played by the fair value as the best expression of the value of the "cost (profit) opportunity" combined with an enterprise's assets (liabilities). In fact it is difficult to refer to the concept of "cost opportunity" lacking the conditions allowing the easy settlement of positions.

Besides, we note that FASB defines fair value as *"an estimate of the price an entity would have realised if it had sold an asset or paid if it had been relieved of a liability on the reporting date in an arm's-length exchange motivated by normal business considerations. That is, it is an estimate of an exit price determined by market interactions"*.
On the basis of the above considerations it is clear that the conditions mentioned by FASB in order to obtain an appropriate estimate of the fair value cannot be found in relation to insurance liabilities. In fact once again we would like to point out that they are usually maintained by the enterprise until they are completely discharged and are not exchanged on a liquid and active market.
At any rate, apart from general comments we would like to point out that a more detailed judgement on the appropriateness of fair value in measuring insurance liabilities shall be possible only once the SC has explained the application methods of this principle.

5. Disclosure

We share the need pointed out by the SC to define disclosure in a detailed and exhaustive way, given the important role it plays also in relation to the actual comparability between the financial statements of insurance companies from various countries.
At this stage of the project, however, we do not make specific remarks on each Issue and Sub-issue, for, as pointed out also by the SC, the information to be submitted is the direct consequence of the criteria adopted in the valuation of the items peculiar to the insurance enterprise.

ANNEX II

ISVAP DETAILED COMMENTS ON THE IASC ISSUES PAPER

Basic issue 1: Should the project cover all aspects of accounting by insurers (insurance enterprises) or should it focus mainly on insurance contracts of all enterprises?

As anticipated in Annex I, we believe that the adoption of an accounting approach of the institutional type centred on insurance enterprises and not on contracts better serves the purpose to represent the insurance transaction, in particular because it allows to consider the whole insurance process in a coherent way.
This has a remarkable significance, for instance, for with-profits life assurance contracts, in which the valuation of technical reserves is influenced by the accounting criteria used for assets according to contract terms (see Basic issue 9).
Moreover, an approach based on the insurance contract, with the consequent application of a set of standards to the insurance enterprise, would be feasible if within the different standards due consideration were given to the above-said specific

features and the links between the different elements connected with the pursuit of the insurance process.

Sub-issue 1A: Should the project cover all aspects of accounting by insurers or should it focus mainly on insurance contracts of all enterprises?

The project should cover all aspects of accounting by insurers because insurance business is pursued by the insurance enterprise and its peculiarities call for a specific approach.
If in other jurisdictions contracts similar to the insurance one are issued by other enterprises, rules similar to those envisaged for the insurance enterprise should apply.
Although following this approach it is clear that with regard to aspects not requiring a specific treatment (which should be marginal) regulations should not differ from general ones.

Sub-issue 1B: How should insurance contracts be defined?

We think that insurance contract is a contract sold by a licensed insurance company (see commentary in Basic issue 1).
At any rate it could be useful to give a definition of insurance operation (the definition of insurance contract should involve juridical aspects which may lie outside the scope of this project).
In this latter case it is essential to refer to a definition which thoroughly reflects its economic profiles.
It is therefore of paramount importance to underline that it cannot be defined, as other financial instruments, by making reference only to the exchange of financial benefits, given that there are elements typical of the contract for the provision of a service.
In fact, the insurance contract is a means to sell the service of "protection from risks": a certain and quantified financial benefit (premium) corresponds to an insurance service definable as the "coverage of insured risks", which can materialise as a financial benefit. If, after the premium has been paid, the insured event does not occur, the insurer does not have to pay any financial benefit, although he has anyhow provided insurance protection, i.e. a coverage for a future and uncertain event, during the contract term. The provision of a "protection" service, even in the absence of any financial consideration, implies that the enterprise must start the insurance process and sustain the relevant costs.

