8 Period 2000-2005 – the single-track reporting approach strengthened on the basis of IAS/IFRS

8.1 Introduction
The most important players in the period reviewed in this chapter were, in my view, still the European Commission and the IASC/IASB. The first continued to issue financial and prudential reporting directives to be implemented in the legislation of the member states, although their number and importance were much less than in the previous periods. And important initiatives such as the complete reform of the solvency requirements for European insurers, the so-called ‘Solvency II’ project, based on IAS/IFRS, were started but not finalised before the end of 2005. But another important development was completed within the period: the conclusion of a debate on the future financial reporting regime in the EU. It resulted, in 2002, in a decision to require companies listed in the EU to apply IAS/IFRS in their consolidated financial statements from 2005 onwards, and to allow other companies to do the same.

Both the decision to base Solvency II on IAS/IFRS and the decision to require the application of these standards, from 2005 onwards, in the consolidated financial statements of listed companies occurred at the time that IAS/IFRS was far from stable and still under considerable development. In that sense, I consider both decisions bold and remarkable. They also resulted in the reconfirmation, and even strengthening, of a single-track reporting approach for insurers, both on the European and the Dutch level, with the financial reporting requirements clearly in the lead: a type 8 approach.¹

This explains my choice to designate the IASC, which was transformed into the IASB, as the second most important player in the period. Under the 2002 ‘IAS regulation’, its pronouncements were, once endorsed in the EU, directly binding for the companies applying this financial reporting regime. This was in addition to the influence that the IASC/IASB already had indirectly through the ongoing work of national standard setters such as the UK ASB and the Dutch RJ to incorporate these pronouncements, as much as possible, in their own standards and guidelines.

This chapter presents these developments, and several others of lesser importance. As usual, it starts with an overview of the general developments impacting the Dutch insurance industry, followed by a description of the activities of global and European organisations in respect of reporting developments. Next, it continues with the Dutch financial reporting developments, the financial and prudential reporting developments in the US and the UK, and the Dutch prudential reporting developments. It ends with an overview of the actual reporting practices of the three companies reviewed in this chapter, and a section presenting a summary and conclusions.

The section on the Dutch financial reporting developments shows that, from 2005 onwards, two distinct reporting regimes existed: IAS/IFRS for companies that were required or choose to apply these standards, and the civil code combined with the RJ pronouncements for those companies that did not follow IAS/IFRS. This development creates the need to amend, from 2005 onwards, my interpretation of the meaning of Dutch GAAP. As is explained in chapter 2, I use a wide definition of GAAP, as follows:

¹ For an overview of the types of single-track reporting approaches, see table 2.1 in section 2.5.
“GAAP is a set of generally agreed conventions, rules and procedures for the financial reporting practices by companies”. Until 2005, applying this definition to Dutch GAAP means that it included IAS/IFRS, as these standards influenced the pronouncements of the RJ. From 2005 onwards, Dutch GAAP, as used in this chapter, excludes IAS/IFRS to avoid confusion.

The main Dutch and European developments are summarised in the following figure.

Figure 8.1 Overview of the main Dutch and European developments in the period 2000-2005

8.2 General developments impacting the Dutch insurance industry

8.2.1 Introduction
This section shows that the trends observed in the previous period continued: a growth in the population and economy (although less than before), an ongoing austerity of the social security system, and a growth in the insurance market. Additionally, there was an increased level of concentration on this market. The only novelty was a change in the tax system for insurance companies, prohibiting the immediate expensing of acquisition costs.

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2 See section 2.7.
8.2.2 Developments in the Dutch society and economy, the social security system and the tax system for companies

Between 2000 and 2005, the Dutch population increased slightly, from 15.9 million to 16.3 million.\(^3\) In contrast to the previous decades, the economic growth was modest as well: GNP per capita increased from EUR 26,300 (NLG 58,000) in 2000 to EUR 30,800 in 2005, i.e. on average with about 3.4% annually. However, adjusted for inflation, the growth in real terms was only 0.6%.

The Dutch social security system remained substantially in place, after all the reductions introduced in the 1990s.\(^4\) There were only some changes, one of these occurring in 2002, when an amendment of the sickness benefits act of 1996, discussed in the previous chapter,\(^5\) reintroduced the possibility for employers to take the risks under this act for their own account.\(^6\) Another change took place in November 2005, when two acts were published amending the existing system of disability benefits for employees, stimulating re-entry into the labour process of persons who were not fully and permanently disabled.\(^7\) The acts amended several social security acts, but in particular the disablement insurance act of 1997.\(^8\) However, the most important change in the social security system in the period concerned a fundamental change in the Dutch health insurance system, which resulted, mid-2005, in the publication of the ‘Zorgverzekeringswet’ (the ‘health care insurance act’).\(^9\) This act was followed by an implementation act,\(^10\) which changed several provisions of the compulsory health care insurance act of 1964,\(^11\) introduced a number of changes in related legislation, and repealed the 1986 act on the access to health insurance,\(^12\) as well as the act on the access to health insurance 1998.\(^13\) This completed the reform of the Dutch health insurance system which had started in the 1980s.\(^14\)

As in the previous period, the Dutch tax system for companies remained largely unchanged, but at the end of 2000 one change for insurance companies was introduced with the publication of the ‘Besluit winstbepaling en reserves verzekeraars’ (the ‘Decree on insurers’ profit determination and reserves’).\(^15\) It repealed the 1972 Decree on insurers’ reserves,\(^16\) incorporated the provisions of this Decree and the 1969 covenant between the Dutch government and the insurance industry,\(^17\) but also introduced a new element in the rules to determine the annual taxable profit of Dutch insurers.

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\(^3\) See table A8.1.
\(^4\) See section 7.2.2.
\(^5\) See section 7.2.2.
\(^6\) Minister van Justitie (2002), Staatsblad 2002, nr. 584.
\(^7\) Minister van Justitie (2005g), Staatsblad 2005, nr. 572, and Minister van Justitie (2005h), Staatsblad 2005, nr. 573.
\(^8\) See section 7.2.2.
\(^9\) Minister van Justitie (2005c), Staatsblad 2005, nr. 358.
\(^10\) Minister van Justitie (2005f), Staatsblad 2005, nr. 525.
\(^11\) See section 5.2.3.
\(^12\) See section 6.2.2.
\(^13\) See section 7.2.2.
\(^14\) See section 6.2.2.
\(^15\) Minister van Justitie (2000d), Staatsblad 2000, nr. 643.
\(^16\) See section 5.2.4.
\(^17\) See section 5.2.4.
As before, the new Decree allowed insurers to establish a tax-exempt equalisation reserve, the rules for which were not changed. Also, life insurers still had to calculate their insurance liabilities using the net premium method, with capitalisation of interest rate rebates to be amortised in eight years: by 15% in the first four years, and by 10% in the second four years. Furthermore, they were still not allowed to measure fixed-income investments below cost. The new element was that acquisition costs had to be capitalised and amortised in even amounts during a period of ten years, unless the term of the policy was less, in which case the shorter term had to be used.

8.2.3 Development of the Dutch insurance industry
The number of domestic life insurers decreased significantly from 98 in 2000 to 74 in 2005. And the number of funeral-in-kind insurers dropped from 47 to 41. At the same time, the number of foreign life insurers providing services to the Netherlands increased from 153 to 168; in contrast, the number of foreign companies with branch offices in the Netherlands decreased from 3 to 2.
A similar development could be observed in the non-life insurance segment: the number of domestic insurers dropped from 250 to 210, and the number of foreign insurers with Dutch branch offices was reduced from 125 to only 7. On the other hand, the number of foreign companies providing services in the Dutch market increased from 426 to 500.
The decrease in the number of domestic companies resulted in an ongoing increase in the level of concentration in the Dutch insurance market. The share of the top-25 life insurers moved, as a percentage of gross premium income, from 86.4% in 2000 to 92.3% in 2005. The share of ING fell from 23.7% to 22.9% and that of AEGON from 12.8% to 11.9%, while the share of Fortis increased from 5.4% to 10.4%, resulting from the acquisition of the ASR Group. For non-life insurance business, the total share of the top-25 companies moved from 65.1% in 2000 to 73.6% in 2005.
In 2000, ING was the largest of the three groups reviewed in this dissertation with 6.5%, with Fortis second on 5.0% and AEGON on the last place with 3.2%. And in 2005, related to the acquisition of the ASR Group, Fortis was first with 8.8%, while ING had fallen to 4.8% and AEGON to 2.7%.
Despite the moderate growth of the economy, total assets of the Dutch supervised life insurers increased from EUR 245 billion to EUR 302 billion. Their equity moved from EUR 27.7 billion to EUR 30.6 billion, and their technical provisions from EUR 185 billion to EUR 235 billion. The gross premiums in the Dutch life insurance market increased from EUR 23.0 billion to EUR 24.1 billion (an average annual growth of just below 1%, so well below the average growth of GNP per capita), and net profit from EUR 2.8 billion to EUR 3.3 billion.
The non-life insurance industry experienced more growth. Total assets moved from EUR 33.4 billion to EUR 46.3 billion, equity from EUR 9.4 billion to EUR 14.1 billion, and the technical provisions from EUR 18.3 billion to EUR 25.0 billion.

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18 See table A8.12.
19 See table A8.17.
21 See section 3.3.3.
23 See table A8.28.
24 See table A8.31.
25 See table A8.35.
Earned premiums of the Dutch non-life insurers increased from EUR 14.3 billion to EUR 25.5 billion (an average annual growth of almost 16%), and net profit from EUR 0.7 billion to EUR 2.5 billion.26 The growth occurred in all lines of business, but in particular in accident and health insurance.27 The latter related to the reform of the Dutch health insurance system: in anticipation of the upcoming changes, private health insurers (which were supervised and included in the statistics presented in annex 8) incorporated health insurance funds into their groups, increasing their size: in 2002, four of the five largest health insurers were combinations of private health insurers and health insurance funds.28

Regarding the investments, debt securities was, for the whole period, the main category for life insurers.29 While in 2000 shares were the second and loans guaranteed by mortgages the third category, this sequence had switched in 2005. For non-life insurers, debt securities, followed by shares, was by far the largest investment category in both years.30

8.2.4 Summary and conclusions
In the (short) period presented in this chapter, the Dutch population and economy continued to grow, although rather modestly. In this environment, the gradual tightening of the social security system also continued, showing, at the end of the period, the creation of a new health insurance regime. The tax system for companies remained, in general, the same, but insurance companies were obliged, from 2000 onwards, to capitalise and amortise acquisition cost, while before they were allowed to charge these expenses immediately to the taxable profits.

The Dutch insurance industry continued to grow, in particular in the non-life insurance segment. ING, AEGON and Fortis maintained their high rankings in market share in the highly concentrated life insurance segment.

8.3 The activities of global and European organisations in respect of reporting developments

8.3.1 Introduction
In the period described in this chapter, the IASC was transformed into the IASB, the IOSCO and the Basel committee delivered their positive assessments of the pronouncements of the IASC, and the IAIS produced several papers on the prudential supervision of insurance companies and financial conglomerates.

But, although most of its consequences were only visible after the end of the period reviewed in this dissertation, the event with the most longstanding impact was, in my view, the conclusion of a debate that has started in the early 1990s on the future of the European financial reporting requirements. It resulted, in 2002, in the adoption of a regulation requiring all companies listed in the EU to apply, from 2005 onwards, IAS/IFRS in their consolidated accounts (the IAS regulation). Furthermore, the regulation permitted these listed companies to use IAS/IFRS also in their non-consolidated accounts, and non-listed companies to use this reporting regime as well.

26 See table A8.39.
27 See tables A8.43 to A8.47.
29 See table A8.27.
30 See table A8.36.
The 2002 IAS regulation was introduced to address existing diversity in the financial statements of European companies, which could not be resolved solely by changes in the accounting directives. It was part of an action plan, adopted in 1999, to complete some main aspects of the single market in financial services, and resulted in an increased focus on the information needs of investors.

The decision to require listed companies to apply IAS/IFRS in their consolidated financial statements was taken at a time that it was far from clear how this future reporting regime would look like: as is described later in this chapter as part of the Dutch financial reporting requirements, IAS/IFRS was not yet complete and stable. Furthermore, the newly established independent IASB had just taken over from its predecessor the IASC, and still had to determine its position in a number of important areas, such as in respect of accounting for insurance contracts.

8.3.2 Reporting developments at the global level – The activities of the IASC/IASB and other global organisations

8.3.2.1 The activities of the IASC/IASB

The completion of the work program to obtain IOSCO endorsement, discussed in the previous chapter,\(^{31}\) and the growing global acceptance of its pronouncements led to a fundamental change in the structure of the IASC.

The first step occurred in September 1996, when a strategic working party was created to provide “advice on strategies to be pursued by the IASC after completion of the current work program in 1998”.\(^{32}\) This group delivered a discussion paper in December 1998, presenting its proposals for change.\(^{33}\) According to the paper, the IASC should be more focused on helping participants in capital markets (i.e. investors) and others to make economic decisions, and promoting the use of IAS to bring convergence between national accounting standards and IAS. The paper identified a number of key issues to address, and provided a list of recommendations.

An analysis of the comment letters on this discussion paper showed a clear fundamental difference in views between the Anglo-Saxon and the continental-European constituents and members of the IASC.\(^{34}\) According to Vergoossen, the debate was, effectively, a battle of competence: Europe was afraid it would have to give away much influence, and the US considered the European influence too big, since it had only one vote whereas the US capital market was about twice the size of the European capital market.\(^{35}\) After numerous alternative proposals developed by the chairman and the secretary-general of the IASC, in November 1999 a ‘deal’ was made with the SEC, which was subsequently presented to the executive committee of the IASC.\(^{36}\) There would be an independent standard setting body of 12 independent full-time and two part-time members, whose geographical background would not play a role in the nominating process, with a group of trustees in which geographical and functional background would be of relevance.

\(^{31}\) See section 7.3.3.1.
\(^{33}\) IASC (1998j).
\(^{34}\) Camfferman and Zeff (2007), p. 466-499.
\(^{35}\) Vergoossen (1999a).
The ‘deal’ was presented as a ‘take-it-or-leave-it package’ and was, in the end, unanimously accepted by the executive committee and incorporated in the final report of the strategic working party.\textsuperscript{37} The recommendations were unanimously approved by the IASC Board in December 1999 and by the member bodies on 24 May 2000. The members of the newly created IASB were announced on 25 January 2001.

Upon its inception, the IASB adopted all pronouncements issued by the IASC. It also decided to use the name IFRS for any new standards. A final change in the structure was made in 2002, when the SIC was replaced by the ‘International Financial Reporting Interpretations Committee’, in practice abbreviated to the ‘IFRIC’.\textsuperscript{38}

In the last years of its existence, the IASC adopted a standard on investment properties and some amendments to existing standards. Subsequently, the IASB issued seven own standards and approved a number of changes to standards developed by the IASC. All relevant pronouncements are described later in this chapter when presenting the Dutch financial reporting developments.

\textbf{8.3.2.2 The activities of other global organisations}

Regarding the activities of other global organisations, the most important contribution to the financial reporting developments was, in my view, delivered by the IOSCO. In May 2000, it published its report on the assessment of the existing standards of the IASC.\textsuperscript{39} It recommended its members to allow the use of 30 standards for cross-border listings, supplemented where necessary to address substantive issues at the national or regional level. These supplements could take the form of reconciliations to local GAAP, additional disclosures, or interpretations to deal with options in IAS or to cover issues on which IAS was silent. The report included a detailed appendix, showing the 200+ comments made by the IOSCO on individual standards. The IASB responded in March 2001, noting that many of the identified matters had previously been communicated in IOSCO comment letters on exposure drafts and other IASC documents.\textsuperscript{40} As a result, they had been taken into consideration when standards were developed. However, there were a number of outstanding substantive issues, several of which had already been addressed, particularly those in respect of IAS 39 and those handled by the SIC. Other issues would be included in another improvements project or in future projects, which would be considered in the discussion on the IASB work program. The IASB staff expected that, by the end of 2001, all matters in the assessment report would have been addressed appropriately.

In respect of prudential reporting developments, the main player continued to be the Basel committee. In June 2004, it released a new capital framework, known as ‘Basel II’.\textsuperscript{41}

It consisted of three pillars:

\textsuperscript{37} IASC (1999d).
\textsuperscript{38} IASB (2002c).
\textsuperscript{39} IOSCO (2000). The background of this document and the underlying ‘work program’ is described in section 7.3.3.1.
\textsuperscript{40} IASB (2001a).
\textsuperscript{41} Basel committee (2009).
• Minimum capital requirements (in insurance terminology: required solvency margins), which sought to develop and expand the standardised rules set forth on the 1988 accord;\(^{42}\)
• The supervisory review of an institution’s capital adequacy (available solvency margins) and internal assessment process; and
• The effective use of disclosure to strengthen market discipline and encourage safe and sound banking practices.

