

# MARKET BULLETIN

REF: Y4085

<b>Title</b>	Results of market consultation to consider possible adoption of International Financial Reporting Standards (IFRS) by the Lloyd's market
<b>Purpose</b>	To advise the outcome of the market consultation regarding possible adoption of IFRS by the Lloyd's market
<b>Type</b>	Event
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<b>Date</b>	3 December 2007

## Deadline

## Related links

### Purpose

To report the outcome of the recent market consultation regarding whether the Lloyd's market should adopt International Financial Reporting Standards (IFRS).

### Policy decisions

Adoption of IFRS for **syndicate annual accounts and Lloyd's aggregate accounts** will not be considered until a final IFRS Phase II insurance standard has come into effect. This is unlikely to be before 2012.

**The Lloyd's pro forma financial statements (PFFS)** will continue to be prepared using UK GAAP for the time being but further consideration will be given to collecting additional data in the annual returns to allow the PFFS to be presented on an IFRS basis. If adopted, this would not occur before 2010 (with comparatives for 2009), and a decision with respect to this will be advised to the market by late 2008.

### Background

Lloyd's syndicates and the Lloyd's aggregate market accounts adopted UK GAAP in 2005. In late 2006, Executive Team approved a project to consider whether Lloyd's syndicates and the Lloyd's aggregate market accounts should adopt IFRS.

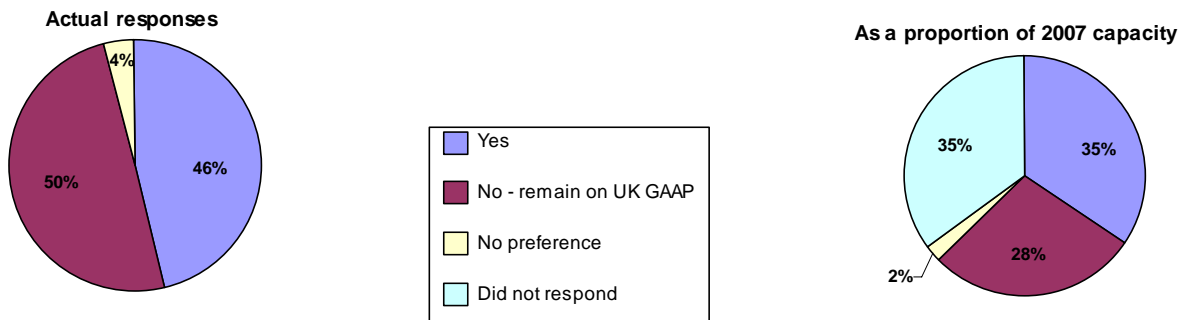
A working group was set up, comprising of Lloyd's, the LMA and market practitioners, to consider the key issues, adoption options and proposed timetable associated with the possible adoption of IFRS by Lloyd's syndicates.

Based on the work performed by this group, a consultation paper seeking the views of market participants was issued in July with a deadline for response by the end of September. A good response was received from the market: 26 formal responses were received including 19 from managing agents representing 65% of 2007 market capacity. In addition, the non-responding managing agents were contacted by telephone and their feedback was in line with that of the formal respondents.

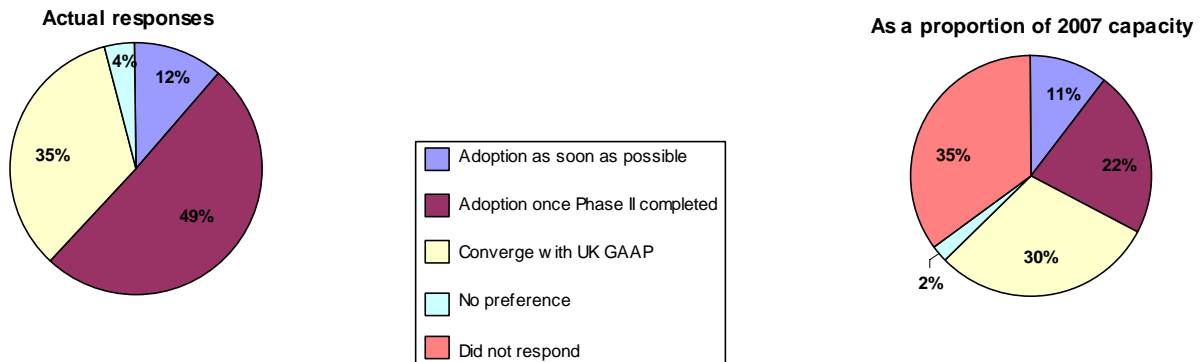
Attached at Appendix 1 is the detailed report on the consultation, including a summary of the responses received and Lloyd's observations thereon.

**Summary of formal responses**

***Do you think the market should move to IFRS?***



***If the decision is made to adopt IFRS, which timing option do you think is most appropriate?***



### **Syndicate annual accounts and Lloyd's aggregate accounts**

Adoption of IFRS by syndicates (and for the Lloyd's aggregate accounts) will not be considered until a final IFRS Phase II insurance standard has come into effect, as:

- IFRS Phase II will have a fundamental impact as an insurance specific standard
- The priority for Lloyd's and market practitioners in the next few years in this respect is to ensure that sufficient resources are dedicated to the proper evaluation and preparation for the implementation of Solvency II and IFRS Phase II, recognising the common aspects and impact of these projects. In particular, both models feature a similar three part basis of valuing insurance liabilities, being a best estimate, less a discount for the time value of money, plus a risk margin. We have made a response to the IASB's recent discussion paper on this matter.
- A 'two stage' conversion (before and after IFRS Phase II) would be resource-consuming with regard to agent staff, processing, IT and audit costs. The market's recent move to UK GAAP represented a major exercise in terms of time and effort. Therefore a single conversion to IFRS after the implementation of Phase II would be more preferable by allowing for a period of stability within the market.
- If IFRS is adopted, we will take into account the lessons learned from the conversion to UK GAAP in 2005. In particular, we would collect the comparatives a year earlier, rather than collecting them at the same time as the 'first year' data, as we did when converting to UK GAAP.
- Syndicates would also need to prepare for new IFRS specific disclosures, such as development tables, which would require the presentation of information for periods earlier than the comparative period (as much as 10 years earlier).
- There are no significant changes planned for UK GAAP other than the potential impact of a reporting standard in line with IFRS Phase II concerning insurance contracts. The Accounting Standards Board's technical plan is to adopt a phased approach to convergence of UK standards with IFRS. The ASB's technical plan is based on the current IASB timetable; if UK GAAP were to adopt the IFRS Phase II concepts (as would reasonably be expected), conversion to IFRS at that time would not present a material issue in respect of the other changes required.

### **Lloyd's pro forma financial statements (PFFS)**

- The PFFS will continue to be prepared using UK GAAP for the time being but further consideration will be given to the collection of additional data to allow the presentation on an IFRS basis.
- Lloyd's will consider further the workload which this would create for the market and how we could assist the market in this respect, balancing this with the perceived benefits of presenting the PFFS using IFRS. As part of this, we will consider the views of users of the PFFS including ratings agencies and other external analysts.

- The main changes would be in relation to additional disclosures in relation to investments.
- Such a conversion would not be to 'full' IFRS as it would not be meaningful or possible to aggregate the additional IFRS disclosure requirements in respect of each syndicate and thus generic disclosures would be provided. The PFFS would, therefore, continue to be 'pro forma' accounts, particularly in view of the inclusion of members' letters of credit on the balance sheet.
- If a decision is made to go down this route, the PFFS would only be presented in this format from 2010 (with comparatives for 2009) at the earliest. Such move would more than likely necessitate a move to IFRS (post Phase II) by syndicates, as maintaining both UK GAAP and IFRS records would be inefficient.
- Annex A of the report attached at Appendix 1 sets out the outline project plan relating to this matter.

### **Queries**

Any queries relating to this bulletin, the report on the consultation or IFRS in general should be submitted by e-mail to Glenn Carrick in Market Finance ([glenn.carrick@lloyds.com](mailto:glenn.carrick@lloyds.com)).

This bulletin is being sent to the compliance officer of all managing and members' agents, direct participants, recognised accountants and market associations.

John Parry  
Head of Market Finance

**Consideration of adoption of IFRS by Lloyd's syndicates**  
**Outcome of Market consultation**  
**Summer 2007**



# Consideration of adoption of IFRS by Lloyd's syndicates Outcome of Market consultation - Summer 2007

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## 1 Executive summary and outcome

1.1 Adoption of IFRS for **syndicate annual accounts and Lloyd's aggregate accounts** will not be considered until a final IFRS Phase II insurance standard has come into effect. This is unlikely to be before 2012. This is because:

- IFRS Phase II will have a fundamental impact as an insurance specific standard.
- The priority for Lloyd's and market practitioners in the next few years should be to ensure that sufficient resources are dedicated to the proper evaluation and preparation for the implementation of Solvency II and IFRS Phase II, recognising the common aspects and impact of these projects. In particular, both models feature a similar three part basis of valuing insurance liabilities, being a best estimate, less a discount for the time value of money, plus a risk margin.
- A 'two stage' conversion (before and after IFRS Phase II) would be resource-consuming with regard to agent staff, processing, IT and audit costs. The market's recent move to UK GAAP represented a major exercise in terms of time and effort. Therefore a single conversion to IFRS after the implementation of Phase II would be more preferable by allowing for a period of stability within the market.
- If we adopt IFRS, we will take into account the lessons learned from the conversion to UK GAAP in 2005. In particular, we would collect the comparatives a year earlier, rather than collecting them at the same time as the 'first year' data, as we did when converting to UK GAAP.
- There are no significant changes planned for UK GAAP other than the potential impact of a reporting standard in line with IFRS Phase II concerning insurance contracts. The Accounting Standards Board's technical plan is to adopt a phased approach to convergence of UK standards with IFRS. The ASB's technical plan is based on the current IASB timetable; if UK GAAP were to adopt the IFRS Phase II concepts (as would reasonably be expected), conversion to IFRS at that time would not present a material issue in respect of the other changes required.

1.2 The **Lloyd's pro forma financial statements (PFFS)** will continue to be prepared using UK GAAP for the time being but further consideration will be given to collecting additional data in the annual returns to allow the PFFS to be presented on an IFRS basis. If adopted, this would not occur before 2010 (with comparatives for 2009):

- Lloyd's will consider further the workload which this would create for the market and how we could assist the market in this respect, balancing this with the perceived benefits of presenting the PFFS using IFRS. As part of this, we will consider the views of users of the PFFS including ratings agencies and other external analysts.
- The main changes would be in relation to additional disclosures in relation to investments.
- Such a conversion would not be to 'full' IFRS as it would not be meaningful or possible to aggregate the additional IFRS disclosure requirements in respect of each syndicate and thus generic disclosures would be provided. The PFFS would, therefore, continue to be 'pro forma' accounts, particularly in view of the inclusion of members' letters of credit on the balance sheet.

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- If a decision is made to go down this route, the PFFS would only be presented in this format from 2010 (with comparatives for 2009) at the earliest. Such move would more than likely necessitate a move to IFRS (post Phase II) by syndicates, as maintaining both UK GAAP and IFRS records would be inefficient.
- The approach to this project is outlined at Annex A to this report. The results of this review will be advised to the market by late 2008.