More precisely, we believe that the definition given by the SC *"a contract under which one party (the insurer) accepts an insurance risk by agreeing with another party (the policyholder) to make payment if a specified uncertain future event occurs"* can be supplemented with the following elements:

- first of all it would be useful to envisage a reference to the "insurable interest", that is to the existence of a relation between the policyholder and the risk. This element defines the reason, i.e. the economic function, of the insurance contract and highlights its features of contract providing a service;
- given that the definition should focus on the economic aspects of the insurance operation, it would be useful to refer to the process of technical mediation, which consists in transferring the risk from the single policyholder to a pool of homogeneous risks *(pooling of risks).* This process is the basis for the determination of the premium and the commitments arising under the insurance

contract and represents an element that distinguishes the insurance contract from any other contract having similar purposes (i.e. issuing of bank guarantees).

Sub-issue 1D: Should an enterprise assess whether a contract creates insurance risk only at inception of the contract or throughout the life of the contract?

The insurance risk runs throughout the life of the contract.

Sub-issue 1E: Should an enterprise account separately for the components of insurance contracts that bundle together an insurance element and other elements such as an investment element or an embedded derivative?

In most cases, unbundling is not practicable. It must be considered that life assurance products typically have a more or less marked financial component. If this component contributes to determine insurance payments (i.e. linked to the uncertainty of the event), it must not be unbundled.
Taking account of the economic and technical substance, the contract can be unbundled when it includes two technically distinct subcontracts, one with insurance elements and the other with financial elements - i.e. a unit-linked contract where the value of shares is paid at the expiry date or on death, or where a fixed additional capital is paid on death: this is the case of a contract for underwriting a (financial) common trust and a temporary policy on death.
In this regard the conditions set by the SC for the unbundling should be explained better.

Sub-issue 1G: Should financial guarantees be treated as insurance contracts or as (other) financial instruments?

We agree with the SC. In fact, the financial guarantees under a) do not have the features of the insurance operation described in the remarks on Sub-issue 1B.

Sub-issue 1H: Should product warranties be included in the scope of the project?

We agree with the SC.

Sub-issue 1I: Should the project deal with accounting by insured enterprises?

The accounting project should deal only with insurance enterprises. In fact, for insured enterprises, insurance is a protection against risks and not their business.

Sub-issue 1J: Should the project deal with employee benefit plans?

We agree with the SC.

Sub-issue 1K: Is the distinction between general insurance and life insurance important? if so, how should the distinction be made?

With a view to underlining the economic and technical differences between general insurance and life insurance, which are essential, in our opinion the approach proposed

by SC is too simplistic, since it does not allow to establish the real differences between the two insurance activities such as risk development over time and the fact that the claim payment can be provided more than once.

Sub-issue 1M: Should different accounting requirements be set for different types of insurer or for insurers with different legal forms?

In principle, we agree with the SC.

Sub-issue 1N: Should specific guidance be given on self-insurance?

We agree with the SC.

Basic issue 2: Should the project deal with financial instruments (other than insurance contracts) held by insurers?

We believe that the accounting of all the insurance process, including the investment phase, must be based on a coherent and uniform approach. Moreover, also in case of operations without any apparent connection to the process such as the investment of funds not allocated to cover specific insurance commitments, the relevant management framework must always be taken into account.
However this does not exclude that marginal operations alien to the process must follow standards set for undertakings in general.
We must anyhow take into account that, in view of the concerns over the application of IAS 39 expressed so far at various international meetings, the objective of full fair valuation of assets does not seem easy to attain.

Basic issue 3: Should IASC issue provisional guidance on certain aspects of insurance accounting or disclosure?

Considering the long period required for the adaptation to a new system, an interim guidance will be necessary if IASC will move toward fair value in order to obtain a readily understandable, relevant, reliable and comparable information.

Basic issue 4: What should be the overall objectives of a recognition and measurement system for insurance contracts?

Sub-issue 4A: Should the project focus on general purpose financial statements?

See General Comments.

Sub-issue 4B: Should IASC use the IASC Framework as a basis for developing an international accounting standard on insurance?

We agree with the SC position that it is desirable that insurance accounting is integrated into the IASC framework. However, the reference to a framework must in no way prevent the possibility of taking the specific features of insurance business into account: for example, the list of assets and liabilities must not leave out some technical

items typical of the insurance process only on the grounds that they do not meet the definition given by IASC.