The implementation of Basel II in the EU is described later in this chapter, when presenting the Dutch prudential reporting developments.

But the Basel committee also participated in the debate on IAS. This resulted, among others, in a report, issued in April 2000, on the findings and conclusions on its review of 15 standards that had a significant effect on banks.\(^{43}\) There were no significant concerns on seven standards and, with two exceptions, only a few issues on the other standards. The first exception concerned IAS 30:\(^{44}\) the committee believed that it needed updating, as it had not been changed since 1991. The IASC promised to address this issue by starting a project to update IAS 30, which resulted – ultimately – in IFRS 7, described later in this chapter as part of the Dutch financial reporting developments. The second, more fundamental, exception concerned IAS 39. The Basel committee was concerned that the increased use of fair value accounting would increase the volatility of the results and of the equity of banks, which might not reflect the banks’ underlying risk management practices. Furthermore, the committee believed that the IASC should provide considerable guidance on the measurement of fair value in the absence of active markets, and significant interpretative and implementation guidance to enable companies to comply with IAS 39. Regarding these points, the IASC responded by creating an ‘IAS 39 Implementation Guidance Committee’.

Next to the Basel Committee, also the IAIS started to involve itself in the global development of financial and prudential reporting requirements. It issued several documents to assist local insurance supervisors in performing their tasks. The first publication in the period occurred in 2000 and concerned a standard on the supervision of financial conglomerates, introducing a number of definitions to serve as a basis for defining coordination requirements between supervisors.\(^{45}\) The standard enabled the continuation of the Dutch solo-plus approach, mentioned in the previous chapter.\(^{46}\) Subsequently, the IAIS published, in 2002, its principles on capital adequacy, which could serve as the basis for solvency regimes,\(^ {47}\) and a guidance paper on public disclosures by insurers.\(^ {48}\) The latter document explained that insurers had to present, at least, information on their financial position, financial performance, accounting policies including underlying methods and assumptions, risk exposures and how they were managed, and basic business, management, and corporate governance information.

None of these documents had a direct impact on the prudential reporting requirements for Dutch insurers, as almost all of their contents was already incorporated in existing legislation.

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\(^{42}\) See section 7.3.3.2.
\(^{43}\) Basel committee (2000).
\(^{44}\) See section 7.4.2.1.3.
\(^{45}\) IAIS (2000).
\(^{46}\) See section 7.6.2.2.
\(^{47}\) IAIS (2002a).
\(^{48}\) IAIS (2002b).
The only novelty concerned the IAIS recommendation to disclose the risk exposures and how they were managed, something that did not explicitly exist in the Netherlands. Such information was, however, required by IFRS 4 ‘Insurance contracts’, discussed later in this chapter when presenting the Dutch financial reporting requirements.

In 2005, the IAIS issued several papers on solvency requirements: a framework paper, presenting a similar three pillar approach as included in Basel II, and a paper on the cornerstones of insurance prudential supervision. The latter document made it clear that, in line with the existing practice in many jurisdictions, the IAIS preferred as much as possible similarity between public financial information and reporting to prudential supervisors, with prudential filters if necessary to assess the solvency position of an insurer. As is described earlier in this dissertation, under this approach the balance sheet in the financial statements was taken as the starting point to assess the amount of the available solvency margin, but, purely for this exercise, non-admissible assets were eliminated and the measurement bases of assets and/or liabilities were adjusted to take into account the supervisory views. In my opinion, this approach was much more aligned with the prevailing Dutch single-track reporting approaches, as is described later in this chapter when presenting the Dutch prudential reporting developments, than with the US regime, under which two completely separate reporting environments had emerged. In a note dated 14 April 2005, the CEA expressed overall agreement with the IAIS proposals.

8.3.3 Reporting developments at the European level

8.3.3.1 Developments in the European Union
In the period reviewed in this chapter, the member states reached agreement, in December 2000, on the treaty of Nice (France). It amended the earlier treaties, but did not introduce changes relevant to this dissertation. Subsequently, all amendments on the treaty on the European Union and the treaty establishing the European Communities were included in consolidated versions of these treaties, issued in 2002. And in 2005, the European Union was expanded with the admission of Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia. Concerning the introduction of the euro, Greece became, on 2 January 2001, the 12th member. The euro coins and notes entered into circulation in 1 January 2002.

The activities in respect of the financial and prudential reporting requirements are discussed when presenting the Dutch developments in these areas.

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49 IAIS (2005a).
50 IAIS (2005b).
51 See section 6.6.4.1.
52 The IAIS paper made no recommendations as to whether the financial or the prudential reporting requirements should be leading. It is, therefore, impossible to identify the type of approach that was advocated.
53 See section 6.5.2.8.
54 CEA (2005).
57 European Commission (2010).
8.3.3.2 The European adoption of IAS/IFRS

As is noted in the previous chapter, the European Commission started in the early 1990s a debate on the future accounting regime in the EU and the possible adoption of IAS.\textsuperscript{58}

The first step occurred in January 1990, when the European Commission organised a conference on the future of the harmonisation process of accounting standards.\textsuperscript{59} It focused in particular on an analysis prepared by Hopwood, who presented a perspective for the future. He noted that, although some harmonisation had been achieved, considerable degrees of technical diversity existed and the annual accounts of companies incorporated in different member states were still difficult to compare. In his view, a new initiative was required to provide a more adequate basis for the future. He pointed at the growing interest in the wider international standardisation of accounting practice, not least because of the globalisation of the capital markets and the growing importance of the activities of the IASC. Therefore, every effort should be made to maintain the momentum of the IASC and to further develop its independence and authority. The set-up of a European technical standard setting organisation, which had been mentioned on several occasions, would not solve all issues. Instead, there should be a refinement of the existing structure, by the creation of an independent European accounting forum as a consultative body to the European Commission, in combination with the strengthening of the role and activities of the Contact Committee.\textsuperscript{60}

The ‘Accounting Advisory Forum’ was established shortly after.\textsuperscript{61}

The next step was, in 1995, the issuance of a public document in which the European Commission presented its view on IAS.\textsuperscript{62} It stated that, although the fourth and seventh directives had been successful in improving the comparability of annual accounts, they had not provided and could not provide the answers to all problems in the 1990s. As a result, annual accounts prepared in accordance with the directives did not meet the more demanding requirements required elsewhere in the world, notably by the US SEC. The result was that large European companies seeking capital on the NYSE were obliged to prepare a second set of accounts.\textsuperscript{63} This was burdensome and costly, constituted a clear competitive disadvantage and increased the risk that large companies would be more and more drawn towards US GAAP, a set of standards developed without any European input. The proposed approach was to put the EU’s weight behind the international harmonisation that was already well under way in the IASC. At the same time, the EU should preserve its own achievements in the direction of harmonisation, which were a fundamental part of the internal market legislation. It therefore needed to take steps to ensure that existing IAS were consistent with the directives and that new IAS remained compatible with the legislation of the European Communities.

To address the problems of multi-listed companies, the European Commission had examined several approaches, such as to exclude large listed companies from the directives, to obtain an agreement with the US on the mutual recognition of accounts, or to update the accounting directives.

\textsuperscript{58} See section 7.3.2.1.
\textsuperscript{59} European Commission (1990a).
\textsuperscript{60} For the role of this committee, see section 6.4.2.2.2.
\textsuperscript{61} Krens (1995).
\textsuperscript{63} Haller (2002) reported that the number of EU companies listed on the NYSE until 1990 was 26. However, this number increased to 146 until 2001. This was, in his view, one of the main drivers behind the new accounting strategy of the European Commission.
However, all these approaches would take considerable time, with the risk that new issues would have arisen by the time the solutions were put in practice. Another alternative, to establish a European accounting standard-setting body, was not well received by the member states, which had concerns on creating an additional layer of standards, bearing in mind the progress already made by the IASC. For all these reasons, the focus should be on the IASC.

To accommodate IAS, a number of steps were needed to preserve the necessary degree of legal certainty and to ensure respect for the legislation of the European Communities. The Contact Committee should examine, as a matter of priority, the conformity of IAS with the accounting directives. If this would reveal inconsistencies, these needed to be examined on a case-by-case basis. The European Commission’s preliminary view was that few if any difficulties would emerge. In case of a conflict, a solution would have to be found. The IASC had indicated its willingness to re-examine any IAS which was found to be not in conformity with the directives. But if absolutely necessary, the European Commission would propose changes in the directives. The Contact Committee should also seek to establish an agreed position on future exposure drafts published by the IASC, to ensure appropriate European input into the process, with a focus on the consolidated accounts. Finally, the Contact Committee, supported by the Accounting Advisory Forum, should step up its efforts to facilitate a harmonised approach by dealing with practical problems that arose in connection with the application of the directives.

Fairly soon after the issuance of the 1995 document of the European Commission, the Contact Committee issued its first conformity report.64 Its examination had focused on the IASC conceptual framework and all IAS published as at 31 December 1995, the only exception being IAS 32 (which was examined by a separate group, including the Banking Advisory Committee).65 Only a limited number of issues were identified. Regarding options directly available to companies, the document pointed at the possibility to charge positive consolidation differences immediately to the reserves under the seventh directive and the use of the additional valuation allowances and a fund for general banking risks under the banking accounts directive. Transitioning to IAS would prevent companies from using these options.

The developments accelerated towards the end of 1998 when the European Commission published a number of proposals to complete some main aspects of the single market in financial services.66 One was to create deep and liquid European capital markets which served both issuers and investors better. In my view, this was a clear indication that, in line with the focus of the IASC,67 also the European Commission started to move away from its earlier approach to focus on investors and third parties,68 in favour of serving the information needs of investors. The European Commission announced that it would consider which options in the accounting directives (if any) were no longer necessary and appropriate, and would review whether listed companies should be required to prepare their financial statements in conformity with a more harmonised framework, such as IAS.69

64 European Commission (1996). The Contact Committee had been able to build on several surveys carried out by the FEE: see FEE (1999a) and FEE (2000).
65 For a description of the role of this committee, see section 7.6.2.1.
67 See section 7.3.3.1.
68 See section 6.4.2.2.2.
These proposals were followed, in May 1999, by the publication of a specific action plan. It announced that the European Commission was considering a solution that would provide companies with an option to publish financial statements on the basis of IAS. A screening mechanism would be required to ensure that IAS confirmed with EU rules and corresponded fully with EU public policy concerns. These issues would be included in a proposal to amend the fourth and seventh directives by the end of 1999, to account for certain financial assets at fair value, in accordance with IAS. The action plan further announced the publication, by the end of 2000, of a proposal for the modernisation of the accounting directives.

Some indications on the possible direction that the European Commission would take regarding IAS were provided by Van Hulle in September 1999. He noted that any reform would primarily be directed towards large and listed companies. A question was whether these should not only be allowed but be required to use IAS in the future. If the latter objective was pursued, it was clear to him that the European influence within the IASC would have to be much strengthened. It would be impossible to have the IASC decide on the way European major companies would have to report without having a say in the development of the standards. To achieve this, he argued, Europe would have to be represented by a European delegation which could speak on behalf of all member states of the EU, and institutional changes should be made to make this possible. Van Hulle made no reference to the 1995 ideas to give the Contact Committee a role in this process.

Shortly after this publication, the FEE issued a financial reporting strategy paper, which stated that IAS represented the best opportunity to achieve both global and European harmonisation of financial reporting standards. Consequently, the FEE proposed that a company option should be introduced to permit companies using IAS instead of national GAAP, without requiring compliance with the accounting directives. Companies continuing to produce consolidated accounts using their national GAAP should produce a reconciliation statement to IAS. Furthermore, the fourth directive should be modified to enable the member states to permit future developments of IAS without further legislative intervention and thus avoid the possibility that European companies would be unable to apply IAS in full. Given the extent to which US GAAP was already used in Europe, it seemed to be necessary to allow also the use of US GAAP, although only for a limited period of time.

A next step in respect of the adoption of IAS was made in June 2000, when the European Commission published its near future actions. It would present a formal proposal requiring all companies listed in the EU to prepare their consolidated accounts in accordance with IAS. This requirement would enter into effect, at the latest, from 2005 onwards. The member states would be allowed to extend the application of IAS to unlisted companies, in particular to unlisted financial institutions (including insurance companies) to facilitate sector-wide comparison and to ensure efficient and effective supervision, and to non-consolidated accounts. The proposal would also contain transitional arrangements to encourage the early adoption of IAS together with the rules for the establishment of an EU endorsement mechanism, which would oversee the integration of IAS in the EU and confirm that IAS would represent an appropriate basis for financial reporting. There would be a presumption that this was the case: the mechanism would confirm that.

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70 European Commission (1999a).
72 FEE (1999b).
The EU endorsement mechanism would consist of a two-tier structure: a political level and a technical level, under the control of the political level. The technical level should consist of a group of highly qualified experts, who should not only scrutinise IAS, but also provide input to the IASC standard setting process, particularly in the early phases. Objections to IAS – probably infrequent – would have to be substantiated and publicly recorded. Recommendations made at the technical level on a particular standard would need ratification at the political level. Additionally, the European Commission would bring forward a proposal to modernise the accounting directives so that they could remain the basis for financial reporting for all limited liability companies. According to a survey conducted by PricewaterhouseCoopers under 700 European CFOs, a large majority (75%) of the European business community supported the European strategy: they wanted to use IAS as the only set of standards in preparing their annual accounts.\(^\text{74}\)

The June 2000 proposal did not make reference to the indications provided by Van Hulle in September 1999, arguing that it was necessary to have a European delegation in the IASC that could speak on behalf of all member states. The proposal also did not discuss the May 2000 decision to transform the IASC into the IASB, as is described earlier in this chapter. It is, therefore, impossible to assess whether or not these events were related, in one way or another. On the other hand, the June 2000 proposal did mention that the to be created group of highly qualified experts should provide input to the IASC standard setting process. As a result, I cannot rule out the possibility that the European Commission had decided not to interfere in the setting up of the new independent IASB and, instead, created another mechanism to provide the European input to the IASB activities.

In a communication issued in April 2001, the FEE commented on the European Commission’s proposal.\(^\text{75}\) It noted that when the accounting directives would remain the basis of the EU’s accounting rules for all limited liability companies including listed companies, this would require continuous amendments of the directives to avoid non-compliance with IAS. In its view, the European directives should not form an obstacle to use IAS. Therefore, the FEE continued to believe that the preferred solution would be to exempt listed and other companies applying IAS from the accounting directives.

The promised proposal on the application of IAS was delivered by the European Commission in February 2001.\(^\text{76}\) Assisted by an ‘Accounting Regulatory Committee’ (henceforth, the ‘ARC’) composed of representatives of the member states, it would be authorised to make IAS mandatory at European Communities level. An accounting technical committee would provide support and expertise in the assessment of IAS. It would also contribute to the strengthening of the coordination of positions within the EU in the IASC discussions, the definition at an early stage of European positions on new international accounting issues, and active European participation in the IASC deliberations to influence and shape the solutions eventually chosen. The over 7,000 companies governed by the laws of the member states, whose securities were admitted to trading on a regulated market within the EU, or whose securities were offered to the public in view of such an admission, should prepare their consolidated accounts over the financial year starting on or after 1 January 2005 in conformity with adopted (or, as it is also called ‘endorsed’) IAS.

\(^{74}\) De Accountant (2001).
\(^{75}\) FEE (2001).
\(^{76}\) European Commission (2001d).
The member states could permit or require listed companies to prepare their non-consolidated accounts, and other companies to prepare their consolidated and/or non-consolidated accounts in conformity with IAS. To adopt an IAS, the technical committee would first prepare a proposal and then ask the ARC to deliver an opinion. At the latest by 31 December 2002, the European Commission should decide on the applicability of all then existing IAS and SICs. The document of the European Commission was complemented by a memo responding to frequently asked questions.\textsuperscript{77} It clarified that the work of the ARC would be prepared by an accounting technical committee, being the ‘European Financial Reporting Advisory Group’ (henceforth, the ‘EFRAG’). A description of the history and activities of this group is presented later in this section when discussing the European endorsement process.