## **2 Background**

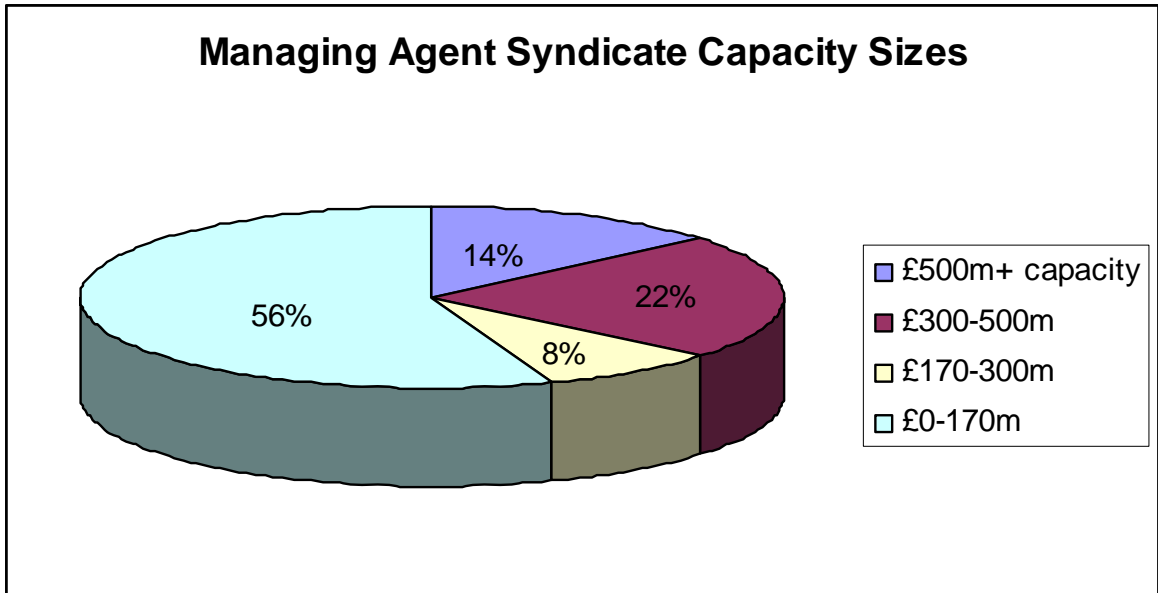
- 2.1** Following on from the successful move of syndicate annual accounts as well as Lloyd's aggregate market accounts to UK GAAP for financial years commencing on or after 1 January 2005, in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 ('the Regulations'), it was deemed appropriate to consider whether Lloyd's syndicates and the Lloyd's aggregate market accounts should adopt International Financial Reporting Standards (IFRS).
- 2.2** The Lloyd's Executive Team approved the formation of a working group jointly by Lloyd's and the Lloyd's Market Association (LMA) in late 2006. The principal objective of this group was to consider the key issues, adoption options and proposed timetable associated with the adoption of IFRS by Lloyd's syndicates.
- 2.3** Based on the work performed by this group, a consultation paper seeking the views of market participants was issued in July 2007. Respondents were invited to comment either generally on the contents of this paper, or specifically to questions which in general tried to ascertain the appetite for adoption, and if relevant the favoured implementation and timing options. Responses to specific questions have been analysed in section 4. General comments have been noted under section 5.
- 2.4** Currently the annual reports produced by managing agents comprise the following:
- Syndicate annual accounts - audited annual report of a syndicate showing the annual result for all underwriting years combined (prepared under UK GAAP).
  - Underwriting year accounts – audited report on each underwriting year which has reached the three year stage or beyond, prepared under the three-year accounting basis, and only required if the syndicate is not exempted from preparing these accounts under the Regulations (UK GAAP).
- 2.5** Currently the accounts produced by Lloyd's are:
- Society accounts – the consolidated audited financial results of the Corporation of Lloyd's and its subsidiaries and associates, and the Lloyd's Central Fund (IFRS).
  - Aggregate Accounts - audited annual report, aggregating all syndicate annual accounts, required to be prepared by the Regulations (UK GAAP).
  - Pro forma financial statements (PFFS) - audited annual report, aggregating the aggregate accounts, Society accounts and incorporating members' funds at Lloyd's (FAL), in order to present an overall financial report for the activities of the Society of Lloyd's comparable with the accounts of other insurers (UK GAAP).



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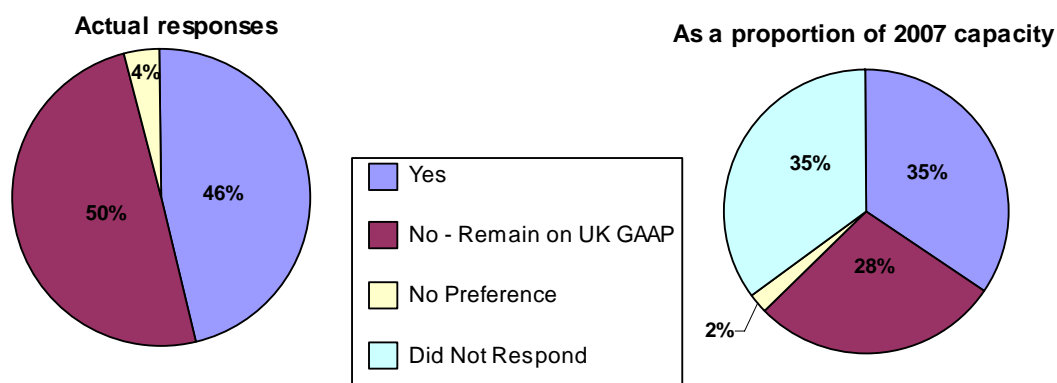
**3 Overview of responses**

In total 26 responses were received consisting of 19 managing agents, 4 auditors, 1 service provider, 1 members' agent and 1 from the LMA. Managing agent respondents represented 65% of the 2007 year of account market capacity and also covered a wide spectrum in respect of syndicate capacity size and type, analysed as follows:



#### 4 Summary of market responses to specific questions

##### 4.1 Question 1a: Do you think the market should move to IFRS?



##### 4.1.1 46% (35% of 2007 capacity) of respondents say market should adopt IFRS:

- Comparability (10 respondents)  
 Syndicate accounts would have greater comparability with the rest of the international insurance market as well as other financial sectors. In the long term entities reporting under the same basis should result in greater transparency and comparability.

