AVIVA

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Seema Jamil-O'Neill, Project Director - Insurance
Accounting Standards Board
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Dear Ms Jamil-O'Neill,

We welcome the invitation to comment on the options presented in the recent staff paper "Insurance Accounting – Mind the UK GAAP".

We recognise that the gap between the commencement of Solvency II (and the withdrawal of existing solvency regulations) and the commencement of IFRS 4 Phase II presents a significant challenge for UK insurers. We support the ASB's approach in seeking to address this issue and to provide guidance to ensure consistency of approach across the UK industry.

About Us

Aviva provides around 43 million customers with insurance, savings and investment products. We are the UK's largest insurer[1] and one of Europe's leading providers of life and general insurance.

Aviva adopted IFRS in its consolidated financial statements in 2005. IFRS was also adopted for financial reporting by all material UK and Irish subsidiaries of the Group at the same time. The Group therefore no longer has any material entities reporting under UK GAAP. Aviva is listed on the London and New York Stock Exchanges.

Summary

- **We have a strong preference for maintaining the existing "grandfathered" accounting treatment for insurance contracts, until the commencement of IFRS 4 Phase II.** This solution would have the lowest overall costs and present the fewest technical problems. We believe this would enable preparers and users of the financial statements to focus on the adoption of IFRS 4 Phase II and avoid the duplication of effort and potential confusion that would arise from adopting two fundamental changes in accounting for insurance contracts in the space of three or four years.

- **Transitioning the measurement of insurance contracts to a Solvency II basis for financial reporting would not be a practicable option.** Fundamental questions about the suitability of Solvency II as a basis for the reporting of financial

[1] Based on aggregate FY10 UK life and pensions sales (PVNBP) and general insurance gross written premiums.

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performance remain to be answered. This approach would also involve significant costs. Adopting Solvency II for financial reporting as a temporary measure would likely mean two fundamental shifts in the reporting of insurance contracts in close succession, increasing costs for preparers and diminishing the period on period comparability of insurance company financial statements.

- **Transitioning to a version of IFRS 4 Phase II based on an exposure draft issued by the IASB is also likely to be impracticable.** This approach is also likely to require two significant changes in insurance contract financial reporting. Given the progress of the development of IFRS 4 Phase II so far, we believe the risk of significant changes between the exposure draft stage and the final standard stage is high. Therefore in practice this approach would have many of the drawbacks of adopting Solvency II for financial reporting.

Applicability of changes in UK GAAP to entities that prepare financial statements in accordance with IFRS

Changes in UK GAAP will be required for entities that report under UK GAAP. However, for entities that report under IFRS, our understanding is that current IFRS 4 does not require insurance entities to adopt any changes in local GAAP or regulation after the date of initial adoption of IFRS. Insurance entities can voluntarily adopt changes as improvements in financial reporting if they meet the tests of relevance and reliability in IFRS 4. Therefore any changes in UK GAAP or regulation would not necessarily require a change in Aviva's IFRS financial statements. This approach was tested in 2007 following a change to the FSA's regulatory rules for calculating technical provisions, and also in 2010 with respect to changes to US GAAP which were not adopted by European IFRS reporters who use 'grandfathered' US GAAP for measuring technical provisions of their US subsidiaries.

We would strongly encourage the ASB to focus its efforts on raising awareness of the need for a consistent global accounting standard for insurance contracts and to influence the IASB to complete the insurance contracts project within a reasonable timeframe so as to minimise the period between the withdrawal of the current regulatory based approach and the availability of the new accounting standard

The attached appendix provides further details of our assessment of the options presented in the staff paper.

We would be happy to discuss any of the matters raised in this letter further, please contact myself or my colleague, Jo Clube, in this regard.

Yours sincerely,

David Rogers.

David Rogers

Chief Accounting Officer

Appendix

1. Impact on insurance companies that prepare financial statements in accordance with IFRS

Section 2.1(b) of the staff paper states that: "*Any changes in insurance accounting requirements under UK GAAP will impact accounting for insurance contracts by these* [IFRS] *reporting entities in the short term, to the extent that their accounting refers to FRS 27 and/or the ABI SORP.*"

Our understanding of IFRS 4 is that this is not automatically the case.

IFRS 4, Paragraph 22, states that "*An insurer may change its accounting policies for insurance contracts if, and only if, the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs.*"

The use of the word "may" in this requirement establishes that any change in accounting policy for insurance contracts is at the discretion of the entity – any voluntary change must meet the tests set out, but there is no requirement for when a change must be made.

Therefore a change in UK GAAP or regulation will not automatically require a change in accounting policy under current IFRS 4, as an insurer could continue with its existing accounting policies, grandfathered at the time of adoption of IFRS, amended for any voluntary improvements since that point.

2. Possible Short Term Solutions

The staff paper rightly identifies the period between the effective date of Solvency II and the effective date of IFRS 4 Phase II as a period of uncertainty for insurers that report under IFRS using grandfathered UK GAAP for some or all of their business.