To assist the European Commission in its analysis of IAS, the Contact Committee delivered in 2001 two reports on conformity between IAS (including the SICs) and the accounting directives.\textsuperscript{78} These reports identified a limited number of potential conflicts, some of which could be avoided by choosing the appropriate options under IAS. In other instances, a conflict could be resolved by relatively simple and straightforward amendments of the accounting directives. IAS 39 was not examined because the accounting directives were being amended to facilitate the adoption of this standard by EU companies. The reports of the Contact Committee were, broadly, consistent with two comparison reports issued by the FEE in April 1999 and July 2000, respectively.\textsuperscript{79}

The final IAS regulation was approved by the European Commission on 19 July 2002.\textsuperscript{80} In its preamble, it stated specifically that it “aims at contributing to the efficient and cost-effective functioning of the capital market. The protection of investors and the maintenance of confidence in the financial markets is also an important aspect of the completion of the internal market in this area.” Apart from two aspects, the final regulation did not differ from the proposal. The first difference was that the regulation defined the criteria to be applied in assessing the possibility for adopting IAS in the EU:

- They were not contrary to the true and fair principles set out in the directives and were conducive to the European public good; and
- They met the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

The second difference concerned the transitional provisions. The member states could permit a company to postpone the application of IAS/IFRS for two years if only debt securities (not shares) were listed, or if the shares were (also) listed in a non-member state and the company, for that purpose, had previously been using another international accepted standard (e.g., US GAAP).

The regulation was binding in its entirety and directly applicable in all member states. In other words, there was no need to amend national legislation. The regulation would be amended every time a new standard or interpretation was endorsed.

\textsuperscript{77} European Commission (2001b).
\textsuperscript{78} European Commission (2001a) and European Commission (2001g).
\textsuperscript{79} FEE (1999a) and FEE (2000).
\textsuperscript{80} European Commission (2002d).
In November 2003, the European Commission published comments on topics where authoritative clarification appeared to be required in respect of the IAS regulation. The following topics are relevant for this dissertation:

- The IAS regulation required the annual accounts to be prepared in accordance with endorsed IAS/IFRS, i.e. IAS/IFRS adopted by the EU under the regulation. Accordingly, if a standard was not endorsed it was not required or in certain circumstances not permitted to be applied;
- The accounting policies should refer to “international financial reporting standards adopted for use in the European Union”. However, if these endorsed standards resulted in annual accounts also complying with all IAS/IFRS, a simple “in accordance with all international financial reporting standards” would suffice;
- Since the conceptual framework itself was not an IAS/IFRS, there was no need to adopt it. However, it played a role in cases where there was no particular standard or interpretation available. In view of its importance in this situation, the European Commission decided to annex it to the publication;
- In case companies reported under IAS/IFRS, no provision of the accounting directives could restrict or hinder the company’s compliance with endorsed IAS/IFRS. In other words, a company applied endorsed IAS/IFRS irrespective of any conflicting or restricting requirements in national legislation. As a consequence, the member states were not able to restrict explicit choices in IAS/IFRS; and
- Since the IAS regulation focused on the (consolidated) annual accounts, some articles of the accounting directives were still applicable, on audit, annual reports and certain disclosures that were beyond the scope of IAS/IFRS, for instance in respect of corporate governance. This applied, according to the document, both in case of mandatory application (either through the regulation or by member state requirements) and in case of voluntary adoption at the choice of the reporting company. However, in all cases the member states were not allowed to mandate disclosures on top of what was required under IAS/IFRS for topics that were in the scope of these standards.

Although its impact was only visible from 2005 onwards, i.e. mainly outside the scope of this dissertation, the adoption of the IAS regulation was, in my view, one of the most important events described in this dissertation, next to the adoption of the 1970 Dutch companies’ annual accounts act, and the approval and subsequent implementation of the European accounting directives. As is described in the next sections of this chapter, the move to IAS/IFRS eliminated most of the previously existing differences between the financial reporting requirements and practices of Dutch insurers, significantly increased the amount of disclosures focusing on the information needs of investors, and made their financial statements much more comparable, both within the Netherlands and on an international basis.

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82 See section 5.3.4.2.6.
83 See sections 6.4.2.2.3, 6.4.2.3.3, 7.4.2.1.3 and 7.4.2.2.3.
8.3.3.3 The European endorsement process

8.3.3.3.1 The establishment and activities of the EFRAG

In anticipation of the IAS regulation, the European Commission asked the FEE to develop suggestions to establish an accounting technical committee, to assist itself and the ARC in the endorsement process.\(^{84}\) In response, a memorandum was published dated 31 March 2001, presenting a proposal to establish the EFRAG to play this role.\(^{85}\) It was fully supported by a large group of pan-European organisations, including preparers, auditors and users of financial statements.

The EFRAG should consist of a relatively small independent ‘Technical Expert Group’ (the ‘TEG’), which should carry out the technical work with an open, wide, and transparent consultation process. Its members should represent the European point of view rather than the individual organisation they came from. The TEG would fulfil the four functions discussed during the development of the regulation:

- To provide a proactive contribution to the work of the IASC, in particular at an early stage;
- To initiate changes to the EU accounting directives;
- To deliver technical assessments of the IASC standards and interpretations; and
- To identify issues for which the IASC general interpretation guidance was not sufficient to ensure consistent application of a given standard in the EU, communicate such issues to the IASC, and urge it to identify appropriate solutions.

A rejection of an IAS should be exceptional and contemplated only as a last resort. Endorsement of parts of standards or interpretations should not be possible. In case of a potential negative advice on endorsement, it was essential that a full consultation process would take place as soon as it became likely that this situation would occur. Regarding the first endorsement steps, the 2001 FEE proposal recommended that the existing standards and interpretations as well as the conceptual framework should be assessed as a ‘package’. The existing pronouncements had already been compared with the accounting directives and only a limited number of deviations had been found, which would most likely be covered by the planned modernisation of the directives.

Without significant changes, the proposal was adopted by the European Commission shortly after and the EFRAG started its work on the endorsement activities. The experience obtained in the first years resulted, in January 2004, in the publication of a document to enhance the process, including clarification of the necessary steps in case of potential negative endorsement advices and the publication of dissenting views.\(^{86}\)

8.3.3.3.2 The endorsement activities

Since its establishment, the EFRAG issued a large number of endorsement advices to the European Commission. Based on these advices and the recommendations of the ARC, the European Commission subsequently endorsed the standards and interpretations. In general, there were no specific issues; however, in some cases peculiarities could be observed, which are mentioned hereafter.

\(^{84}\) EFRAG (2001).
\(^{85}\) The idea to create an EFRAG-type organisation was already raised by the FEE in its 1999 financial reporting strategy report: see FEE (1999b).
\(^{86}\) EFRAG (2004a).
The only exception relevant for this dissertation was, as is explained in some detail hereafter, IAS 39, for which a ‘carve-out’ was introduced. The IASC/IASB pronouncements issued in the period are discussed later in this chapter as part of the Dutch financial reporting developments.

The first endorsement advice was issued on 19 June 2002,\(^{87}\) i.e. before the publication of the November 2003 document of the European Union, described earlier in this section. It recommended ‘en bloc’ endorsement of all existing IAS (1 to 41, inclusive) and SICs (1 to 33, inclusive) to the extent that they were extant at 1 March 2002. However, the advice did not include the conceptual framework. I discussed this discussed on 13 September 2010 with Ulf Linder and Reinhard Biebel, staff members of the European Commission. Both were at the time, in different capacities, related to or involved in the initial endorsement activities of the EFRAG. They explained that the European Commission decided that no request for endorsement was necessary under the IAS regulation:

- The regulation referred to standards. The conceptual framework was not a standard and could, as such, not be part of the endorsement process;
- The conceptual framework was not binding and was considered as guidance for standard setters and interpretations only; and
- The member states had different views on the status of the conceptual framework: some countries considered it binding, while others took it as guidance that could be overruled. For this reason, it would have been difficult to incorporate it in the European legislation.

The first endorsement advice referred to the IAS regulation, stated that the standards met its requirements, and recommended endorsement of the current standards. However, it also noted that IAS 39 gave rise to great difficulties – particularly in the area of hedge accounting – and was currently under review by the IASB. The European Commission subsequently endorsed all standards apart from IAS 32 and IAS 39 in 2003.\(^{88}\) With the exception of one IFRIC,\(^{89}\) not relevant for this dissertation, all subsequent advices were positive, although occasionally with some dissenting views.

In general, the endorsement process went rather smoothly. Significant delays near the end of 2005 were overcome quickly, and, as a result, the EFRAG endorsement status report of 27 January 2006 mentioned that all decisions relevant for the 2005 annual accounts had been taken.\(^{90}\) Furthermore, it stated: “The Commission has announced that, if an IASB document is endorsed and published after the balance sheet date but before the date of the financial statements, it can be treated as endorsed for the purposes of those financial statements if application prior to the date of endorsement is permitted by both the Regulation endorsing the document and the related IASB document.” This approach was discussed and approved in a joint meeting of the ARC and the Contact Committee on 30 November 2005.\(^{91}\)

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\(^{87}\) EFRAG (2002).
\(^{88}\) European Commission (2003e).
\(^{89}\) EFRAG (2005).
\(^{90}\) EFRAG (2006).
\(^{91}\) European Commission (2005g).
As is mentioned above, the European Commission did not endorse IAS 32 and IAS 39 on financial instruments as part of the ‘en bloc’ procedure. As a result of amendments in these standards after 1 March 2002, the EFRAG had to assess the revised standards. It issued a positive endorsement advice on (amended) IAS 32 on 8 July 2004,\(^\text{92}\) and the adoption was published on 31 December 2004.

Also on 8 July 2004, the EFRAG issued its endorsement advice on amended IAS 39.\(^\text{93}\) It mentioned that five members of the TEG voted to support and six members voted to oppose endorsement. The arguments in favour and against the standard were reflected in the letter. The members were united in supporting very significant parts of IAS 39, but some members opposed certain important elements of the standard, in particular in respect of hedge accounting, liabilities repayable on demand and some other measurement issues.\(^\text{94}\) As a result of the voting, the EFRAG was not in a position to issue any advice whether to endorse IAS 39 or not. On 26 September 2004, the EFRAG issued another letter to the European Commission on IAS 39, responding to a request to give technical input to two ‘carve-outs’ proposed by the European Commission.\(^\text{95}\) It discussed the technicalities, but also stated that the EFRAG made its evaluation based on the assumptions that the carve-outs were intended to be temporary and that the EFRAG did not express any opinion on whether the carve-outs were desirable solutions.

The first carve-out would impose a restriction on the use of the fair value option, which allowed companies to report the changes in any financial assets or liabilities in the profit and loss account, if certain conditions were met. This fair value option was well received by the preparers but not by the regulators who feared that the option might be used inappropriately by weaker financial institutions to reduce their liabilities to their fair values. In response to these concerns, the European Commission requested the IASB to introduce changes to IAS 39 restricting the use of the fair value option. The European Commission proposed a temporary carve-out of the fair value option, but hoped the issue would be solved by early 2005: if so, it would remove this carve-out from endorsed IAS 39. The second proposed carve-out would facilitate the use of fair value hedge accounting for the interest rate hedges for core deposits on a portfolio basis, an issue heavily promoted by European banks.\(^\text{96}\) Since this topic is not relevant for insurers, it will not be further discussed. The carved-out version of IAS 39 was adopted by the European Commission on 19 November 2004.\(^\text{97}\)

Subsequently, the IASB introduced several changes in IAS 39, including a limitation of the fair value option. The EFRAG supported the changes by issuing positive endorsement advices and the European Commission adopted all amended standards.

\(^{92}\) EFRAG (2004c).
\(^{93}\) EFRAG (2004d).
\(^{94}\) As is mentioned in the beginning of this section, the contents of the standards are presented later in this chapter as part of the Dutch financial reporting developments. For this reason, the specific issues listed here are not discussed in this section.
\(^{95}\) EFRAG (2004e). According to De Accountant (2004b), four member states indicated that they would vote against endorsement in the meeting of the ARC held on 14 June 2004.
\(^{96}\) This issue was strongly related to the objections of a number of European banks against the ‘deposit floor’ in IAS 39. Under this method, measurement of these liabilities had to be based on contractual maturities, instead of expected maturities. The debate on endorsement of IAS 39 was lengthy and fierce: even high politicians such as the French president Jacques Chirac involved themselves in the discussions.
\(^{97}\) European Commission (2004e).
While the IASB discussion on changes were taking place, the European Commission published a memorandum on the fair value option, now stating that own debt instruments could be measured at fair value – despite the prohibition in the fourth directive – since the IAS regulation explicitly stated that subject to the application of a standard resulting in a true and fair view of the financial position of a company, there did not need to be a strict conformity with each and every provision of the accounting directive.  

On IFRS 4, an interim standard on insurance contracts described later as part of the Dutch financial reporting developments, the EFRAG issued its endorsement advice on 4 June 2004. The letter stated that two significant concerns (the accounting mismatch between assets and liabilities, and the deposit floor limitation for contracts falling under IAS 39) had not been fully satisfied in the final standard. Both issues resulted in annual accounts that did not reflect the real economic situation of European insurers. However, the EFRAG acknowledged that IFRS 4 had not been developed as a long-term standard, but, rather, had to be seen as a stepping stone towards a more comprehensive and conceptually sound standard dealing with the accounting issues for insurance contracts that met the needs of all stakeholders. For this reason, the EFRAG believed that the standard would serve the interest of Europe because it would improve existing accounting practices for insurance contracts, and recommended its adoption. The letter did not include the specific requirements of the IAS regulation. The positive endorsement decision was published on 31 December 2004.

8.3.3.4 The ‘Lamfalussy approach’ and the establishment of the ‘Committee of European Securities Regulators’

Another development in the EU concerned the introduction of the so-called ‘Lamfalussy approach’ in 2001, based on the report dated 15 February 2001 of a ‘Committee of Wise Men’ chaired by the Belgian economist and central banker Alexandre Lamfalussy, appointed to issue recommendations on the future regulation of European securities markets. It noted that the EU’s current regulatory framework was too slow, too rigid, complex and ill-adapted to the pace of global financial market change. Existing rules and regulations were implemented differently and therefore inconsistencies occurred in the treatment of the same type of business, which threatened to violate the prerequisite of the competitive neutrality of supervision. Therefore, the committee proposed a new approach for securities market regulation, centred on a four level approach:

- Level 1: the creation of framework principles to be decided by the normal EU legislative procedures (i.e. a proposal by the European Commission to the Council of Ministers/European Parliament for co-decision);

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100 Stig Enevoldsen, at the time the chairman of the EFRAG, explained to me on 14 April 2010 the reason for this deviating text: the TEG was not happy and did not think the standard met the endorsement criteria per se, but also decided not to block endorsement. For this reason, the letter spelled out the concerns, while the other letters were mostly quite short in those days.
102 An example is included in Schoenmaker and Mink (2002): in 2002, 39 different prudential supervisors existed in the EU.
103 Lamfalussy (2001).
- Level 2: the establishment of two new committees – a ‘Securities Committee’ and a ‘Securities Regulators Committee’ to assist the European Commission in determining how to implement the details of the level 1 framework;
- Level 3: the introduction of enhanced cooperation and networking among EU securities regulators to ensure consistent and equivalent transposition of level 1 and level 2 legislation (common implementing standards); and
- Level 4: the introduction of strengthened enforcement, notably with more vigorous action by the European Commission to enforce community law, underpinned by enhanced cooperation between the member states, their regulators, and the private sector.

Schematically, the levels and proposed procedures were as presented below.

The proposals were adopted by the European Commission and resulted, in June 2001, in the establishment of the ‘Committee of European Securities Regulators’ (henceforth, the ‘CESR’), which was the ultimate name of the ‘European Securities Regulators Committee’.104 Simultaneously, the ‘European Securities Committee’ was created.105

The CESR issued a number of publications on different topics. One group focused on financial reporting under IAS/IFRS. The ‘Recommendation for additional guidance regarding the transition to IFRS’, issued in December 2003, encouraged companies that had to apply IAS/IFRS from 2005 onwards to describe, in their 2003 financial statements, their plans to achieve this.106 The CESR also encouraged these companies to disclose financial information on the impact in their 2004 accounts.