*Lloyd's comment: Lloyd's is supportive of the development of a global accounting standard that will aid comparison between entities within a similar industry or sector, irrespective of where they are domiciled.*

- Reporting efficiencies (6 respondents)  
 A key driver for adoption of IFRS would be the requirements of Solvency II. The expected similarities between Solvency II and Phase II measurement model for the valuation of insurance liabilities would mean that syndicates will be substantially following a similar approach in applying these. Therefore syndicates will benefit from efficiencies by having their financial and regulatory reporting broadly aligned. Furthermore, a majority of capital providers have to produce group accounts using IFRS, therefore it would result in a cost and resource saving for such groups as they will be able to report their Lloyd's activities under the same basis.

*Lloyd's comment: The market should not view the two projects (ie Solvency II and IFRS Phase II) in isolation, but should strive to benefit from the various similarities to reduce costs and time employed for their regulatory and financial reporting. Furthermore, we are currently assessing the possible impact on the Lloyd's market of the US Securities and Exchange Commission's recent decision to relax the US GAAP reconciliation requirement for foreign companies preparing financial statements under IFRS as issued by the IASB.*

- Public accountable entities (1 respondent)  
 The ASB has suggested that all publicly accountable entities in the UK such as banks and insurance companies should report under IFRS. Based on the definition in the scope section of the draft IFRS for small and medium-sized entities, both the Society and syndicates would be regarded as publicly accountable entities

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*Lloyd's comment: Emphasises the need for a continuing assessment of the potential impact of IFRS adoption as well as the effect that the proposed Phase II changes would bring about on their financial results and reporting.*

- **Investors** (1 respondent)

Investors will be able to interpret syndicate accounts more easily as they will be reporting on the same accounting basis as that of listed company accounts.

*Lloyd's comment: Lloyd's members represent a diverse global background, many of which would report in a different reporting basis in their country of origin as to that currently employed by Lloyd's. At present, the primary difference under IFRS is the accounting for investments, while that for insurance contracts is still under the local GAAP provisions for Phase I of IFRS insurance contracts. We therefore do not perceive the accounting basis of Lloyd's to have a significant impact on potential investors.*

### 4.1.2 50% (28% of 2007 capacity) of respondents say Lloyd's should not adopt IFRS:

- **Cost versus benefit** (6 respondents)

Increased disclosure levels and accounting complexities would require significant investment in systems and resources, which will not necessarily bring about more meaningful accounts. Due to the aforementioned complexities as well as the need to exercise judgements, there is a concern that accounts may be even less clear. Furthermore, the PFFS would never be fully compliant with IFRS due to the need to aggregate rather than consolidate numbers and to impute notional investment income.

*Lloyd's comment: The ASB is committed to UK GAAP ultimately converging with IFRS. Therefore increased investment in resources and systems as well as increased reporting requirements will ultimately be a reality for syndicate financial reporting. We will consider the issues preventing the publishing of a fully compliant IFRS PFFS, and whether it is possible to overcome these stumbling blocks. However, we believe the areas of non-compliance with IFRS would not necessarily exceed the benefit to users through the application of the other feasible IFRSs.*

- **Comparability** (6 respondents)

Reporting will diverge significantly from US GAAP which is used by many of Lloyd's closest competitors (e.g. Bermudian based groups writing predominantly speciality risks including reinsurance) as well as many of Lloyd's capital providers. Currently, there are few differences between UK GAAP and US GAAP, and these differences are well understood. At present there is no clear indication as to whether US GAAP will converge with IAS/IFRS as far as accounting for insurance contracts is concerned. There is a further concern that it could also restrict access for potential new participants who apply a basis more comparable to UK GAAP.

*Lloyd's comment: Due to anticipated UK GAAP convergence with IFRS, significant reporting differences with Lloyd's US GAAP reporting peers will be inevitable if FASB does not move to converge with IFRS. We do not perceive the accounting basis to be a significant stumbling block to new entrants. In our experience, new entrants' concerns are generally focused on other issues such as costs, capital requirements, Lloyd's underwriting guidelines and oversight.*

- **Instability** (2 respondents)

The market is still coming to terms with move to annual accounting. Another change so soon would only lead to more confusion amongst key stakeholders. Another key concern is that IFRS is still evolving within the insurance sector and there is no real clarity as to

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where and how it will converge with Solvency II, which could result in an extended period of instability.