Sub-issue 4C: What should be the overall objectives of recognition and measurement in accounting for insurance contracts?

See General Comments**.**

Basic issue 5: To what extent should the measurement of an insurer's assets affect the measurement of its liabilities?

We agree on the fact that the homogeneity of the valuation method adopted for assets and liabilities is a principle to adhere to. However we cannot assume that, in principle, the valuation of liabilities be independent from the valuation of assets. The insurer shall meet its commitments by using assets. Having considered the close connection between assets and liabilities in insurance management we therefore think that the assumptions adopted in the valuation of assets must be taken into account in the valuation of liabilities. Community regulations on the maximum rate which can be used in the valuation of reserves is an example of it (art. 18 of directive 92/96/EEC).

Basic issue 6: What assumptions and conventions should be used in measuring insurance liabilities?

Sub-issue 6A: Should the unit of account be individual contracts or groups of similar contracts?

The need to prudently calculate the amount of liabilities implies that the object of valuation must, in principle, be the single contract (the analytical approach is adopted by Community regulations).
Synthetic approaches can also be adopted whenever it can reasonably be assumed that they do not lead to different valuations. These approaches can sometimes be an essential basis of valuation. It must be anyhow pointed out that the analytical approach must not prevent the portfolio from being taken into consideration as a whole, whenever it is necessary to evaluate its consistence and composition (valuation of the reserve for unexpired risks – premium deficiency – or valuation of the risk adjustment).

Sub-issue 6B: Should there be an implicit or an explicit approach to assumptions?

We agree with the SC.

Sub-issue 6C: Should assumptions reflect current information at the date of the financial statements or long-term expectations?

Having considered the above peculiarities of insurance business we think that the assumptions should reflect long-term expectations, obviously based on all present and past available information relating to the risk valuation.

Sub-issue 6D: Should measurement reflect the market's expectations or the insurer's expectations?

We believe that measurement must reflect the insurer's expectations, obviously based on the information available both on the market and inside the company.
The concept of risk adjustment required by the market seems merely theoretical to us and difficult to define in its application. We need a clear definition of "market expectations". Moreover we wonder what the insurer's behaviour should be if there are no directly observable "market expectations".

Sub-issue 6E: Should assumptions reflect all future events that will affect the amount and timing of cash flows?

According to the EU directive and the SC's view, liability measurement should "reflect the entire cost of the claim", thus technical provisions should be sufficient to allow the insurance company to meet any liabilities arising out of insurance contracts as far as it can be reasonably foreseen.

Sub-issue 6F: Should the measurement of assets and liabilities arising from insurance contracts reflect risk and uncertainty?

The measurement of liabilities arising out of insurance contracts should reflect risk and uncertainty that arise from the assumptions used.
Nevertheless we confirm that the risk adjustment required by the market is a theoretical concept, difficult to define in its application.
In fact *"arm's length transactions between knowledgeable, willing parties"* do not exist for insurance liabilities. It is also unrealistic to rely on reinsurance prices to evaluate insurance liabilities.
At any rate this valuation should be referred to the principle of the "prudent valuation" as defined by the third directives, i.e. "a valuation that shall include an appropriate margin for adverse deviation of the relevant factors". This valuation must be left to the insurance company's administrators and auditors, who have the necessary valuation elements.
As recognised by the SC, determining the adjustment for risk is inevitably subjective; therefore, guidance on this topic is necessary.

Sub-issue 6G: When and how should an insurer account for changes in assumptions about future cash flows and actual experience that differs from assumptions?

We agree with the tentative SC's view.

Basic issue 7: What assumptions and conventions should be used in accounting for general insurance contracts

Sub-issue 7A: Should alternatives to the annual basis of accounting be prohibited, permitted or required?

We agree with the SC's view.

Sub-issue 7B: Should an insurer recognise a liability for claims payable?

We agree with the SC's view.

Sub-issue 7C: Should an insurer recognise a liability for unexpired risk?

We disagree with the SC's recommendation to recognise a liability for unexpired risks (see General Comments). We think that present European regulations on the reserve for unearned premiums and the reserve for unexpired risks (premium deficiency) should be kept, since – although in a perspective approach – they guarantee an adequate level of prudence.