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104 European Commission (2001i).
This CEIOPS document was supplemented, in October 2005, by another on alternative performance measures, which were data that were not, as such, extracted from the financial statements. Examples were operating earnings or embedded value. Such measures could provide investors with appropriate additional information if properly used and presented. However, they could also mislead investors by hiding the real financial position and results or by making the profitability of the reporting entity seem more attractive. For these reasons, the CESR recommended a number of principles when alternative performance measures were used, to increase transparency, comparability and consistency. The October 2005 statement was aligned with a similar document issued by the IOSCO in 2002. In my view, these documents showed again that the focus of the European activities had shifted from investors and third parties to, solely, investors.

Next to the CESR, level 2 and level 3 committees were also created for the banking sector (the ‘European Banking Committee’ and the ‘Committee of European Banking Supervisors’, henceforth, the ‘CEBS’), and for the insurance sector (the ‘European Insurance and Occupational Pensions Committee, henceforth, the ‘EIOPS’, and the ‘Committee of European Insurance and Occupational Pensions Supervisors’, henceforth, the ‘CEIOPS’). The European Banking Committee was officially established in March 2005, replacing the Banking Advisory Committee. The CEIOPS was the successor of the Conference of European Insurance Supervisory Authorities, and the EIOPS replaced the Insurance Committee.

8.3.4 Summary and conclusions
In the period described in this chapter, the IASC became the independent IASB, the IOSCO and the Basel committee endorsed IAS, and the EU decided to require companies listed in the European Communities to prepare their consolidated annual accounts under IAS/IFRS from 2005 onwards, at the same time allowing this for their non-consolidated financial statements and for non-listed companies. With this decision, the European Commission concluded a debate that it had started in the early 1990s on the future of its accounting directives. But it also introduced an increased focus on the information needs of investors, in line with that of the IASB. These developments resulted in the establishment of a European endorsement mechanism and the creation of the EFRAG and the ARC as two important parties in this process, and in amendments of the accounting directives to eliminate a number of differences between these directives and IAS/IFRS.

The European adoption of IAS/IFRS was, in my view, not just an important but also a bold move, since it occurred at a time when a number of standards were still under improvement or even development (such as the one on insurance contracts) and there was not yet a stable financial reporting platform. In fact, as is shown in the next section, the standards applicable to the 2005 financial statements were only finalised mid-2005.

On the global level, another development concerned the activities of the IAIS, which issued, in 2000, a standard on the supervision of financial conglomerates that enabled the continuation of the Dutch solo-plus approach introduced a decade earlier.

107 CESR (2005).
108 IOSCO (2002).
110 CEIOPS (2005a).
111 CEBS (2005).
And in 2005, the IAIS issued another paper that explained that its preferred approach was to have as much similarity as possible between the financial statements and the prudential returns. In other words, it supported (without specifying the type) the single-track reporting approaches which were customary in the Netherlands and the UK, and rejected in the US. Since the IAIS, in fact, supported the existing Dutch situation in both areas, its impact on the Dutch prudential reporting requirements in the period was, in my view, virtually absent.

The final development in the period was, in 2001, the introduction of the so-called ‘Lamfalussy approach’ in the European legislative environment, which resulted in the establishment of a number of new committees to create and coordinate improved supervision of banks (by the CEBS), insurers (by the CEIOPS), and listed companies (by the CESR). The latter issued several requirements in respect of financial reporting, among others in respect of the transition to IAS/IFRS and the presentation of alternative performance measures such as operating earnings and embedded value.

8.4 Financial reporting developments in the Netherlands and the European Union, and the non-incorporated pronouncements of the IASB

8.4.1 Introduction
In this period, the Dutch government made two fruitless attempts to introduce improvements in the financial reporting requirements, one in respect of the financial statements of insurance companies, and another concerning goodwill accounting. It did, however, implement the European IAS regulation and the amended accounting directives.

This section also describes the activities of the RJ, which continued to incorporate, to a large extent, IAS/IFRS in its own pronouncements. Since listed companies were required, from 2005 onwards, to apply IAS/IFRS in their consolidated accounts, and other companies were permitted to do so, it is necessary to also present the non-incorporated pronouncements of the IASB, because they were, as a result of the IAS regulation (described in the previous section) and the related changes in the Dutch financial reporting legislation, part of the Dutch financial reporting requirements for these companies if they reported under IAS/IFRS. They are presented in a separate subsection after the descriptions of the activities and the guidelines of the RJ. As is discussed later when presenting the Dutch prudential reporting developments, these developments had impacted the prevailing single-track reporting approach, since they resulted in a type 8 approach for all Dutch insurers.

Since the amount of available literature of the actual reporting practices in the Netherlands of non-insurers was limited, the findings are incorporated in the descriptions of the actual reporting practices described later in this chapter and, in contrast to the previous chapters, not presented as a part of this section.
8.4.2 Legislative developments

8.4.2.1 The recommendations of the ‘Traas committee’
As is described in the previous chapter, this committee was installed by the government at the end of 1999 to investigate possible improvements in the financial reporting requirements for insurance companies.\textsuperscript{112} According to its mandate, the focus was on both financial and prudential reporting requirements, and on practical short-term improvements to be aligned to ongoing international developments.\textsuperscript{113} Furthermore, the existing practice of a single-track reporting should be maintained. The committee issued its report in May 2001, which included a large number of recommendations, grouped in four core issues: the meaning of profit and the measurement of investments, the introduction of a statement of other comprehensive income, additional disclosures on the technical provisions, and additional disclosures in respect of solvency information. Regarding gains and losses on investments, the committee expressed an explicit preference for the ‘all-inclusive’ concept. As second best, it recommended a system under which realised gains and losses on investments should always be included in the profit and loss account. The application of the structural indirect return method should be prohibited.

The recommendations raised considerable debate in the insurance industry.\textsuperscript{114} Despite these comments, the government started the preparation of a bill based on the recommendations on the core issues.\textsuperscript{115} However, several members of the Second Chamber expressed serious concerns about the government intentions, since they wondered whether the committee’s proposals were aligned with IAS and would not result in two series of changes (the implementation of these new regulations and the transition to IAS/IFRS) in a rather short period of time. Although the government denied this (a view that I, based on my knowledge of the ongoing developments at the time, fully supported), the debate resulted in a temporary stand-still situation, and nothing happened until February 2003, when a bill to amend the articles in the civil code concerning the financial statements of insurance companies was submitted.\textsuperscript{116} Its focus was on those insurers that would not transition to IAS/IFRS, to create more alignment with Dutch GAAP.\textsuperscript{117} For that reason, only those topics on which there was international agreement were addressed, the most important ones being a prohibition of the structural indirect return method (at the time, used by 50 companies) and the introduction of a requirement that all realised gains and losses should be included in the profit and loss account (resulting in a change in accounting policies for 65 companies). However, the bill was not able to address the 2001 concerns of Parliament and was put aside for more than two years.

The government restarted its activities only at the end of 2005, after the implementation of the revised EU accounting directives, described later in this section. A number of proposals in the original bill were deleted, and the amendment act was only adopted in March 2006.\textsuperscript{118} Since this date is outside the scope of this dissertation, the contents of this act are not described.

\textsuperscript{112} See section 7.4.2.3.
\textsuperscript{113} Commissie Traas (2001).
\textsuperscript{114} For instance, see Verhoog (2001) and van Beurden (2001).
\textsuperscript{115} Tweede Kamer (1999b), nr. 26489.
\textsuperscript{116} Tweede Kamer (2003a), nr. 28799.
\textsuperscript{117} As is noted in the introduction to this chapter, from 2005 onwards the term Dutch GAAP excludes IAS/IFRS.
\textsuperscript{118} Minister van Justitie (2006a), Staatsblad 2006, nr. 180.
In my view, the debate in the Second Chamber shows that it had, in reality, no intention at all to improve, at the time, the reporting requirements for insurers. As a member of the Traas committee (and as the editor of its final report), at the same time that I was a member of several advisory committees of the IASC, I was sure that the committee’s recommendations were fully aligned with IAS as it was at the time, and with its most likely developments. This was, in my view, confirmed by subsequent developments, which show that none of the core recommendations of the committee was in conflict with IAS/IFRS effective as at 31 December 2005. In my opinion, the delay caused by Parliament was a missed opportunity to create short-term improvements in the financial and the prudential reporting requirements for insurers.

8.4.2.2 The implementation of the IAS regulation and the amendments in the accounting directives

As is described next, the first steps to implement IAS in the Dutch financial reporting legislation occurred in the beginning of the 21st century, when the Dutch government published its plans to enable companies to apply IAS, in line with the announcements of the European Commission described earlier in this chapter. This followed the statements made in May 1999, when the government noted that it should be possible, for companies active internationally, to apply, under certain conditions, IAS or US GAAP, and clarified that it would amend the existing legislation, where necessary.\footnote{Tweede Kamer (1999c), nr. 25732.} This intention was confirmed in August 2000, when the government announced that the civil code would be amended.\footnote{Ministerie van Justitie (2000c).} A bill was submitted in February 2002.\footnote{Tweede Kamer (2002a), nr. 28220.}

This bill proposed that the application of IAS was allowed, if all standards were applied, the requirements of the European accounting directives were met, and the necessary ‘insight’ was provided. The application of US GAAP was not permitted. The reporting company had to disclose which standards it applied, and if it followed the requirements in the Dutch civil code, it had to state whether or not its financial statements were compliant with the guidelines of the RJ (which was, in my view, a clear recognition of the growing importance of the RJ over the years). Finally, the legal option to charge goodwill directly to the reserves was deleted; instead, goodwill had to be capitalised and amortised.

In particular the last proposal triggered discussions in Parliament, where members opposed the proposed prohibition, but also questioned the requirement to clarify whether or not the guidelines of the RJ had been applied. Based on these views, the government dropped this part of its proposals in July 2004, but maintained its position on goodwill accounting. In response, the Second Chamber voted, in February 2005, in favour of an amendment to remove this part of the bill and to keep allowing goodwill to be charged to the reserves.\footnote{Tweede Kamer (2005a), Handelingen 10 februari 2005.}\footnote{Tweede Kamer (2002a), nr. 28220, nr. 16.} A final vote on the bill as a whole was, at the request of the government, postponed, since there was, after the rejection of the goodwill proposal and the progress in the discussions on another bill, described hereafter, hardly anything left to adopt. The bill was subsequently withdrawn in May 2005.\footnote{Tweede Kamer (2002a), nr. 25732.}
This other bill was submitted in May 2004 to implement the IAS regulation, described earlier in this chapter as part of the European reporting developments, and directives 2001/65/EC and 2003/51/EC amending the existing accounting directives.\textsuperscript{124} Consistent with the historical Dutch approach, only the mandatory parts of the regulation and the directives were incorporated as requirements, and, as is described hereafter, almost all options were maintained. The amendments would be applicable at 1 January 2005.

Directive 2001/65/EC dealt with fair value accounting for financial instruments.\textsuperscript{125} It enabled the application of IAS 39 (described later in this section) for companies falling under the fourth directive, the seventh directive and the banking accounts directive, by amending these directives. Regarding insurance companies, the preamble stated that the European Commission might bring forward similar proposals to amend the insurance accounts directive after having consulted the relevant advisory committee.\textsuperscript{126} In line with the strategy regarding IAS, it was necessary to maintain consistency between these standards and the accounting directives, and to allow certain financial assets and liabilities to be measured at fair value. However, this should only be possible for those items where there was a well-developed international consensus that fair value accounting was appropriate. It should not be applied to all financial assets and liabilities, for instance not to most in the banking book.

Under the amended fourth directive, the member states should permit or require valuation at fair value of financial instruments, including derivatives. However, regarding liabilities this was only possible if they were held as part of a trading portfolio or were derivatives. Fair value accounting should also not apply to financial instruments held to maturity, loans and receivables originated by the company and not held for trading purposes, and participating interests. If no reliable measurement would be possible, historical cost accounting was required. A change in fair value should be included in the profit and loss account, but the member states could permit or require such a change on an available-for-sale financial asset to be included directly in equity, in a fair value reserve. Such reserve should be adjusted when amounts therein were no longer necessary.

Directive 2003/51/EC, called the ‘modernisation directive’, amended all four existing accounting directives to create a level playing field between companies applying IAS/IFRS and those that did not.\textsuperscript{127} Under the revised fourth directive, the member states could permit or require all companies or any classes of company to value specified categories of assets other than financial instruments at fair value. This could be restricted to the consolidated accounts. The directive did not provide a definition of these ‘specified’ assets. Furthermore, the member states could permit or require, with the same scope, the fair value changes of such assets to be included in the profit and loss account. In addition, the amendments eliminated a number of other (potential) differences between IAS/IFRS and the accounting directives. The directive also amended the insurance accounts directive along the lines of the changes in the fourth directive, introducing member states options to permit or require specified assets other than financial instruments to be measured at fair value. However, again, no definition of such assets was provided.

\textsuperscript{124} Tweede Kamer (2004e), nr. 29737.  
\textsuperscript{125} European Commission (2001k).  
\textsuperscript{126} As is described in section 7.4.2.2.2, the insurance accounts directive included cost accounting as the basic valuation principle for investments. However, the member states could permit or require investments to be measured at their current values.  
\textsuperscript{127} European Commission (2003b).
The Dutch May 2004 bill proposed to allow the application of IAS/IFRS in the consolidated financial statements of all companies, even if this was not required under the regulation. Furthermore, it also allowed IAS/IFRS in the non-consolidated financial statements if this system was applied in the consolidated statements. The only prohibited combination was the preparation of consolidated financial statements under Dutch GAAP, and the use of IAS/IFRS in the non-consolidated accounts (although such combination was allowed under the IAS regulation, as a member state option). Any differences between the amounts of equity in both accounts should be disclosed and explained.

Although the European IAS regulation allowed the application of US GAAP instead of IAS/IFRS until 2007 in certain cases, the government had deleted this option in the bill, since this would undermine the comparability goal behind the transition to IAS/IFRS. All necessary amendments to enable a wider application of fair value accounting would be included in an amended Administrative Decree on the valuation of assets.

During the discussions in Parliament, the topic of goodwill accounting was raised again, as well as the issue that, under the proposals, the amounts of equity in the consolidated and non-consolidated financial statements could be different. This issue was also raised by the business community. Both Parliament and the preparers wanted to maintain the prevailing approach to report the same amounts of equity and result in the consolidated and the non-consolidated financial statements. To achieve this, an amendment to the bill was submitted, proposing the possibility to apply the same accounting policies in the Dutch GAAP-based non-consolidated accounts as applied in the IAS/IFRS-based consolidated accounts. Furthermore, a clear legal distinction between the two sets of accounts would be introduced, breaking the traditional bond under which the consolidated accounts were, legally, considered to be part of the notes to the non-consolidated accounts.

In February 2005, another amendment to the bill was proposed, linked to the withdrawal of the bill on the early adoption of IAS/IFRS. The amendment required goodwill, if capitalised, to be amortised. However, given the voting results in the Second Chamber on the other bill, the original proposal to prohibit a direct charge of goodwill to the reserves was not included. The Second Chamber adopted the bill on 15 March 2005. The First Chamber followed, without debate, on 4 July 2005. The final act was published shortly after. It became effective immediately, making it applicable to the 2005 financial statements. The related ‘Besluit actuele waarde’ (the ‘Decree on current value’), replacing the Decree on the valuation of assets, was effective for the same financial statements.

8.4.2.3 The development of the act on the supervision of financial reporting
The last Dutch legislative action in respect of financial reporting requirements concerned the development of the ‘Wet toezicht financiële verslaggeving’ (the ‘act on the supervision of financial reporting’). It started with a letter from the government to Parliament at the end of May 2002. The initiative to propose the act was directly linked to the decision of the European Commission to require the use of IAS/IFRS in the consolidated annual accounts of companies listed in the EU, described in the previous section.

131 Minister van Justitie (2005e), Staatsblad 2005, nr. 378.
133 Tweede Kamer (2002b), nr. 28386.
The preamble to the 2002 IAS regulation clarified that a successful implementation of this reporting regime was only possible under an appropriate system of national supervision and enforcement, to safeguard the quality of the financial statements. The May 2002 letter explained that the responses to a 2001 consultation document on public-sector supervision of financial reporting showed that such a development received broad support, and that the government intended to draft a bill, regulating supervision on all financial reporting publications issued by companies listed on the Amsterdam Stock Exchange, and on compliance with national and European financial reporting requirements. The supervision should be done after the filing of the published documents, and not in advance. It would be exercised by the ‘Autoriteit Financiële Markten’ (the ‘Authority for the Financial Markets’, henceforth, the ‘AFM’), which was, since 1 March 2002, the successor of the STE.  

A bill for the act was submitted to Parliament at the end of October 2005.  