*Lloyd's comment: Based on the experience of the market's move to UK GAAP, it is essential that a full understanding of the direction of IFRS is acquired. Therefore we concur that any decision should be delayed until IFRS Phase II is finalised and analysis of its impact has been completed.*

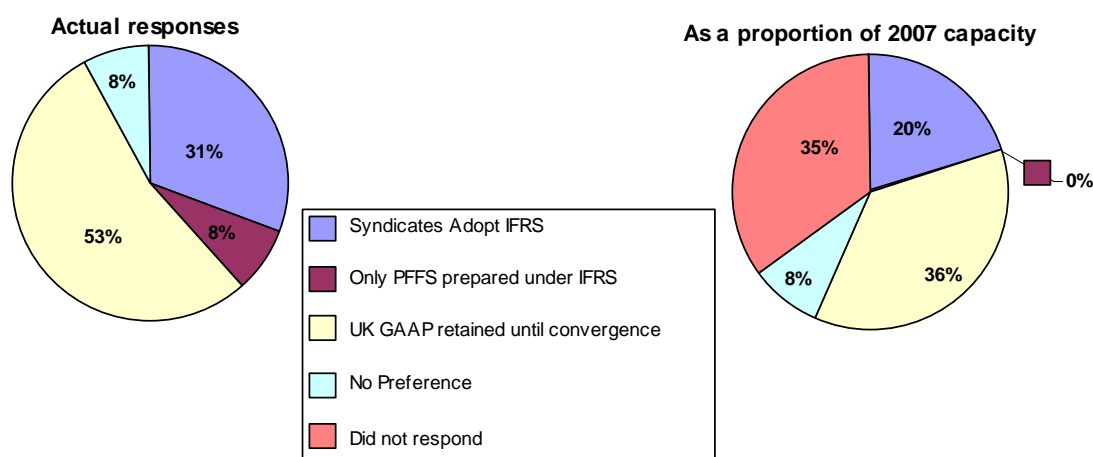
- **Increased reporting requirements** (2 respondents)  
Managing agents may be required to keep both IFRS accounting records as well as UK GAAP accounting records to meet corporate members' reporting requirements. Otherwise corporate members may be forced to report on an IFRS basis, which in turn would force every company within same group to adopt IFRS.

*Lloyd's comment: The directors of the parent company do not have to ensure that all subsidiaries use the same financial reporting framework if "in their opinion there are good reasons for not doing so" (CA 1985 227 C (1)). Therefore, the fact that Lloyd's only prepared IFRS information for corporate members might be a satisfactory reason.*

- **Fully closed syndicates** (1 Respondent)  
Syndicates closed by RITC premium could in theory be required to produce accounts until all liabilities are extinguished. This could be a significant compliance burden for no tangible benefit to either Lloyd's or its members.

*Lloyd's comment: we consider that the substance of the liability would have been transferred to the reinsuring syndicate and the accounting for these items should reflect this, ie in the accounts of syndicate which has accepted the RITC and not in the syndicate which has closed. This matter will be considered further with the IASB.*

### 4.2 Question 1b: If decision made to adopt IFRS, which implementation option is most appropriate?



#### 4.2.1 53% (36% of 2007 capacity) of respondents say the most appropriate implementation option is one where Lloyd's converges as UK GAAP evolves towards IFRS:

- **Stability** (9 respondents)  
It would enable a longer period of stability while the market further embeds the transition to UK GAAP and is able to absorb how the EU and US responds to IFRS implementation. This would also allow time to fully assess what the final direction of the Phase II structure, timing and implementation will be.

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*Lloyd's comment: An informed assessment can only be made once Phase II is finalised. However, if it is then considered to be beneficial for market to move to IFRS, it should take place as soon as practically possible.*

- **FASB/IFRS convergence** (5 respondents)  
Lloyd's would have the option to remain within an accounting framework similar to that used by some of their main competitors (i.e. Bermuda and US), while it assessed the direction of US GAAP and whether it plans to converge with IFRS.

*Lloyd's comment: Please see 4.1.2 "Comparability"*

- **Costs** (2 respondents)  
Gradual convergence will allow costs for retraining and system amendments to be spread over time.

*Lloyd's comment: As Phase II is currently envisaged, system enhancements and training requirements for personnel would be significant, therefore a single conversion to IFRS would be more practical than employing a gradual program of enhancements and training as UK GAAP converges.*

- **Resource and implementation** (1 respondent)  
This would allow systems and the market understanding of IFRS to develop and adapt over time as UK GAAP converges with IFRS. There would also be fewer issues with conversion as no reconciliations between UK GAAP and IFRS will be required. The effect of changes in accounting policies would be reported by syndicates as required in the STRGL and provided to corporate members via the Schedule 9A information.

*Lloyd's comment: Please see comment for 4.2.1 "Costs". Furthermore, adoption disclosure requirements should not be seen as a stumbling block, if it is deemed to be in the market's interest to move to IFRS.*

### **4.2.2 31% (20% of 2007 capacity) of respondents say the most appropriate implementation option would be that where syndicates adopt IFRS for their annual accounts:**

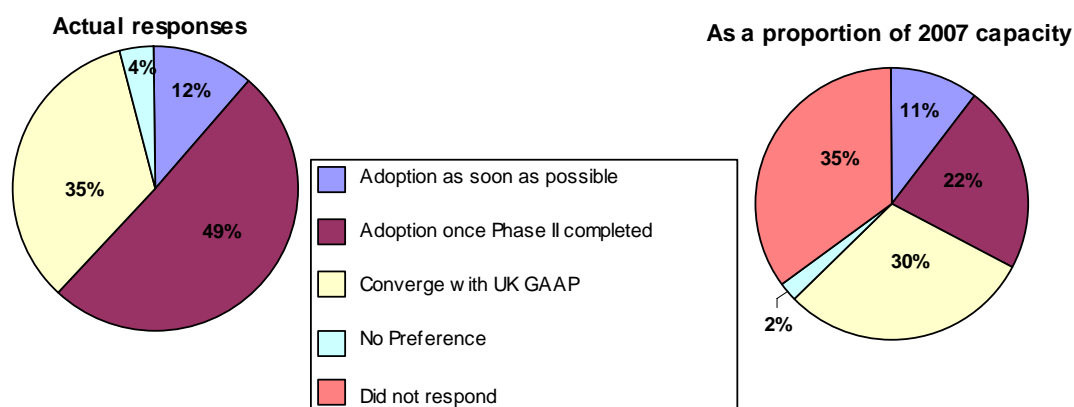
- Support for this option is broadly for the reasons listed under section 4.1.1 above.