Sub-issue 7D: Should acquisition costs be deferred and recognised as an asset?

We do not agree with the SC's firm refusal of any possibility to defer acquisition costs. In fact we believe that an alternative solution must be sought, so that deferred acquisition costs can be reported as assets, even if they do not fall within the definition of assets given by IASC. In this way undertakings that have been newly set up or are marketing new products can show as assets part of the costs that have been sustained for the purpose of acquiring the relevant portfolio and have therefore increased its value.
In this regard we also point out that this recognition is consistent with the accounting approach currently used in Italy. This approach correlates costs with the relevant income without leading to any double counting, as envisaged by the SC, since only acquisition costs reported in the profit and loss account of the financial year can be deducted from gross premiums written when calculating the provision for unearned premiums.

Sub-issue 7E: If acquisition costs are deferred and recognised as an asset, how should they be measured?

In our system deferred acquisition commissions can be shown as intangible assets and include the residual share of acquisition commissions paid in advance when the contract is concluded with reference to its whole term.

Sub-issue 7F: How should an insurer account for recoveries related to claims?

We totally disagree with the compensation of potential recoveries from other entities and liabilities towards policyholders, since it is a basic accounting principle not to compensate debts and receivables on different entities.

Sub-issue 7H: Should provisions for catastrophes or equalisation be required, permitted or prohibited?

We do not agree on the fact that these provisions are not liabilities. If there are specific technical conditions they lead to a representation of the insurer's commitments and therefore represent liabilities (see General Comments).

Sub-issue 7I: Should general insurance liabilities be measured using present value (discounting) techniques?

We think that the adoption of discounting techniques in the calculation of the provision for claims outstanding implies a lessening of guarantees which cannot be accepted unless under rigorous conditions. Discounting, in fact, is an appropriate operation if flows are certain as to their timing and amount, two missing features in the provision for outstanding claims. Moreover, from a practical viewpoint on top of the subjective

elements already present in the measurement of future debit flows would come those ensuing from the difficulty in calculating the timing of payments and the rates of interest to be used.
Moreover, to take account of the significance of a prudent valuation of the provision for claims outstanding for an undertaking's stability it must be pointed out that:

- discounting rewards undertakings which are less efficient as regard the claims payment speed;
- discounting may delay supervisory action as, in comparison to insurers with the same equity, and in the case of a financially inadequate management, deficits in the margin emerge slowly (and even more sluggish in the case of slow claims paying insurers);
- the insurer that discounts provisions enters the amount of claims outstanding in the annual accounts with a value inferior to that of the ultimate cost, which can lead to disparities in the treatment of guarantees for insured and injured parties in case of compulsory winding-up in respect of insurers that work on the basis of the ultimate cost.

The subject-matter of technical reserves in non-life insurance is being studied by a working group set up within the Conference of EU Insurance Supervisors and chaired by Italy. The report by the group will provide useful elements for measuring the practice of discounting the provision for outstanding claims.

Sub-issue 7J: If present value techniques are used, what discount rate is appropriate?

We definitely need guidance on the choice of the discount rate.

Basic issue 8: What assumptions and conventions should be used in accounting for life insurance contracts?

Sub-issue 8A: Are the conclusions reached in previous issues applicable to life insurance?

In general, the same basic perplexities and objections already raised for non-life insurance apply to life assurance.
Moreover, in order to formulate more precise remarks it seems indispensable to find a criterion that distinguishes between life and non-life insurance business without any uncertainty and taking account of the existing differences (see comments to Sub-issue 1K).

Sub-issue 8C: Should the various assets and liabilities created by a life insurance contract be combined into a single recognition and measurement scheme?

We agree that the insurer's right and obligation under a contract create a single net liability.
However we do not agree with the SC's approach and its proposal for an accounting model by groups of contracts. More specifically, as regards the calculation of technical reserves, this solution does not seem to be in line with directive 92/96/EEC, which - in principle - calls for an analytical calculation of reserves that takes account of adverse variations of the risks as well as of the commitments to be met by contract.