The act was finally adopted at the end of September 2006. As this date is outside the scope of this dissertation, its contents are not discussed.

8.4.3 The status, role, and pronouncements of the RJ

8.4.3.1 The continuing debate on the status and role of the RJ

During the last period reviewed in this dissertation, the debate on the status and the role of the RJ continued. In respect of its status, it started in November 2002, when the Enterprise Chamber ruled in a court case on the 2000 annual accounts of ‘KPN’ that the guidelines should be considered as the elaboration of the legal requirements, and that the involved company had not sufficiently motivated why it had not followed them. According to Hoogendoorn, at the time the chair of the RJ, this gave the guidelines a sort of legal basis. The ruling was confirmed one year later, when the Enterprise Chamber stated in another case that the guidelines should be considered as authoritative literature in respect of the legal requirements for financial reporting. However, they were not mandatory, and the guidelines should be assessed in each case that compliance with the legislative requirements was reviewed. In other words, the start should always be the legal requirements, followed by jurisprudence, and the guidelines were the third level to be assessed. But if a final guideline was relevant, any deviations from its affirmative pronouncements should be justified.

On the role of the RJ, Vergoossen advocated, early 2003, that the adoption of the IAS regulation required a re-evaluation of its position and composition. In his view, neither the European nor the Dutch legislator were able to respond, in a timely manner, to the international developments in respect of financial reporting requirements, and the RJ, with its existing structure of delegations and consensus, was also not in an appropriate position to perform this role.

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134 Minister van Financiën (2002), Staatscourant 2002, nr. 134.
135 Tweede Kamer (2005c), nr. 30336.
136 Minister van Justitie (2006b), Staatsblad 2006, nr. 475.
137 Beckman and Harmsen (2008), part 9, p. 9.41.01-9.41.42.
139 Schoonderbeek (2004).
140 A ruling of the Supreme Court in the same case, adopted in February 2006, strengthened the position of the RJ even further. According to the court, the RJ pronouncements were an important point of orientation and an authoritative source to determine what was acceptable in a certain case. See Beckman and Harmsen (2008), part 9, p. 9.41.42-9.41.61.
141 Vergoossen (2003).
According to Vergoossen, the only possible solution would be to reform the RJ into an organisation of independent members, who decided on a majority basis, and were able to issue pronouncements with sufficient authoritative status that could be enforced in practice.

A further development occurred in 2005, when, to clarify its status, the RJ changed its English name from the ‘Council for annual reporting’ into the ‘Dutch Accounting Standards Board’, and its ‘Guidelines for annual reporting’ into ‘Dutch accounting standards’, to emphasise the status of its pronouncements. 142 It had come to the conclusion that the authoritative level of ‘guidelines’ was perceived less than was intended, but that the term ‘directives’ was too strong: for this reason, the choice was made for the term ‘standards’.

Finally, the RJ issued, also in 2005, a strategy document discussing the consequences of the IAS regulation for its activities. 143 Based on the diminished group of users of its pronouncements, it decided, going forward, to incorporate the developments in IAS/IFRS only if they were considered adequate for the Dutch financial reporting environment. At the same time, it considered it desirable to avoid, as much as possible, discrepancies between IAS/IFRS and the guidelines by allowing, whenever possible, all options made available by the IASB and to expand them if necessary.

8.4.3.2 The pronouncements of the RJ and the related IAS/IFRS
In this period, the RJ continued its practice, described in the previous chapter, 144 to issue bound volumes, which included final guidelines that were applicable in the next year as well as draft guidelines. This section describes those that are relevant for this dissertation, organised by topic.

General topics
During the period, the process to incorporate, as much as possible, the pronouncements of the IASC/IASB continued. The first topic concerned provisions, on which draft guideline ORJ 252 had been issued in 1999. 145 It was finalised as RJ 252 in 2000, and incorporated IAS 37 ‘Provisions, contingent liabilities and contingent assets’. 146 This standard was issued in July 1998. 147 It applied to a large group of provisions, but not to liabilities from insurance contracts. A provision should be recognised when, and only when, the company had a present obligation (legal or constructive) as a result of a past event, it was probable (i.e. more likely than not) that an outflow of resources embodying economic benefits would be required to settle the obligation, and a reliable estimate could be made of the amount of the obligation. The provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date. Risks and uncertainties should be taken into account, as should, when material, the time value of money. Provisions should be re-estimated each balance sheet date and reversed when an outflow was no longer probable. Furthermore, a provision should only be used for expenditures for which it was originally recognised. The standard also provided guidance for the recognition of restructuring provisions, which could only take place if certain strict conditions were met. However, as a deviation of IAS 37, RJ 252 still allowed a maintenance provision.

143 RJ (2005a).
144 See section 7.4.3.3.
145 See section 7.4.3.3.
146 RJ (2000b).
147 IASC (1998g).
The 1999 bound volume of the RJ also included a change in RJ 240 on equity, to adopt SIC 16 ‘Share capital – reacquired own equity instruments (treasury shares)’, approved in June 1998. Under this interpretation, treasury shares should be deducted from equity and not presented as assets.

A next publication was issued at the end of 1999 and concerned ORJ 600 on the financial statements of banks. It was prepared in cooperation with the Dutch Bankers Association and the DNB, and was based on the civil code. But it also took account of IAS 30. Next to expanded disclosure requirements, the main features of the draft guideline were:

- Positive and negative gains and losses from exchange transactions of fixed-income instruments were, preferably, amortised, if specific conditions were met. However, it was also allowed to recognise these amounts directly in the profit and loss account; and
- Next to securities and derivatives, also other financial instruments could be included in the trading or in the investment portfolio, depending on the intentions for holding these instruments and the way in which this intention was embedded in the organisation and the administrative systems. Financial instruments could also be included in the banking book, if they were intended to generate a periodic stream of interest income.

According to the bankers W. ten Berg et al., the guideline did not introduce any major changes in the financial statements of banks, since it mainly codified existing practices. The draft was converted into a final guideline in 2000.

The main part of the mid-2001 bound volume focused on the implementation, through ORJ 213, of IAS 40 ‘Investment property’. The draft guideline was finalised as RJ 213 in 2002. IAS 40 was approved in March 2000. Investment property was defined as property held to earn rentals or for capital appreciation or both. It should initially be measured at cost plus transaction costs. Subsequent expenditure should be added to the carrying amount when it was probable that future economic benefits, in excess of the originally assessed standard of performance, would flow to the company. All other subsequent expenditure should be expensed. In respect of subsequent measurement, the company should choose either the fair value model or the cost model. Under the fair value model, all investment property should be measured at fair value, with gains and losses arising from changes in fair value included in the profit and loss account. Under the cost model, the property should be measured in the same way as property, plant and equipment under IAS 16, i.e. cost less depreciation and impairments.

In the mid-2001 volume, SIC 18 ‘Consistency – alternative models’, approved in May 1999, was incorporated as RJ 110. SIC 18 stated that in case of a permitted choice of accounting policies, a company should choose and apply consistently, unless a standard or interpretation specifically required or permitted categorisation of items for which different policies might be appropriate.

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149 RJ (1999c).
150 See section 7.4.2.1.3.
151 ten Berg et al. (2000).
152 RJ (2000b).
153 RJ (2001b).
154 RJ (2002a).
155 IASC (2000a).
156 IASC (1999b).
Under SIC 18, a company should select the most appropriate accounting policy and apply it consistently to each category. Once a policy was selected, a change was only possible in accordance with IAS 8, i.e. when it would result in a more appropriate presentation of transactions and events.

The next bound volume of the RJ was issued mid-2002.\textsuperscript{157} Further amendments were made to align the guidelines with the pronouncements of the IASB, e.g., regarding the treatment of extraordinary income and charges, and several draft guidelines were made final. To achieve further consistency with IAS 1, a draft guideline was included requiring a statement of comprehensive income, which could be presented as a fourth primary schedule (next to the balance sheet, the profit and loss account, and the cash flow statement), but could also be part of the notes. The schedule could be presented as part of a movement schedule of equity as well. The draft guideline was finalised in 2003.\textsuperscript{158}

The mid-2002 volume also included a draft guideline to incorporate SIC 17 ‘Equity – cost of an equity transaction’. It was approved in May 1999, and stated that the cost of an equity transaction should be deducted from equity, net of any related income tax benefit.\textsuperscript{159}

Mid-2003, a number of amendments from revised IAS or SICs were incorporated in the RJ guidelines, and several draft guidelines were converted into final ones.\textsuperscript{160}

The next bound volume was issued mid-2004.\textsuperscript{161} It noted that because listed companies were, from 2005 onwards, required to use IAS/IFRS and the government intended to allow the application of these standards by non-listed companies, the 2004 edition had been considerably restructured and was now only applicable to large and medium-sized companies which continued to report under Dutch GAAP.\textsuperscript{162} The amendments introduced in the volume were not relevant for this dissertation.

In September 2005, the RJ issued another bound volume.\textsuperscript{163} In contrast to existing practice, its contents were, for a large part, applicable for the reporting year 2005, since it included a number of changes related to amended financial reporting legislation and the new Administrative Decrees mentioned earlier in this section. However, some new or amended final guidelines were only applicable from 2006 onwards. The only relevant draft guideline concerned changes in accounting policies (ORJ 140) prohibiting reporting the impact of such changes in the profit and loss account.

**Financial instruments**
In February 2001, the RJ issued a discussion paper regarding financial instruments, with draft guideline ORJ 290a as an annex.\textsuperscript{164} It noted that, given the complexity of such instruments, it had decided to issue such a paper to explain the contents of IAS 39, described later in this section, and ask comments on a number of controversial topics included in this standard.

\textsuperscript{157} RJ (2002a).
\textsuperscript{158} RJ (2003).
\textsuperscript{159} IASC (1999a).
\textsuperscript{160} RJ (2003).
\textsuperscript{161} RJ (2004).
\textsuperscript{162} As is noted in the introduction to this chapter, in this case IAS/IFRS is excluded from the meaning of Dutch GAAP.
\textsuperscript{163} RJ (2005c).
\textsuperscript{164} RJ (2001a).
The discussion paper clearly stated the intention of the RJ to implement IAS 39 without amendments, unless this was necessary because of the Dutch legal requirements. In this respect, it referred to the proposed amendments in the fourth and seventh directive to enable fair value measurement of financial instruments, described earlier in this section. It also noted that changes in the existing industry standards would be required, in particular for banks and insurance companies, among others because IAS 39 prohibited the amortisation of realised gains and losses, as was customary in these industries in case of exchange transactions. For banks, this is described earlier in this section when presenting the guideline for the financial statements of these companies; for insurers, it is explained in their guideline. The RJ, however, considered international harmonisation more important than maintaining industry exemptions, and therefore proposed to follow IAS 39 and abolish existing practices.

The auditors and RJ-project leaders P.H.M. Hofsté and P.F.J. Veuger noted in 2001 that the RJ received 58 comment letters on the discussion paper, in particular from banks. In general, there was very little support, because the standard was considered to be an interim standard, was of insufficient quality because of the time pressure applicable to its finalisation, and impacted the business activities of the banks.

In the subsequent years, the RJ maintained its position of ‘wait-and-see’, until, in September 2005, it issued a guideline on financial instruments (RJ 291), which only dealt with the Dutch legal requirements. It was already applicable for 2005. ORJ 290a was withdrawn, as its contents had become obsolete because of the rapid changes in the underlying IAS 39, discussed later in this section when presenting an overview of non-incorporated pronouncements of the IASB.

**Pension liabilities**

A new draft guideline ORJ 271 for employee benefits accounting was introduced in 1999, with only minor deviations from IAS 19, revised in 1998. This revised standard changed the definitions for post-employment benefits plans. It focused on the legal or constructive obligation of the company: if this was limited to the amount of the contribution, it was a defined contribution plan. This, in fact, meant that, under such schemes, the actuarial risk and investment risk fell on the employee.

In all other cases, the scheme was a defined benefit plan. The revised IAS 19 also provided amended guidance and definitions on multi-employers plans (including industry plans), state plans, and insured benefits. The main changes concerned measurement: projected benefit methods were eliminated and there was a requirement to use the accrued benefit method known as the projected unit credit method. Any constructive obligations should be included. The calculation was based on a number of actuarial assumptions, used as discount rate the market yield on high quality corporate bonds and included estimations on future salary increases and state benefits. Because of differences between assumptions and reality, and changes in assumptions, so-called ‘actuarial gains and losses’ occurred, which should only be recognised when they exceeded certain limits (the ‘corridor’). This excess was allocated to the profit and loss account over the expected average remaining working lives of the participants. However, a company could recognise such amounts faster.

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165 See section 7.4.3.4.
166 Hofsté and Veuger (2001).
167 RJ (2005c).
168 RJ (1999b).
The mid-2000 RJ bound volume noted that the number and contents of received comment letters on ORJ 271 had not enabled the RJ to finalise its discussions: the intention was to issue another consultative document on this topic. This occurred in 2002, in the form of a discussion memorandum, enabling continuation of the discussions before moving to a draft guideline. The RJ did not expect any final guideline to be effective before 2005. However, it did consider IAS 19 a good starting point to improve the accounting treatment of pension obligations and expenses, as well as the disclosure of the related risks, and had therefore based the document in this standard, with recognition of the specific Dutch business and societal environment regarding pension schemes. Compared to the 1999 draft guideline, the following important changes were introduced:

- Companies already providing information using US GAAP were allowed to use FAS 87. However, to be eligible they had to apply all relevant FASB statements in respect of employee benefits; and
- The distinction between defined benefit and defined contribution plans was not based on the descriptions in the pension schemes, but on who actually carried the actuarial risks, including investment risks.

The discussion memorandum included the changes made to IAS 19 in October 2000, which had introduced a revised definition of plan assets and the accounting treatment of reimbursements, e.g., by an insurance company. The memorandum also incorporated the limited amendments made to IAS 19 in May 2002.

Despite its earlier announcements, the mid-2003 RJ bound volume included a final guideline in respect of employee benefits, effective as of 1 January 2005. It was based on the 2002 discussion memorandum, and therefore on IAS 19, adjusted for the Dutch pension situation where applicable.

**Tax accounting**

In respect of tax accounting, the changes to the existing guidelines were limited. One occurred in 2001, when RJ 272 incorporated amendments to IAS 12. These were approved by the IASC in October 2000, removing the scope exclusion related to the accounting for the income tax consequences of dividends. The only other change took place in 2005 and concerned a change in RJ 272, mandating the creation of a deferred tax provision for revaluation differences.

**Consolidation, business combinations and goodwill accounting**

Concerning these topics, the RJ published two draft guidelines in 1999. Both were made final in 2000.
The first was ORJ 121, subsequently RJ 121, to implement IAS 36 ‘Impairment of assets’. This standard was published in April 1998, and applied to a large category of assets, but it excluded financial instruments. It was, however, applicable to goodwill and provided indicators for impairment and the methods to determine and account for impairment losses on this asset. Impairment was assessed using the concept of the ‘recoverable amount’. This was “the higher of an asset’s net selling price and its value in use”. For goodwill, the standard also introduced a new concept, the ‘cash-generating unit’. This was the “smallest identifiable group of assets that generated cash inflows from continuing use that were largely independent of the cash flows from other assets or groups of assets”.

The second draft guideline was ORJ 214, subsequently RJ 214, to incorporate a part of the revised IAS 22, issued in July 1998. It severely restricted the cases when restructuring provisions could be recognised in an acquisition, and introduced strict limits on the costs to be included. These changes were made for consistency with IAS 37. In addition, in determining the fair value of identifiable assets and liabilities, the intended use of the acquirer was no longer relevant. Finally, the amortisation period and impairment testing of goodwill was made consistent with the requirements of IAS 36. In the revision of the Dutch guidelines, also SIC 12 ‘Consolidation – special purpose entities’ was included. It was issued in June 1998, interpreting the consolidation requirements of IAS 27 when applied to a ‘special purpose entity’ (henceforth, a ‘SPE’). This was a company created to accomplish a narrow and well-defined objective (e.g., to effect a securitisation of financial assets), with legal arrangements that imposed strict limits on the decision-making powers of its governing board, trustee or management over the operations of the SPE, and specifying that the policy guiding the ongoing activities of the SPE could not be modified, other than perhaps by its creator or sponsor (i.e. they operated on so-called ‘autopilot’). SIC 12 determined that an SPE should be consolidated when the substance of the relationship between the company and the SPE indicated that the SPE was controlled by that company.