### **4.2.3 8% (0% of 2007 capacity) of respondents say the most appropriate implementation option would be where syndicates remained on UK GAAP and only the PFFS is prepared under IFRS:**

- Reconciliation of Annual and underwriting accounts (1 Respondent)  
Members would still be able to easily reconcile UK GAAP results shown in annual accounts and underwriting accounts.

*Lloyd's comment: The real advantage of this option would be to reap the benefits of IFRS reporting for the market's overall results, while syndicates avoid the full brunt of the onerous disclosures under IFRS reporting.*

**4.3 Question 2: If decision made to adopt IFRS, which timing option most appropriate?**



**4.3.1 49% (22% of 2007 capacity) of respondents say that adoption should be delayed until Phase II is finalised for the following reasons:**

- Resource and implementation

Due to the significant increase in disclosure and complexity of certain accounting requirements, this would allow for sufficient time for proper training and preparation for ultimate adoption. It would also be more efficient to train staff for IFRS conversion once.

*Lloyd's comment: We agree that it would be premature to adopt IFRS before the majority of existing issues are resolved as well as the final direction of the insurance standard is clear.*

- Cost Saving

By delaying adoption until Phase II is completed, the market would avoid need for a two-step conversion process. This will be the most prudent option, especially as the industry might be at or near the bottom of the underwriting cycle at that time, and therefore there will be pressure to control costs. This will also allow more time to assess adoption of IFRS in other insurance markets. Finally with implementation of Solvency II also due within a similar time frame there will be an opportunity to benefit from a possible adoption of both regimes at the same time.

*Lloyd's comment: It would be beneficial if the impact of both Solvency II and IFRS could be managed through means of a joint implementation project. The investment in resources and systems could be shared and this would limit the period of instability for a continuous process of change in the market. However there is a concern that such a dual implementation may be difficult for managing agents with smaller resource levels to cope with.*

- Stable standard

The intention is for the contentious issues and interim measures from the first phase of implementation to have been resolved in Phase II. Therefore the implied benefits of greater transparency and comparability would only be realised on adoption at this stage. Furthermore, there is also a risk that the standard could change direction significantly from that proposed in the discussion paper, consequently nullifying any changes previously implemented.

*Lloyd's comment: same as for 4.3.1. "Resource and implementation"*

**4.3.2 35% (30% of 2007 capacity) of respondents say that Lloyd's should retain UK GAAP and converge as UK GAAP evolves towards IFRS for the following reasons:**

- Please see section 4.2.1 above.

**4.3.3 12% (11% of 2007 capacity) of respondents say that adopting IFRS as early as is practical was the best option for the market for the following reasons:**

- Resource and time (1 respondent)

No new major statutory financial or regulatory requirements affecting syndicates are anticipated before Solvency II is finalised. Therefore syndicates would be able to commit more time and resource to IFRS implementation, particularly those syndicates using IFRS for the first time. However, this opinion was given assuming syndicates retaining UK GAAP and only the PFFS prepared under IFRS.

*Lloyd's comment: Although the current stable accounting background is advantageous for an adoption of IFRS, the market's efforts would be better spent on analysing the impact of the more complex Phase II insurance contracts proposals as well as the opportunities to benefit from the similarities with Solvency II implementation.*

**4.4 Question 3: Are there any other advantages and/or issues concerning the adoption of IFRS for syndicates and Lloyd's market accounts which you think need to be considered?**

**4.4.1 IFRS disclosures and adjustments**

- The insurance and financial risk management disclosure is likely to be one of the most onerous areas of work under IFRS. This will require substantial amount of resource and expertise, and will be cumbersome for corporate members with spread portfolios.
- Lloyd's needs to ensure that syndicate auditors agree the treatment of all the IFRS adjustments to ensure that the Lloyd's pro forma financial statements are produced using consistent approaches.
- It is not clear whether adoption of IFRS by Lloyd's would mean only adoption of those IFRS that have been endorsed by the EU. If that is the case, comparability with non-European peers reporting under IFRS may not be achieved.

*Lloyd's comment: In theory we appreciate that an issue could arise if the EU either rejected a standard or only partially endorsed a standard. However, we believe that the IASB and EFRAG are appreciative of the consequences of such a situation and would seek to ensure that any issue is resolved well in advance of the publishing of any new standard.*

- The impact of the cost of auditing the more complex IFRS syndicate accounts versus the benefit.

*Lloyd's comment: The prospect of UK GAAP converging with IFRS makes this issue unavoidable. We are more concerned that the market is well prepared and educated for the changes that lie ahead.*

**4.4.2 Distributable underwriting results**

- If Lloyd's adopts IFRS early then consideration needs to be given to the impact that this would have on the distribution process and the payment of profits: would profits be distributed on an IFRS basis or a UK GAAP basis? Potentially the largest adjustment that the syndicates will need to make relates to foreign exchange on non monetary items - this can have a significant impact on the syndicate's results, and although it is a timing issue, it could affect when profits are distributed to members, via early releases based on profits at 12 and 24 months of a year of account.



*Lloyd's comment: Due to the fact that distributions are paid in the principal two accounting currencies at Lloyd's, namely Sterling and US dollars, the impact on foreign exchange would only be in respect of other currencies which would generally not be significant. That said we accept that the accounting effort required to report non-monetary items at the appropriate rate may be considerable.*

#### **4.4.3 Information impact**

- The impact on other returns driven by the Annual Return (FSA, SRD), together with historic data, and tax returns (US, Canadian & UK) needs to be considered. If these require the same level of data, then major system changes would be required.
- Information (including historic comparatives) may not be readily available from data warehouses.
- A detailed costs/benefits analysis would need to be carried out. In particular the practical and costs implications of compliance with IFRS by a significant proportion of the market (i.e. the smaller corporate members which typically participate on a spread basis) would need to be assessed.