Both Solvency II and IFRS 4 Phase II are major changes to the financial reporting and regulation of insurance companies, which currently, and in the future, require significant management time and resources, systems changes, and discussion with external users of our financial statements. We believe it is appropriate that time and focus should be devoted to these long term changes in financial and regulatory reporting for the industry, and therefore any interim approach for the "gap" period should require the minimum diversion of effort consistent with maintaining the objectives of financial reporting.

2.1. Option I *Incorporate the current version of IFRS 4 into UK GAAP* & Option II *Embed the relevant rules of FSA's Realistic Capital regime into UK GAAP*

As discussed above, IFRS 4 allows insurance companies that report under IFRS to continue with their existing reporting basis once Solvency II is effective. Therefore options I (Incorporate the current version of IFRS 4 into UK GAAP) and II (Embed the relevant rules of FSA's Realistic Capital regime in UK GAAP) would not change the accounting policy choices already available to Aviva or entities in a similar position, although it would allow current UK GAAP reporters to grandfather their existing MSSB.

Continuing with current accounting policies will require that systems for calculating insurance liabilities under current solvency regulations are maintained after the effective date of Solvency II, with associated costs. While this is far from optimal, it is preferable to the adoption of a change in accounting model as an interim solution prior to the adoption of IFRS 4 Phase II. We believe the ASB should focus its efforts on applying its influence to the completion of the IASB's Insurance contracts project so as to reduce the period in which entities have to maintain their grandfathered accounting systems.

We note that the staff paper notes that the continuance of existing accounting policies is the least favoured option amongst users surveyed. We support the objective of IFRS Phase II to introduce greater consistency in financial reporting across global insurers, and we believe time and resources should be focussed on ensuring that this objective is met. Continuing with existing reporting basis until IFRS 4 Phase II will be no worse in terms of comparability that the current position.

2.2. Option III *Update FRS 27 and the ABI SORP for Solvency II requirements*

As noted above, incorporation of Solvency II requirements into FRS 27 and the ABI SORP would not automatically mean that current IFRS reporters would adopt this change.

Our initial view is that adopting Solvency II for IFRS reporting in the interim period before the effective date of IFRS 4 Phase II would incur costs significantly greater than the benefits it would bring.

A number of technical issues would have to be resolved for this approach to be implemented, most significantly how performance would be measured and recognised given that Solvency II is designed to give a "point in time" view of an entities solvency and does not address the presentation of movements between one period's position and the next. Income statement presentation for IFRS Phase II has been the subject of discussion by both the IASB and industry groups and as yet no method for Phase II has been settled.

Devising an income statement presentation approach for Solvency II based financial reporting would likely require significant time and resources and it is not clear if this could be resolved before the effective date for Solvency II.

If the "Solvency II" income statement approach differs significantly from the presentation approach adopted for IFRS 4 Phase II this will require preparers and users of the financial statements to understand and adapt to two significant changes in reporting in a relatively short time span. Even if the income statement approach for "Solvency II" based reporting matches IFRS 4 Phase II as closely as possible, they will inevitably be significant differences due to conceptual differences between the approaches – for example the lack of a residual margin in Solvency II and the recognition of day one profits.

2.3. Option IV – *Incorporate IFRS 4 Phase II into UK GAAP*

As stated above we support this in principle as a long term solution for UK GAAP, although it will not be of direct relevance to Aviva.

Currently we are not proposing to early adopt IFRS 4 Phase II when it is issued. Given the significance of this change for our financial reporting, and the potentially difficult transition requirements we believe the full period from publication to mandatory effective date will be required for adoption of this standard.

We believe adopting an accounting standard based on an IASB exposure draft would not be appropriate. In our view there is a very high risk that material changes will be made to the exposure draft before issue of the final standard, based on the high level of stakeholder interest in, and comment on, previous exposure drafts.

Adopting a reporting approach based on a subsequently superseded exposure draft would require two significant shifts in financial reporting in a relatively short period of time, similar to Option II above.

3. Preferred short term solution

As set out above, under IFRS 4 Aviva is not required to adopt any changes in financial reporting for insurance contracts unless it voluntarily opts to do so.

Our preferred approach is to maintain our existing reporting basis until IFRS 4 Phase II becomes effective.

While this approach will have significant costs attached to it (principally through maintain the systems used to calculate existing Solvency I insurance liabilities) we believe these would be significantly lower than the costs involved with adopting Solvency II for IFRS reporting or early adopting IFRS 4 Phase II (especially if based on an exposure draft).

We believe that focusing on IFRS 4 Phase II as the key change in financial reporting, and devoting resources to this transition, including internal and external education, will best serve the needs of Aviva and the users of our financial statements.

4. Long-term proposals

The Aviva Group consolidated financial statements, and the individual financial statements of its UK and Irish subsidiaries are prepared in accordance with IFRS. Therefore the long term future development of UK GAAP is not currently of direct relevance for our financial reporting. However, we are monitoring the ASB's proposals for the future of UK GAAP and FRS 102 and will consider the implications for our stand alone subsidiary financial statements. If IFRS 4 Phase II results in a globally accepted standard for the measurement of insurance contracts in principle we would agree that UK GAAP should incorporate this standard.