A further step of the RJ to incorporate IAS 22 was made in February 2000, with the publication of a separate draft guideline ORJ 500 on mergers and acquisitions. The standard was proposed to be adopted with only one minor change, which concerned the creation of a restructuring provision at acquisition: the RJ was, in this area, more liberal than the IASC. The ORJ introduced a requirement that almost all business combinations should be accounted by the purchase accounting method, under which acquired assets and assumed liabilities were measured at their fair values at the acquisition date. It also proposed to require capitalisation and amortisation of goodwill: the legal possibility to debit goodwill directly to equity should be abolished. This was in line with the position expressed in the 1999 discussion memorandum, discussed in the previous chapter. The draft simultaneously proposed amendments concerning the sale of participating interests, stating that any past charges of goodwill to equity should be partially reversed.

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182 The ‘net selling price’ is often described as the ‘fair value less costs to sell’.
183 IASC (1998f).
185 RJ (2000a).
186 See section 7.4.3.3.
In case the sale of a participating interest occurred within one year, the goodwill reversal should be 100%; in case of two years, the amount should be 80%, with another 20% for year subsequent year. RJ 500 was finalised in 2000.  

The 2001 edition of the RJ guidelines incorporated, through a change in RJ 500, the contents of SIC 22 ‘Business combinations – subsequent adjustment of fair values and goodwill initially reported’. This interpretation was issued in October 1999 and provided additional guidance on the possibility to restate goodwill after the acquisition date.  

The RJ position that goodwill had to be capitalised and amortised was changed in 2005. Referring to the political decision that the three existing methods to account for goodwill were maintained in the civil code (as is described earlier in this section when presenting the legal developments), the RJ now stated a preference to capitalise and amortise goodwill, allowed a direct charge to equity, and considered a direct charge to the profit and loss account not acceptable. The background of this position was explained in May 2006, when the RJ issued an addendum to its 2005 strategy document. The paper noted that the 2005 changes in the civil code had forced the RJ to reconsider the relationship between its pronouncements and the Dutch legislation. As a result, it had decided not to limit options that were explicitly included in the civil code, although it could express a preference for one or more options. The accounting treatment of goodwill fitted in this category. 

**Segment reporting**  
In respect of segment reporting, the RJ made no changes to its guidelines.  

**The statement of cash flows**  
The draft guideline on the cash flow statements for insurance companies (presented as illustrative examples) was finalised without changes.  

**The RJ-IAS alignment at the end of 2005**  
At the end of 2005, the following differences between the pronouncements of the RJ and the IASB existed as far as relevant for this dissertation:

- The scope of IAS 1 and IAS 7 was not aligned;  
- The December 2003 changes in IAS (which would, as is explained hereafter, result in some significant changes) were mostly not (yet) incorporated;  
- Some details in and elements of IAS 12, IAS 19, IAS 27, IAS 30, IAS 32, IAS 36, IAS 37 and IAS 40 were not (yet) included;  
- IFRS 1 on first-time adoption was not and would not be incorporated given its special character; and  
- IAS 39 on financial instruments, IFRS 3 on business combinations, IFRS 4 on insurance contracts and IFRS 7 on financial risk disclosures were not (yet) incorporated at all.

188 RJ (2001b).  
189 IASC (1999c).  
190 RJ (2005b).  
192 RJ (1999b).  
193 RJ (2005c).
Overall, this meant that, at the end of 2005, there were differences between the RI guidelines and IAS/IFRS, but these were mainly caused by the ongoing development of new or amended standards issued by the IASB. Ignoring the IASB pronouncements issued after December 2003, the level of alignment between the two sets of standards was, in my view, rather high.

8.4.4 Non-incorporated pronouncements of the IASB

8.4.4.1 The completion of the financial instruments project

As is noted in the previous chapter, the IASC decided in 1994 to split the financial instruments project into two phases.\textsuperscript{194} For the second phase focusing on recognition and measurement, a discussion paper was approved in March 1997,\textsuperscript{195} and exposure draft E62 in April 1998.\textsuperscript{196} A revised IAS 32 and a new standard IAS 39 followed in December 1998.\textsuperscript{197}

The 1997 discussion paper proposed that all financial assets and financial liabilities should be measured at fair value subsequent to initial recognition, and all gains and losses arising from changes in fair value should be recognised in the profit and loss account when they arose. This proposal raised considerable debate.\textsuperscript{198} There was support from the SEC, strong opposition from the banking industry,\textsuperscript{199} and some general concerns, particularly on the reporting of unrealised gains and losses in the profit and loss account and on the valuation of debt at fair value. In an attempt to meet the deadline for the project, the IASC decided to look for an interim solution, based on US GAAP.\textsuperscript{200} In a very short period of time, a (unpublished) draft standard was developed along these lines, to be discussed in October 1997. However, this approach – which came as a surprise to many people – raised strong resistance as well, in particular in continental Europe, where the proposal was perceived as a clear choice in favour of US GAAP, at a time when many large companies in Europe were hesitating whether they should opt for US GAAP rather than for IAS. In the end, the IASC rejected the proposal and decided to develop another draft standard.

This new exposure draft E62 proposed that the standard should only be mandatory for companies whose securities were publicly traded or were in the process of achieving this. The document introduced a general exception to the measurement principles, which applied to companies operating in an industry that had a defined and adopted practice of measuring substantially all financial assets at fair value in the profit and loss account. In such cases, they should apply this practice. Insurance companies were mentioned as one of the examples.

\textsuperscript{194} See section 7.4.3.3.
\textsuperscript{195} IASC (1997a).
\textsuperscript{196} IASC (1998b).
\textsuperscript{197} IASC (1998h) and (1998i), respectively.
\textsuperscript{198} Camfferman and Zeff (2007), p. 371-374.
\textsuperscript{199} Dickinson (2003) confirmed this resistance, in particular from the commercial banks, which disliked the volatility in equity and results as a result of the proposals. Koot (2000) noted that the proposals were also strongly rejected by the Dutch Bankers Association.
\textsuperscript{200} This deadline was related to the IOSCO endorsement process, discussed earlier as part of the global reporting developments. The relevant US standard was FAS 115: see section 7.5.2.2.
Under E62, the definitions in IAS 32 were expanded, to include, among others, derivatives, financial instruments held for trading purposes, held-to-maturity instruments, amortised cost, and the effective interest method. After initial recognition, financial assets, including derivatives, should be measured at their fair values, except for held-to-maturity investments and financial assets whose fair value could not be reliably measured. Held-to-maturity instruments and assets from the second category with a fixed maturity should be measured at amortised cost using the effective interest rate method. Assets in the second category without fixed maturity should be measured at cost. Financial liabilities should be measured at amortised cost, unless they were held for trading purposes or were derivatives: in these cases, they should be measured at fair value. Gains and losses resulting from a change in the fair value of a financial instrument that was held for trading purposes should be included in the profit and loss account, unless the instrument was part of a hedging relationship. Changes in the fair value of other financial instruments could be recognised either in the profit and loss account or directly in equity until the instrument was derecognised or impaired.

This accounting policy choice should apply to all financial assets and liabilities that were measured at fair value. Impairment losses on financial assets measured at amortised cost were determined, as for other assets, by comparing the recoverable amount with the carrying value. Reversal was possible up to the amount the amortised cost would have been without impairment. In case a company had chosen to measure the assets at fair value with gains and loss reported in equity, losses remained in equity until there was objective evidence that the asset was impaired. Although there were a number of notable differences, for instance in the impairment rules, E62 showed significant similarities with FAS 115 and FAS 133, presented in the previous chapter.

The final standard IAS 39 ‘Financial instruments: recognition and measurement’ was approved in December 1998, only three months after the end of the comment period on the exposure draft. IAS 32 was amended to create consistency with IAS 39. Some important changes were made in the definitions. The trading category was maintained, as was the category ‘held-to-maturity’, but the latter excluded ‘loans and receivables originated by the enterprise’. Another new category was ‘available-for-sale financial assets’, being those assets that were not included in one of the other three categories.

Subsequent measurement of financial assets was the area of biggest change compared to E62. A reporting company had to categorise its assets into the four categories mentioned above. Fair value was required, except for loans and receivables originated by the company and not held for trading, held-to-maturity investments, and any financial instrument that did not have a quoted market price in an active market and whose fair value could not be reliably measured. Of these, financial assets with a fixed maturity should be measured at amortised cost, the others at cost. All financial assets were subject to review for impairment. Regarding the held-to-maturity category, an anti-abuse clause was introduced, in practice called the ‘tainting’ rule. According to this rule, a company should not classify a financial asset (i.e. the approach was by individual instrument) as held-to-maturity if it had, during the current year or during the two preceding years, sold or transferred more than an insignificant amount of held-to-maturity instruments (more than insignificant in relation to the total held-to-maturity portfolio) other than in limited circumstances. If ‘tainted’, the held-to-maturity instrument should be remeasured at fair value.

201 See section 7.5.2.2.
Fair value changes should always be included in the profit and loss account for trading instruments. For available-for-sale assets, the company could choose between immediate recognition in the profit and loss account, or directly in equity until the moment of impairment or sale: in the latter case, the amount should be transferred to the profit and loss account (‘recycled’). The selected accounting policy should be applied to all available-for-sale assets.

The remainder of IAS 39, in so far as relevant for this dissertation, was substantively unchanged compared to E62. However, the IASC did create, as is already mentioned earlier in this chapter when describing the activities of the Basel committee, the IAS 39 Implementation Guidance Committee, charged with the task of publishing detailed questions and answers. This committee issued guidance on 1 January 2002,\textsuperscript{202} and on 1 January 2003,\textsuperscript{203} but was abolished soon after.

\textbf{8.4.4.2 Subsequent amendments of the financial instruments standards}

The issuance of IAS 39 in December 1998 was, however, not the end of the story and it did not yet result in a stable financial reporting environment: this standard and the related standard IAS 32 were, within a short time period, amended several times.

The first time was in October 2000, addressing several technical implementation issues of IAS 39.\textsuperscript{204} Much more significant changes to IAS 32 and IAS 39 were made in December 2003, to reduce complexity by clarifying and adding guidance, eliminating internal inconsistencies and incorporating elements of SIC interpretations and other IAS 39 guidance into the standard.\textsuperscript{205} The main change in IAS 39 concerned the introduction of a new category called ‘a financial asset or financial liability at fair value through profit or loss’. It included the former trading category, but also any other financial asset or liability that was designated as part of this category upon initial recognition.

However, the fair value of a financial liability with a demand feature (e.g., a demand deposit) was not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.\textsuperscript{206} Reclassification in or out of this new category was not allowed.

Regarding impairment, a new requirement was introduced: losses recognised in the profit and loss account for an investment in an equity instrument classified as available-for-sale should not be reversed. This made this part of IAS 39 comparable to FAS 115. Finally, the revisions to IAS 39 also resulted in amendments to IFRS 1 (a standard on the first-time adoption of IAS/IFRS, discussed later in this section): if 2005 was the first year of preparing IAS/IFRS financial statements, companies had the option to present the comparative 2004 amounts for their financial instruments either on the basis of IAS 32/IAS 39, or on the basis of their previous GAAP. This exemption was provided because of the late moment that IAS 39, in its final form after the amendments presented below, would be available. As is described earlier in this chapter as part of the European endorsement activities, the unlimited fair value option resulted in a carve-out of EU-endorsed IAS 39.

\textsuperscript{202} IASC (2002a).
\textsuperscript{203} IASC (2003a).
\textsuperscript{204} IASC (2000d).
\textsuperscript{205} IASB (2003e) and IASB (2003f).
\textsuperscript{206} This requirement was known in practice as the ‘deposit floor’.
Subsequent amendments to IAS 39 were published in March 2004, in December 2004, and in April 2005. As the included topics were either minor clarifications or outside the scope of this dissertation, they are not discussed here.

In June 2005, IAS 39 was amended again. This was a reaction to the changes made in March 2004. After this publication, the IASB had become aware that some constituents, including prudential supervisors of banks and insurers, were concerned that the unrestricted fair value option introduced in December 2003 might be used inappropriately, as the fair value was not always verifiable, its use might increase (rather than decrease) volatility in the profit and loss account, and it might result in an entity recognising gains or losses on its own credit risk of liabilities in the profit and loss account. On the other hand, the European insurance industry, organised through the CEA, was completely against any limitations and wanted the unlimited option to be retained. In its views, regulatory concerns should not be addressed through accounting standards, since financial statements focus on investors and insurance supervisors focus on protection of the interests of policyholders. Therefore, the supervisors should not be allowed to play a role in setting accounting standards. In my view, in this comment the CEA confirmed, in line with, in particular, Oosenbrug, the existence of the two different objectives of financial and prudential reporting. The comment, however, did not include any observations on a single-track reporting approach or alternative ways to address potential conflicts between these two objectives.

To address the concerns raised, the IASB changed the classification of a financial asset or financial liability at fair value through profit or loss. Designation into this category was only permitted when it resulted in more relevant information, because either:

- It eliminated or significantly reduced a measurement or recognition inconsistency (sometimes referred to as ‘an accounting mismatch’) that would arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
- A group of financial assets, financial liabilities or both was managed and its performance was evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group was provided internally on that basis to the entity’s key management personnel.

After this amendment, the European Commission removed the related carve-out from its endorsed version of IAS 39.

The final amendment to IAS 39 discussed in this dissertation was made in August 2005, with a linked amendment to IAS 32 and IFRS 4 (a standard on insurance contracts, described later in this section). It resolved a debate about the treatment of financial guarantee contracts: should they be included in the scope of the standards on financial instruments, or in the scope of the standard on insurance contracts?

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207 IASB (2004c).
208 IASB (2004g).
209 IASB (2005a).
210 IASB (2005b).
211 CEA (2004b).
212 See section 7.4.3.4.
213 IASB (2005f).
As an interim solution, the IASB decided that, although financial guarantee contracts would be in the scope of IAS 39, the issuer was permitted to apply IFRS 4 if it had asserted previously that it regarded such contracts as insurance contracts and had used accounting applicable to insurance contracts.

There was, however, one more important development in respect of financial instruments. This was, in August 2005, the publication of IFRS 7 ‘Financial instruments: disclosures’, and the related amendment to IAS 1 in respect of capital disclosures. The standards were effective for periods beginning on or after 1 January 2007. IFRS 7 applied to all risks arising from all financial instruments, except instruments covered by other standards. It also applied to all entities. However, the extent of disclosure required depended on the extent of the entity’s use of financial instruments and of its exposure to risk. IFRS 7, the development of which has started with updating IAS 30 to address the concerns of the Basel committee (described under the global reporting developments), replaced and incorporated many of the requirements previously in IAS 32, leaving the presentation requirements unchanged, and also superseded IAS 30. As a result of this incorporation exercise, the title of IAS 32 was changed into ‘Financial instruments: presentation’. Finally, IFRS 7 also amended some disclosure requirements in IFRS 4. The amendment to IAS 1 introduced the requirement, for all entities, to disclose information on an entity’s capital, its process of capital management and its (non-)compliance with external capital requirements.

8.4.4.3 IFRS 1 ‘First-time adoption of international financial reporting standards’
The first new standard issued by the IASB was IFRS 1, approved in June 2003 and dealing with the first-time adoption of IAS/IFRS. The standard should be applied for periods beginning on or after 1 January 2004 and replaced SIC 8. IFRS 1 was amended several times between June 2003 and December 2005 as a result of changes in other standards, but remained substantively intact.

Under the standard, the first step was to prepare an opening IAS/IFRS balance sheet at the date of transition to IAS/IFRS. This date referred to the beginning of the earliest period for which an entity presented full comparative information under IAS/IFRS in its first IAS/IFRS financial statements. The accounting policies used in this opening balance sheet and, throughout all periods presented, should comply with each IAS/IFRS effective at the reporting date, except as specified below.

The reporting date was defined at the end of the latest period covered by the financial statements. To explain: if the first IAS/IFRS financial statements were for the financial year 2005 and one year of comparative information was provided, the reporting date would be 31 December 2005 and the transition date would be set at 1 January 2004. Any adjustments from changing accounting policies to IAS/IFRS should be recognised directly in retained earnings at the transition date.

IFRS 1 provided the following relevant exemptions, at the election of the reporting entity:

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214 IASB (2005d).
215 IASB (2005e).
216 IASB (2003b).
217 As annex 12 shows, this interpretation was issued in January 1998. It dealt with the same topic.
Regarding business combinations before the transition date, several sorts of relief were available, the most important being that it was not required to restate all previous business combinations;

- For property, plant and equipment, it was allowed to use the fair value at transition date as deemed cost. This election was also available for investment property, if the entity elected to use the cost model in IAS 40; and
- Regarding employee benefits, it was allowed to recognise all actuarial gains and losses at the transition date (resulting from the transition of previous GAAP to IAS 19) in retained earnings, even if the entity would use the corridor approach subsequently.