*Lloyd's comment: The market will be faced with significant system enhancements due to future Solvency II and UK GAAP/IFRS requirements. There is a risk that if each of these future projects is viewed in isolation, the market will incur additional costs through duplication of systems and other work.*

#### **4.4.4 Lloyd's ratings and results**

- Any potential impact on/changes to the Lloyd's ratings as a direct consequence of the adoption of IFRS Phase II and related standards would need to be assessed. Early discussions should be held with rating agencies before any decision is made on the adoption of IFRS.
- The estimated impact on Lloyd's reported results (and balance sheet) on first time reporting will need to be determined.

*Lloyd's comment: High level discussions on the possible adoption of IFRS by the market have been held with two of Lloyd's three rating agencies. Neither agency was overtly concerned about the impact this would have on the rating. Their expectation was that Phase II would have greater impact on the Lloyd's market. The matter will also be raised with the remaining ratings agency in the near future.*

### **4.5 Question 4: Do you have any observations regarding the potential impact of the Phase II Insurance Contracts proposals?**

#### **4.5.1 Valuation of insurance liabilities**

- The assumptions used in deriving fair value for each book of business will vary depending on the managing agent/insurer. Two organisations writing the same book of business are unlikely to arrive at the same result, as assumptions as to when losses will occur, recoveries will be made, as well as discount rates will all vary. Therefore comparability of entity results will be significantly more difficult under current proposals.
- The modelling and estimation of relevant future cash flows and their timing, the assignment of probabilities to these cash flows and the calculation of risk margins will likely require more human and IT resources than the valuation under UK GAAP. This will stretch the resources of smaller managing agents. The non-homogenous nature of risks in the books of syndicates will make it difficult for them to produce the necessary



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probability weighted cash flows and to calculate the benefits of diversification within a portfolio.

- The idea of computing an unbiased estimate of the margin that market participants require for bearing risk, (ie assessment of 'exit value') is fraught with difficulty since most insurance books are not commutable except after a significant period of run-off.

### 4.5.2 Recognition of profit on inception

- The concept of recognition of profit on inception of a contract could cause difficulties, especially where many of the catastrophe risks written would be later in the year and justifying a profit figure without knowledge of upcoming events will be difficult.

### 4.5.3 Solvency II

- Measuring of insurance liabilities under both Solvency II and Phase II proposals will require a significant investment in people, process and technology. Therefore it will be beneficial for a convergence in both their models.

*Lloyd's comment: Lloyd's has made a response to the IASB's Phase II consultation paper. Please e-mail Glenn Carrick ([glenn.carrick@lloyds.com](mailto:glenn.carrick@lloyds.com)) should you wish to be provided with a copy.*

### 4.6 Question 5: One of the main user groups of the Lloyd's pro forma financial statements (PFFS) are ratings agencies and other external analysts. Do participants use the PFFS for any purpose other than from a general interest perspective? What is the purpose?

- 4.6.1 The overall consensus is that the primary use of the PFFS is to assist rating agencies in their assessment of the overall Lloyd's market, as well as to provide external analysts with high level headline information which can be compared with Lloyd's peers and other financial services entities. Furthermore, the feeling was that the underlying accounting framework used for the PFFS would have little impact on the above users.
- 4.6.2 A secondary purpose of PFFS is to provide participants with an indication of the general health of the market (specifically the strength of the chain of security), as well as a source for benchmarking and comparison of market results, commentary and disclosures.

### 4.7 Question 6: Has your syndicate adopted FRS 26 (IAS 39) – Financial Instruments: Recognition and Measurement?

- 4.7.1 Based on the respondents to the consultation document it would appear only a small minority of the market have adopted FRS 26. This can mainly be ascribed to the fact that few syndicates have investments in derivatives. Furthermore, of those who do hold such investments, the majority have not seen any benefit in adopting fair value accounting for derivatives.

**4.8 Question 7: To what extent might your syndicate be impacted by the IFRS embedded derivative requirements (see IFRS4 paragraphs 7 to 9 and IAS39 paragraphs 10 to 13)? Please describe the embedded derivative involved.**

4.8.1 Overall it appears that very few syndicates would be impacted by these requirements, and for those that are the impact will be immaterial. It is also expected that these requirements will be amended by the Phase II insurance contracts proposals.

**4.9 Question 8: To what extent might your syndicate be impacted by the IFRS unbundling requirements (see IFRS4 paragraphs 10 to 12)? Please describe the nature of the contract and deposit component to be unbundled.**

4.9.1 Respondents felt that unbundling requirements would on the whole have little or no impact on syndicates. Examples of contracts that might be impacted are swing plans, certain multi-year deals or contracts with an exchange risk included. There is also a distinct possibility that the scope of unbundling requirements may be significantly changed in the Phase II insurance contracts proposals.

## 5 Summary of general comments from market

### 5.1 Underwriting accounts

- Lloyd's move to annual accounting cannot be considered to be complete until the requirement for underwriting year accounts is removed.
- Although an additional source of information for spread syndicates, their relevance for wholly aligned syndicates is only in respect of the purpose of determining profit release per Lloyd's distribution rules.
- Therefore it would appear to be sensible to withdraw these accounts and replace them with an enhanced statement of profit distribution and underwriting that could possibly be incorporated within the syndicate annual accounts.