Sub-issue 8D: Should IASC prescribe a single accounting model for life insurance activities?

We agree with the SC's conclusions that liabilities should be evaluated according to the perspective method and their amount should not be lower than that resulting from the retrospective approach.
We also think that all insurers should use the same assets and liabilities accounting criterion.

Basic issue 9: Are there any specific accounting issues for participating (with-profits) contracts?

First of all we would like to remind that – despite the recent development of index-linked and unit-linked policies – 53% of the Italian life assurance portfolio still consists of policies subject to re-appraisal. For these policies the insurance benefit increases year by year according to the yield of special separate managements, funded through assets representing the mathematical reserves of these contracts. The annual yield earned from separate managements, which is mostly retroceded to policyholders and consolidated, is calculated, as envisaged by policy conditions, according to the net yields obtained.
Consequently any changes to the accounting principles as formulated by the SC would not seem in line with these types of contracts.

Sub-issue 9A: Should unallocated divisible surplus be recognised as a liability or as equity?

According to the contract terms of the above-mentioned policies in force in Italy profits must be included in the contract's mathematical reserves.

Sub-issue 9B: Does a mutual insurer have equity?

First of all we must say that there is only one mutual insurer on our national market; then we would like to point out that according to present regulations these insurers must have adequate assets (guarantee fund) and in line with those required for limited companies in order to meet statutory solvency requirements.

Sub-issue 9C: Should insurers recognise allocations to participating policyholders as an expense or as an appropriation of equity?

We agree with the SC's assumption that allocations to participating policyholders are an expense for the enterprise.

Sub-issue 9D: Are any specific disclosures needed about participating (with-profits) contracts?

We share the SC's view that it is necessary to guarantee utmost disclosure and information for policyholders as to the methods of distribution of profits.
In Italy the aforecited separate managements are audited every year by an auditing company which certifies the correct calculation of profits. Every year companies must inform holders of these contracts as well as of unit-linked and index-linked policies of the amount of the new insurance benefit.

Basic issue 10: Are there any specific accounting issues for reinsurance contracts?

Sub-issue 10A: Is the distinction between direct insurance and reinsurance important enough to warrant different accounting treatments?

We agree with the SC's conclusion.

Sub-issue 10B: Should a ceding insurer recognise gains or losses when it enters into a reinsurance transaction?

Recognition of gains or losses at the inception of a reinsurance transaction is not consistent with the accounting approach chosen (Deferral and Matching – General Comments); furthermore, in most cases (i.e. non-proportional reinsurance treaties), a reliable estimate is totally unrealistic.

Sub-issue 10C: Should a ceding insurer recognise separate assets and liabilities arising from reinsurance arrangements, or should amounts be offset against related ceded liabilities?

We agree with the conclusion of the SC.

Sub-issue 10D: How should a ceding insurer report revenue and expenses from reinsurance arrangements?

We agree with the SC's recommendation.

Sub-issue 10E: When if ever, should a reinsurance arrangement be treated as an extinguishment of liabilities?

In Italy, the insurer has a legal obligation towards policyholders; consequently a reinsurance arrangement can never be treated as an extinguishment of liabilities.
It is therefore crucial that the accounting principle takes into account this legal obligation.

Basic issue 11: What issues are raised by use of fair value in the measurement of insurance obligations?

Sub-issue 11A: Are insurance contracts financial instruments?

We believe that insurance contracts are primarily service contracts which include a financial component (see Sub-issue 1B).

Sub-issue 11B: Should insurance contracts be included in a fair value standard?

Apart from what we said in the general remarks as to fair value valuation we would like to point out that full fair value accounting for financial assets raises a number of questions about the insurance business. In particular, in insurance management assets derive from premiums statistically representing liabilities and therefore follow the

duration of the contract risk; consequently one should first focus on the valuation of liabilities and then turn to assets (and not the reverse).
Besides, participations in life assurance contracts are calculated - by contract - on the basis of the realised financial gains and it is impossible to change the existing contracts.
Finally, guidance is crucially needed for the valuation of assets when markets are not sufficiently liquid and deep.