The first IAS/IFRS financial statements should include at least one year of comparative information under IAS/IFRS. Finally, the entity should explain how the transition from its previous GAAP to IAS/IFRS affected the financial position, the financial performance and the cash flows, among others by providing reconciliations of equity and profit or loss.

8.4.4.4 The December 2003 improvements to IAS

In December 2003, the IASB completed a process to improve a number of standards. Its objective was to reduce or eliminate alternatives, redundancies and conflicts in existing standards, and to make other improvements to them. The IASB also dealt with some convergence issues and merged several SIC interpretations into the standards.

The revised IAS 1 required minority interests to be presented as a separate component within equity, and the profit and loss account should show the profit or loss attributable to minority interests and to equity holders of the parent. Furthermore, the separate presentation of extraordinary items was prohibited. In the revised IAS 8, the difference between profit or loss from ordinary activities and extraordinary items was omitted. The section on accounting policies, previously included in IAS 1, was expanded for cases where IAS/IFRS did not provide a standard or interpretation for a specific transaction or event: the entity should first consider standards and interpretations dealing with similar and related issues, and then the conceptual framework. Furthermore, the previous choice on the treatment of voluntary changes in accounting principles was removed. Changes should always be made retrospectively, with an adjustment in the opening balance sheet of the earliest period presented, unless it was impracticable; in that case, the adjustment should be made in the earliest period it was practicable, which could be the current period. Finally, the concept of fundamental errors was deleted, but the term ‘prior period errors’ was introduced. Material prior period errors should be adjusted retrospectively, similar to changes in accounting policies. In the revised IAS 10, the IASB clarified that a dividend declared after the balance sheet date could not be recognised as a liability at that date. Finally, the revised IAS 27 required the application of uniform accounting policies for reporting like transactions and other events in similar circumstances. The old IAS 27 provided an exception to this requirement when it was not practicable.

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218 IASB (2003d).
219 The revised formats under IAS 1 are presented in tables A9.17 and A9.18.
220 The conceptual framework is discussed in section 7.4.3.2.
8.4.4.5  IFRS 3 ‘Business combinations’ and the amendments to IAS 36 and IAS 38

A new standard for business combinations IFRS 3, replacing IAS 22, was approved in March 2004.221

In several areas, IFRS 3 differed substantially from its predecessor. While IAS 22 identified two possible ways to account for an acquisition (the purchase method or the pooling of interests method), IFRS 3 required the application of the purchase method in all cases. After having identified the acquirer, the next step was to measure the cost of the business combination, on which topic IAS 22 was incorporated virtually unchanged. Regarding the final step in acquisition accounting, i.e. allocating the cost of a business combination to the assets acquired and liabilities and contingent liabilities assumed, IFRS 3 required that any minority interest was stated at its portion of the net fair value of those items. Furthermore, recognising liabilities for terminating or reducing the activities of the acquired company as part of allocating the cost of the combination was only possible when the acquired company had, at the acquisition date, an existing liability for restructuring recognised in accordance with IAS 37. Finally, contingent liabilities should be recognised if their fair value could be measured reliably.

An important change concerned subsequent accounting for goodwill. Under IAS 22, goodwill had to be amortised over its useful life on a systematic basis. Under IFRS 3, goodwill was measured at cost less any accumulated impairment losses. For business combinations before 31 March 2004, IFRS 3 was permitted to be applied retrospectively. In all other cases, the standard should be applied prospectively. The same applied to previously capitalised goodwill: the carrying amount should be the starting point, amortisation should discontinue and impairment testing should start. If goodwill was previously deducted from equity, a gain or loss at disposal should not be included in profit or loss, but also in equity. The adoption of IFRS 3 was accompanied by amendments in IAS 36 to ensure full alignment.222 As a result, IAS/IFRS was closely aligned to FAS 141 and FAS 142, described later when presenting the US financial reporting developments.

Several small other changes to IFRS 3 were proposed in April 2004,223 and in June 2005.224 However, the substance of the standard was not amended.

8.4.4.6  Amendment to IAS 19 ‘Employee benefits – actuarial gains and losses, group plan and disclosures’

In respect of the accounting treatment of long-term employee benefits, an important change was made, in December 2004, to IAS 19.225 According to the revised standard, an entity was permitted to recognise actuarial gains and losses outside the profit and loss account. In this case, these items should be presented in a statement of changes in equity titled ‘statement of recognised income and expense’. They could not be included in the profit and loss account (recycled) in a subsequent period.

221 IASB (2004a).
222 IASB (2004b).
223 IASB (2004e).
224 IASB (2005c).
225 IASB (2004f).
8.4.4.7 IFRS 4 ‘Insurance contracts’

8.4.4.7.1 Introduction

For insurance companies reporting under IAS/IFRS, one of the most important standards was IFRS 4 ‘Insurance contracts’, published in March 2004. It started with the preparation, at the request of the IASC, of a statement of principles by the FEE, published in 1995. This document formed the basis to establish an IASC steering committee on insurance contracts (of which I was a member), which first published an issues paper in November 1999 and subsequently an uncompleted draft of a ‘Draft Statement of Principles’ (henceforth, a ‘DSOP’) in September 2001. Under normal IASC procedures, this was the next document in the sequence to develop a new standard. Usually, this DSOP would be followed by an exposure draft and, then, a final standard. However, because of the transition from the IASC to the IASB, discussed earlier in this chapter as part of the global reporting developments, the draft DSOP served as a kind of legacy document of this phase of the project.

Once the IASB restarted the project, it became quickly clear that it would not be feasible to complete the project for implementation in 2005. This date was important because of the mandatory application of IAS/IFRS in the consolidated accounts of EU-listed companies (including insurers), as is described earlier in this chapter as part of the European reporting developments. However, there was a need for a standard on insurance contracts, since there was none available under IAS/IFRS and insurance contracts were scoped out of existing standards that would otherwise be relevant. For this reason, the IASB decided to split the project in two phases and issued ED 5 as the exposure draft for phase I in July 2003. The final standard was IFRS 4, with an effective date of 1 January 2005.

The development of the standard generated a lot of attention, both internationally and in the Netherlands. Where relevant, the discussions and resulting views by the organisations described in this dissertation are presented hereafter. It should, however, already be noted that there was, apart from in the beginning, no public contribution to the debate by any of the companies reviewed in this dissertation. From my participation in the discussions in the IASC steering committee, I know that a large number of Dutch insurance companies commented on the 1999 issues paper, all submitting a letter that was identical to the one issued by the Dutch Association of Insurers. This stopped after I had explained them that, in assessing the comment letters, the steering committee did not look at the number of comment letters, but at their contents. In commenting on the next IASC documents, the Dutch insurers subsequently refrained from sending their own letters, but worked together in their national and European industry organisations.

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226 IASB (2004d).
227 The steering committee consisted of four preparers, three auditors, an analyst and an IASC Board member as the chairman.
228 The comment letters on the issues paper are not anymore available on the IASB website, but are part of my personal archives.
8.4.4.7.2 The 1995 statement of principles of the FEE

This statement of principles (henceforth, the ‘SOP’) was published in March 1995. It was very much based on the European insurance accounts directive, which dealt, in particular, with the investments of insurers and offered a large number of member state options, while providing only limited guidance to determine the technical provisions. Because insurance accounting practices differed significantly between countries and sometimes within a country, it had not proved to be possible to arrive at a single position for each principle. As a result, the SOP contained a number of options, both in respect of valuation and of presentation. In general, these options were similar to those included in the insurance accounts directive. An appendix included an overview of country practices, focusing on Australia, Japan, the US and the EU. It showed the few items where the SOP was not in line with the insurance accounts directive:

- The SOP proposed that life insurance products containing minimal or no insurance risk could be accounted for either as life insurance products or as financial instruments. The directive did not address this matter; and
- The SOP introduced an option for insurers to take future income on investments covering the technical provisions into account, when assessing whether an unexpired risk provision was required. The position in the directive on this issue was unclear.

8.4.4.7.3 The 1999 issues paper of the IASC

The issues paper, published in November 1999, explained there was great diversity in accounting practices for insurers, not just internationally, but also within one country. This made it difficult for users to compare the financial statements of insurers. The paper identified 20 basic issues in insurance accounting and evaluated the merits of alternative approaches to those issues. To provide focus, it set out the tentative views of the steering committee. The most important of these views, in respect of scope and measurement, were:

- The project should focus on insurance contracts, not on insurers;
- The objective should be to measure the assets and liabilities arising from insurance contracts (a balance sheet or asset-liability approach), rather than applying a deferral-and-matching approach (starting from the profit and loss account);
- The measurement of insurance liabilities should be based on discounted current estimates of the future cash flows from the current contracts (the ‘best estimate’ approach);
- In the view of the majority of the steering committee, catastrophe and equalisation reserves or provisions were not liabilities under the conceptual framework;
- The measurement of insurance liabilities should reflect risk to the extent that it would be reflected in the price of an arm’s length transaction between knowledgeable, willing parties. It followed that the sale of a long-term insurance contract could, in some cases, lead to the immediate recognition of profits;
- Acquisition costs should not be deferred as an asset;
- All changes in the carrying amount of insurance liabilities should be recognised as they arose. In deciding which components of the changes should be presented or disclosed separately, the steering committee would monitor the progress of the work on financial instruments;

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230 See section 7.4.2.2.2.
231 IASC (1999e).
The steering committee was working on the assumption that IAS 39 would be replaced, before the end of the insurance project, by a new standard requiring full fair value accounting for the substantial majority of financial assets and liabilities. If such a standard would exist, liabilities under insurance contracts should also be measured at fair value; and

For participating and with-profit contracts, i.e. contracts in which the results of the insurer were partially shared with its policyholders:

- Where the insurer did not control allocation of the surplus to policyholders, any unallocated surplus should be classified as a liability; and
- Where the insurer controlled allocation of the surplus, any unallocated surplus should be classified as equity, except to the extent that the insurer had a legal or constructive obligation to allocate part of the surplus to policyholders.

These tentative views were the result of an exercise in the first meeting of the steering committee in December 1997, in which two of the three days were allocated to understanding the local insurance products and GAAPs of the participants in the meeting.\textsuperscript{232} This exchange of information showed that there was not just an enormous variety of products and legislative requirements around the world, but also that local GAAP was, in almost all cases, heavily influenced by the prevailing prudential reporting requirements. Furthermore, it was concluded that none of the presented local GAAPs would be able to deal with all these differences. As a result, the third day of the meeting started with a blank sheet approach, focusing on the characteristics and economics of insurance products to determine the appropriate way to calculate the related assets and liabilities. In my view, this was a quite revolutionary approach, as it was, to my knowledge, for the first time that the development process of an international accounting standard did not take a specific local GAAP as its starting point; instead, it started from scratch.

Comments on the issues paper
The issues paper raised considerable opposition:\textsuperscript{233}

- The use of the asset-liability approach, which created the possibility of companies recognising a gain on the sale of the contracts, conflicted with the revenue recognition standard;
- Insurance was seen as a long-term business, and therefore changes in short-term assumptions were not relevant in measuring long-term performance;
- Significant volatility would be introduced if changes in fair values of assets and liabilities were taken through the profit and loss account; the proposals had not adequately addressed the issue of performance reporting; and
- The adoption of the fair value model introduced more subjectivity, leading to less reliable financial statements.

\textsuperscript{232} As the minutes of the steering committee have never been in the public domain and I have not kept them in my personal archives, this comment is based on my recollection of the discussions.

\textsuperscript{233} Patel (2001).
These comments were, in particular, provided by the insurance industry itself, for instance the CEA. In its 1999 annual report, it commented that it was basically in favour of the establishment of a single set of financial reports (i.e. a single-track reporting approach), which would not give greater importance to any one specific category of users. It supported the best estimate approach as long as it included a margin for hazard based on a realistic estimate, but it should include the continued use of equalisation and catastrophe provisions, in life and in non-life insurance business. However, the views differed between the CEA members on a number of other topics, such as the focus on insurance contracts and not in insurance companies, the use of fair value accounting for assets and liabilities, and the discounting of provisions for claims outstanding. These differences were, at least partly, also mentioned in the comment letter of the CEA on the issues paper. It stated that the CEA considered that the deferral-and-matching approach was also consistent with the IASB conceptual framework, and questioned the use of fair value accounting as it was, for the time being, less developed than traditional accounting and hence more subjective. This would result in less comparability. Furthermore, the recognition of all changes in fair value would create volatility, and would not provide users with relevant or reliable information. However, a minority of the CEA members supported the proposals.

Diverging opinions also existed in the insurance supervisors’ community. The IAIS comment letter showed considerable differences in views among its members on almost all major issues, although there was consensus that, ideally, an IASB accounting model should also be the basis for supervision, or at least be adaptable to regulatory purposes and needs. In my view, this was another plea for a single-track reporting approach.

From the actuarial side, the main comments were provided by the ‘International Actuarial Association’, henceforth, the ‘IAA’. Its foundation was laid in 1895 in Brussels, when actuaries in Belgium organised a ‘Congress of actuaries’ to meet colleagues from other countries to share ideas. In 1896, the Belgian, French and British actuaries met again, to discuss the possibility of creating a permanent structure for future congresses. They agreed to do so and wrote the bylaws of the ‘Comité permanent des congrès internationaux d’actuaires’. The name ‘Comité permanent’ was in use for more than 50 years, until it was replaced by the name IAA during the 1960s.

Regarding the development of the insurance contracts standard, the IAA had been involved from the start of the project, through an observer in the steering committee developing the proposals. In its comment letter, the IAA was, in general, in support of the proposals in the discussion paper, under the assumption that all assets would be at fair value. However, it stressed there should be consistency, not just between insurance companies, but across industries, e.g., with banks. Furthermore, a number of important practical issues still needed to be addressed. Regarding catastrophe provisions, the IAA was divided. To my knowledge, the submission of the comment letter was the first public contribution of the IAA to the development of international accounting standards, as the meetings of the steering committee were not open for the public.

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234 CEA (1999).
From the auditors’ side, the FEE comment letter on the discussion paper stated that there should be consistency between the future insurance contracts standard and other standards dealing with similar issues. Furthermore, there should be comparability with companies in other industries. However, on the way to achieve this goal, the letter included two strongly held different views between the members, which impacted the comments on all major issues. A number of members advocated the deferral-and-matching model, while others were in favour of an asset-liability model. However, all agreed that, under the second model, there was no place for equalisation and catastrophe provisions.

The views of the member states of the EU differed. There were fully opposite views between Denmark, Sweden, the Netherlands and the UK on one side, and the vast majority of the other member states on the other side. The minority countries considered an insurance contract primarily a financial instrument (versus a service contract), favoured a contract-by-contract approach (versus a company approach), supported an asset-liability view (and not a deferral-and-matching approach) and were in favour of fair value for insurance liabilities.

I summarised the Dutch views on the issues paper in May 2000, noting that about 80% of the participants of two PCNA seminars supported the paper, but that the views of the parties who submitted comment letters differed:

- The RJ considered a move to fair value accounting a step too far, and advocated a choice between including fair value in the balance sheet or in the notes. Catastrophe and equalisation provisions should be prohibited;
- The Insurance Chamber and the Ministry of Finance supported a consistent asset-liability approach, combined with sufficient prudence;
- The Dutch Association of Insurers rejected fair value accounting, because it produced volatile results that did not reflect the long-term nature of the industry. Catastrophe provisions should be maintained, but equalisation provisions abolished; and
- The actuaries supported the proposals, since they would improve the insight in the results.