*Lloyd's comment: We recognise the workload that the underwriting year accounts represent for syndicates to prepare, and will review the way this information is presented, balanced with the essential requirement that participants are able to make fully informed decisions regarding their underwriting.*

### 5.2 Basis of accounting

Given the varied nature of capital providers and other market participants, there could be benefits to allowing syndicates a choice between recognised accounting frameworks. A comparison can be drawn to many international securities exchanges, which permit either IFRS or a national GAAP as a basis for reporting. In the case of wholly-aligned syndicates, there is also a parallel with private UK companies, which are currently permitted but not required to move from UK GAAP to IFRS. It is recognised that allowing a choice of accounting basis would result in inconsistencies in the Aggregate Accounts, but it is not believed that differences in underlying bases would necessarily have a significant impact on the usefulness of the Aggregated Accounts. A further drawback though would be that members participating on different syndicates which adopt different accounting frameworks would make comparisons difficult and confusing.

*Lloyd's comment: We are not in favour of this option, as it will undermine the comparisons between various syndicate results. It will also create an unnecessary burden in producing the Aggregate Accounts.*

### 5.3 Impact of IFRS adoption on corporate members within a non IFRS Group

- If the corporate member is an immaterial part of group, any difference in accounting basis can be ignored as immaterial at group level.
- If the corporate member is substantially the whole of the group, it would make sense for the corporate member to come in line with the syndicate and adopt IFRS as well.
- Where the corporate member is a material activity of the group, but is not the only material activity of the group, an issue can arise if the syndicate is unable to provide the particular corporate member with UK GAAP information. This could force the member as well as every other company within the group to adopt IFRS. This would mean increase reporting requirements across the group as well as a possible impact on tax arrangements.
- The latter scenario would be avoidable with continued provision of UK GAAP information to the affected corporate members. However this would require the managing agent to maintain two sets of accounts.

*Lloyd's comment: Please see 4.1.2. "Increased reporting requirements"*

#### 5.4 Lloyd's competitors / peers

- One respondent disagreed with the objective expressed in the consultation paper regarding consistency with European and certain other competitors. This respondent felt that Lloyd's is competing in the US market primarily and that it is more important, therefore, for the syndicate aggregate accounts to be comparable with the financial statements for major US companies rather than those for major European competitors; the adoption of IFRS would reduce this comparability.
- This respondent noted that the rating agencies also appear to attach more relevance to comparatives between Lloyd's and the UK and US markets, with S&P noting in their June 2007 analysis report that although "Lloyd's has very wide geographic coverage, with specific trading rights to write insurance business in 78 territories and the ability to write reinsurance in many more, a significant majority of income (63% in 2006) continues to be sourced from the US and the UK".

*Lloyd's comment: The choice of a particular accounting basis does not affect the credibility of any of Lloyd's peers reporting under a different accounting basis. We believe that as an entity domiciled in Europe, it is important that we are appreciative of the accounting basis adopted by our European peers, as part of our support for the development of a global accounting reporting standard.*

## **Potential conversion of Lloyd's pro forma financial statements (PFFS) to IFRS: outline of approach**

### **1 Purpose**

- 1.1 To consider whether IFRS should be adopted in respect of the Lloyd's PFFS, taking into account the benefits compared with the additional resources required to achieve this.
- 1.2 It is recognised that such a conversion would not be to 'full' IFRS as it would not be meaningful or possible to aggregate the additional IFRS disclosure requirements in respect of each syndicate and thus generic disclosures would be provided. The PFFS would, therefore, continue to be 'pro forma' accounts, particularly in view of the inclusion of members' letters of credit on the balance sheet.

### **2 Outline of workplan**

- 2.1 The scope as to what extent the PFFS can adopt IFRS will be assessed.
- 2.2 The impact of changes in accounting policies arising from conversion will be assessed.
- 2.3 The specific additional or alternative items of information will be identified and draft accounts formats prepared.
- 2.4 We shall consider how best to collect any additional data. This would be via the core market return system, and would most likely be as an expansion of the annual return/interim return.
- 2.5 We will work closely with the Society auditors in addressing these issues.
- 2.6 An assessment will be made of the extra resources required to implement this.
- 2.7 The views of the rating agencies will be taken into account.
- 2.8 The review will also consider the potential changes in accounting policies and disclosure required by IFRS Phase II

### **3 Approach**

- 3.1 Lloyd's will work with the Lloyd's/LMA IFRS technical working group in progressing this project.
- 3.2 The conclusions and recommendations will be reported to Lloyd's Executive Committee, Audit Committee, LMA Finance Committee and the Franchise Board.

### **4 Timeframe**

- 4.1 The results of this project will be advised to the market by late 2008. The earliest feasible date for a possible move to IFRS for the PFFS would be 2010 (with comparatives for 2009).

**List of Respondents**

ACE Underwriting Agencies Limited  
Amlin Underwriting Limited  
Argenta Syndicate Management Limited  
Atrium Underwriters Limited  
Axiom Consulting Limited  
Beazley Furlonge Limited  
Canopus Managing Agents Limited  
Capita Insurance Services Limited  
Cathedral Underwriting Limited  
Catlin Underwriting Agencies Limited  
CLB Littlejohn Frazer  
Hampden Private Capital Limited  
Hiscox Syndicates Limited  
KPMG Audit Plc  
Liberty Syndicate Management Limited  
Lloyd's Market Association  
Managing Agency Partners Limited  
Markel Syndicate Management Limited  
Mazars LLP  
Mitsui Sumitomo Insurance Underwriting at Lloyd's Limited  
Novae Syndicates Limited  
PricewaterhouseCoopers LLP  
QBE Insurance (Europe) Limited  
R.J. Kiln & Co. Limited  
Talbot Underwriting Limited  
XL London Market Limited