8.4.4.7.4 The 2001 draft DSOP of the IASC

The draft DSOP introduced the principles underlying a future exposure draft and standard. It built on the 1999 issues paper, but took the 138 comment letters on this paper into account. The DSOP maintained most of the tentative views presented in the issues paper, with the following amendments and clarifications:

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241 Schoen (2000).
242 As is described in section 7.4.4.1, the PCNA was a joint committee of the Dutch actuarial and auditing professions. One of its tasks was to organise seminars on topics of mutual interest.
243 IASB (2001b).
The measurement objective was twofold. While IAS 39 was still in place, insurance liabilities should be measured at entity-specific value, i.e. the present value of the costs that the insurer would incur in settling the liability in accordance with its contractual terms over the life of the liability. If a successor of IAS 39 introduced fair value measurement for the substantial majority of financial assets and liabilities, the IASB should consider introducing fair value measurement for all insurance liabilities as well;

- The entity-specific value or fair value of insurance liabilities should not be affected by the type of assets held or by the return on those assets, unless the amount paid to policyholders was directly influenced by the return on specified assets. Furthermore, measurement should be neutral and there should be no use of fund accounting;\textsuperscript{244}

- Separate or additional catastrophe and equalisation provisions should be prohibited, although catastrophe risks should, of course, be included in the cash flows of the existing contracts;

- Risk and uncertainty should always be reflected, preferably in the cash flows, or alternatively in the discount rate, without double counting; and

- The discount rate should be based on risk-free assets, adjusted for risks not reflected in the cash flows.

The DSOP was not finalised when the steering committee was disbanded. In particular, the chapter on performance-linked contracts was missing. However, the tentative views were reported in IASB Insight: the interest of policyholders in some of the assets and liabilities reported in the insurer’s balance sheet might be regarded as analogous to minority interest or deferred tax and should be recognised as a liability.\textsuperscript{245} Additionally, the missing chapters on disclosure and presentation were presented. Regarding disclosures, the approach was to build as much as possible on IAS 32 and IAS 37, with possible additional information on regulatory capital, solvency margins, risk adjustments and sensitivity. Regarding presentation, a revolutionary new approach was suggested, splitting the income from insurance contracts into three categories: the net gain on the issuance of insurance contracts, distinguishing new contracts with existing policyholders and contracts with new policyholders; ‘interest’ on the insurance liability; and differences between actual experience and previous assumptions, and changes in assumptions.

Comments on the DSOP
As the DSOP was published for information purposes only, there was no formal procedure to obtain comment letters. The paper was, however, discussed anyway in several platforms and not very well received by the insurance industry. There was unease with the insurance supervisors, represented by the IAIS, as well as strong resistance by industry organisations, which had sent a series of letters in 2002.\textsuperscript{246} The arguments were similar to those expressed on the 1999 issues paper.\textsuperscript{247}

\textsuperscript{244} As is described in section 2.8.2.2, under this system a separate ‘fund’ was created, to which premiums, claims and expenses were allocated until the moment that the level of uncertainty in respect of the claims or their complexity were sufficiently addressed to move to a ‘normal’ base of accounting.

\textsuperscript{245} Clark (2001). It should be noted that the analogy to minority interests was made before the December 2003 changes to IAS 1, described before.

\textsuperscript{246} Dickinson (2003).

\textsuperscript{247} Patel (2002).
One of the industry organisations was the ‘CFO Forum’, which was a high-level discussion group of ‘Chief Financial Officers’ of major European insurance companies. Its aim was to discuss issues relating to proposed new accounting regulations and how they could improve the information to investors. The Forum was created in 2002. AEGON, Fortis and ING were all members from the start. One of its first activities was the issuance of a letter to the IASB on the DSOP, issued jointly with several non-European insurers. It rejected the proposals, as they did not reflect the business model and the unique characteristics of the insurance industry. According to the CFO Forum, there should be a deferral-and-matching approach, no revenue or gain at inception, no fair value (due to the legal constraints to transfer of an insurance portfolio and the absence of a market), and no artificial volatility. Instead, much more should be done through disclosures (fair values, assumptions, and sensitivities), maintaining the existing deferral-and-matching approach.

The letter of the CFO Forum was supported by the US life insurance industry, with further recommendations to address the issue of volatility. In its view, the model should be consistent with the classification categories of IAS 39, and insurance contracts under the held-to-maturity category should be measured using entity-specific assumptions at issue, with expected present value of cash flows using a prospective approach, and a loss recognition test with remeasurement using current assumptions when impairment was noted.

In respect of the Dutch developments, Hoogendoorn mentioned that 77% of the participants in a seminar held late 2001 expected that the financial statements of an insurance company would be based on fair value in the future. This direction was supported by 57%, and 56% was of the view that full fair value accounting would increase the insight into the financial position and the results. He also reported that in a round table conference, also held late 2001, analysts stated to have no problem with income volatility if there was adequate disclosure.

8.4.4.7.5 The IASB exposure draft ED 5 of July 2003

As is noted earlier, the IASB decided to split the project to develop a standard on insurance contracts in two phases. The main objectives of the first phase were to make limited improvements to accounting practices for insurance contracts, without requiring major changes that might need to be reversed when the IASB completed the second phase of the project, and to require an entity issuing insurance contracts to disclose information about those contracts. The IASB was committed to completing phase II without delay once it had thoroughly investigated all relevant conceptual and practical questions and completed a full and extensive due process.

The standard should be applied to insurance contracts that an entity issued and to reinsurance contracts that it held, and to financial instruments that an entity issued with a discretionary participation feature. Such a feature was a contractual right held by the policyholder to receive, as a supplement to guaranteed minimum payments, additional payments:

- That were likely to be a significant portion of the total contractual payments;
- Whose amount or timing was contractually at the discretion of the issuer; and

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248 See www.cfoforum.nl.
249 CFO Forum (2002).
250 ACLI (2002).
251 Hoogendoorn (2002).
252 IASB (2003c).
• That were contractually based on the performance of a specified pool of contracts or a specified type of contract, on realised and/or unrealised investment returns on a specified pool of assets held by the issuer, or on the profit or loss of the company, fund or other entity that issued the contract.

An insurance contract was defined as proposed in the DSOP, focusing on the transfer of significant insurance risk. Extensive guidance was provided on this definition, explaining the difference between insurance risk and financial risk, showing examples, and elaborating on the meaning of ‘significant’. The scope exclusions included financial guarantees, which – regardless of whether they were described as financial guarantees, letters of credit or insurance contracts – would always be under the scope of IAS 39.\(^{253}\)

The main parts of the exposure draft dealt with recognition and measurement. For accounting periods beginning before 1 January 2007, the criteria in IAS 8 were not applicable.\(^{254}\) In other words, an insurer was permitted to retain its local accounting policies, with, however, some exceptions: an insurance company:

• Should not recognise as a liability any catastrophe provisions or equalisation provisions relating to possible future claims under future insurance contracts;
• Should carry out a ‘loss recognition test’ (subsequently called a ‘liability adequacy test’);
• Should derecognise the insurance liability only when the contractual obligation was discharged, cancelled or expired; and
• Should not offset insurance and reinsurance items.

The loss recognition test should be carried out at each reporting date, using current estimates of future cash flows from the insurance contracts. If existing accounting policies already included such a test, no further requirements were imposed. If not, the exposure draft specified more details on the test to be carried out.

An insurer was allowed to change its accounting policies, but only if the change would make the financial statements more relevant and reliable, judged by the criteria in IAS 8. However, full compliance with all those criteria was not required. In other words, a partial change was allowed, as long as it would produce more relevant and/or more reliable information. A change in the other direction was not allowed, such as measuring liabilities on an undiscounted basis, introducing excessive prudence or using more non-uniform accounting policies for the insurance liabilities of subsidiaries.

For insurance contracts with discretionary participation features an insurer could, but was not required to, report the fixed element separately from the discretionary participation feature, and it should classify unallocated surplus arising from the feature as either a liability or equity. In case of a financial instrument, the same applied, but the liability should be no less than IAS 39 would require for the fixed element (the so-called ‘deposit floor’). The exposure draft also included disclosure requirements and two special transitional provisions:

\(^{253}\) As is described earlier in this section when discussing the standards on financial instruments, this classification requirement was amended in August 2005.

\(^{254}\) This time limit was called, in practice, the ‘sunset’ clause.
• The fair value of insurance liabilities needed not be disclosed before 31 December 2006; and
• When an insurer changed its accounting policies, it was permitted to reclassify some or all financial assets into the category ‘fair value through profit or loss’ under IAS 39. This was permitted both when the insurer first applied IAS/IFRS and subsequently.

**Comments on ED 5**
Comments on the proposals in this exposure draft from the perspective of the European insurance industry were raised again by the CEA. Two notes, issued in 2003, reiterated the views that the proposed definition of an insurance contract was not suitable, IAS 39 would not work well for insurers, and accounting mismatches (i.e. measuring assets and liabilities and/or their changes on different measurement bases) should be avoided. The solution should be found on the asset side, by creating a special category of assets backing insurance liabilities. Two other important comments concerned the full rejection of the sunset clause and the mandatory disclosure of the fair value of insurance liabilities, as a result of a lacking common interpretation. These concerns were also voiced in the CEA comment letter on this exposure draft, which furthermore signalled the need to implement all major changes in standards at a single point in time (also referring to the project on financial instruments, discussed earlier), and concerns about the, in the view of the CEA, much too extensive disclosure requirements.

The CFO Forum provided similar arguments as the CEA. This position was, again, supported by the US life insurance industry. The comments of the CEA were also fully supported by the Dutch Association of Insurers.

On the global level, comments letters were sent by several organisations described in this dissertation. The IOSCO letter was rather limited: it included only a unanimous rejection of the proposed sunset clause. On the other hand, the IAIS comment letter revealed mixed views again on areas such as the treatment of changes in accounting policies. But the letter did specify shared concerns on a possible accounting mismatch between assets and liabilities (suggesting a special category of assets backing insurance liabilities, which should be measured as amortised cost), fair value disclosures without sufficient guidance, the proposed sunset clause, and, generally, the fear that the proposals would not result in comparable and consistent accounting policies. In summary, the IAIS could only support the proposals as an interim solution.

The IAA was also concerned on a number of proposals in the exposure draft. Its comment letter stated that the proposals were too much rules-based, and a number of issues needed more work. The accounting mismatch between assets and liabilities should be addressed, and the IAA was against the deposit floor, since it was not consistent with the general requirement to measure the future cash flows on a best estimate basis (which included policyholder’ behaviour), the fair value disclosures and the sunset clause.

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255 CEA (2003b) and CEA (2003d).
256 IASB, ED 5, CL 64, issued 31 October 2003.
257 IASB, ED 5, CL 12, issued 22 October 2003.
258 IASB, ED 5, CL 72, issued March 2003 with a supplement in August 2003.
259 IASB, ED 5, CL 125, issued 31 October 2003.
260 IASB, ED 5, CL 114, issued 31 October 2003.
261 IASB, ED 5, CL 112, issued 31 October 2003.
262 IASB, ED 5, CL 107, issued 31 October 2003.
On the European level, the EFRAG suggested addressing the accounting mismatch by a relaxation of the tainting rules for held-to-maturity assets in IAS 39.\textsuperscript{263} It also opposed the deposit floor, in particular for investment contracts with discretionary participation features, the sunset clause and the disclosure of fair values. Finally, the EFRAG stated that local loss recognition tests, if required under local GAAP, should be acceptable, and the accounting of deferred acquisition costs should be harmonised. The FEE expressed strong support for the EFRAG views, with particular emphasis on the need to further develop performance reporting for insurance companies.\textsuperscript{264} The Groupe Consultatif fully shared the concerns expressed by the IAA, and also rejected the proposed prohibition of equalisation provisions, and suggested a category ‘matching assets’, measured at amortised cost.\textsuperscript{265}

Regarding the views in the Netherlands, the support for the IASB proposals seemed to be less than in the past: in a seminar held early 2004 on this exposure draft, 36 of the 50 participants voted in favour at the start, which number had decreased to 15 at the end of the event.\textsuperscript{266} The RJ was more specific, commented on the accounting mismatch, and proposed that it should be solved by measuring assets held to back insurance contracts, under strict criteria, at amortised cost.\textsuperscript{267} Furthermore, it strongly objected to the fair value disclosures, because of the lack of guidance, and the RJ was not convinced that a sunset clause should be introduced, because of the risk of delays in finalising phase II of the project.

\textbf{8.4.4.7.6 The interim standard IFRS 4}

In finalising the standard, the IASB confirmed most of the tentative views included in ED 5, but changed some of them. The sunset clause was deleted. The approach concerning changes in accounting policies was, in substance, retained, but it was clarified that a change should be more relevant but no less reliable, or more reliable but no less relevant. Furthermore, an insurer was allowed to move from a fixed to a current market interest rate to discount some of its insurance liabilities, without being obliged to do this for all. However, if this change was implemented, it could not be reversed.

The standard also introduced a new paragraph on ‘shadow accounting’. Under such an accounting policy, the policyholders’ share in unrealised gains reported in equity was reflected as a liability in the balance sheet by, similarly to deferred tax accounting, transferring this amount as a visible deduction in equity.

The requirements regarding contracts with discretionary participation features were also amended. In case of an insurance contract:

- The guaranteed element could be separated, but this was not required. If there was no separation, the whole contract should be classified as a liability. If there was separation, the guaranteed element would be the liability; and
- A separated discretionary participation feature could be classified as a liability or a separate component of equity, but not as an intermediate category. The feature could also, based on a consistent accounting policy, be split.

\textsuperscript{263} IASB, ED 5, CL 79, issued 31 October 2003.
\textsuperscript{264} IASB, ED 5, CL 132, issued 13 November 2003.
\textsuperscript{265} IASB, ED 5, CL 15, issued 15 October 2003.
\textsuperscript{266} Melody (2004).
\textsuperscript{267} IASB, ED 5, CL 59, 31 October 2003.
In case of a financial instrument, the same approach applied, but additionally there were requirements on minimum amounts, either based on the IFRS 4 liability adequacy test, or on IAS 39.

The disclosure requirements were almost identical as proposed, with one exception: the requirement to disclose the fair value was deleted. Finally, relief was provided on disclosing comparative information for periods beginning before 1 January 2005, and on remeasuring comparative insurance liabilities using IFRS 4 if it was impracticable. The proposals regarding redesignation of financial assets were confirmed.

IFRS 4 resulted in a situation that contracts meeting the legal definition of an insurance contracts would not be accounting for under IFRS 4, but under IAS 18 ‘Revenue’, IAS 39, or under a combination of these standards. The figure below summarises the possible situations.

**Figure 8.3: Insurance contract classification under IFRS 4**

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According to a survey, conducted by PricewaterhouseCoopers among over 50 European insurance analysts, 70% of the respondents considered the improvements brought by IFRS 4 only marginal. They were concerned on the issue of comparability between insurance companies and 80% of them considered ‘European Embedded Value’ (discussed later in this chapter when presenting the findings on the actual reporting practices) more useful and better for such comparisons. So, although users supported the standard as a step in the right direction, they were still unsatisfied and requested a speedy development of the final standard, based on fair value accounting for insurance contracts.

The publication of IFRS 4 had no impact on RJ 605 dealing with the financial statements of insurance companies, as the standard grandfathered the existing accounting treatment of insurance contracts if certain conditions were met: this was the case in the Netherlands.

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268 In practice, an insurance contract that did not meet the definition under IFRS 4 and was, therefore, classified as a financial instrument, was called an ‘investment contract’.

269 De Accountant (2005).
8.4.5 The role of the auditing profession and the stock exchange

8.4.5.1 The role of the auditing profession

The role of the auditing profession in the period was limited to providing guidance on the status of the guidelines of the RJ. The 2000 auditing guidelines included a reference to the affirmative pronouncements of the RJ, and, in 2002, the following sequence was applicable for Dutch financial statements, if prepared under Dutch GAAP: the requirements of the civil code and its history, jurisprudence of the courts, affirmative pronouncements of the RJ, and special requirements for financial statements issued by standard setting and supervisory authorities, if applicable. If the Dutch financial statements were not prepared under Dutch GAAP, different standards were relevant, such as IAS and the accounting standards and guidelines of another country.

In respect of the development of IAS/IFRS, the auditing profession contributed actively to the work of the RJ and the FEE, but, generally, refrained from issuing its own comment letters.

8.4.5.2 The role of the stock exchange

In the period, the Amsterdam Stock Exchange made several moves to promote or require the use of IAS, even before this became mandatory from 2005 onwards. At the end of 1999, it issued a circular, stating a preference for the application of IAS in the financial statements of listed companies. And in 2002, it also allowed the application of US GAAP; in such a case, domestic companies were required to include a reconciliation to Dutch GAAP in their financial statements, as was the case, from that year onwards, when applying IAS/IFRS. Finally, from 2004 onwards, companies listed at the secondary markets of the Amsterdam Stock Exchange had to report under IAS/IFRS.

Regarding the listing requirements, in 2005 an amendment was made to the Decree on securities transaction supervision 1995, to adopt directive 2003/71/EC. This directive, which had been approved in November 2003, upgraded, updated and grouped together two older directives. The first one was directive 89/298/EEC, which expanded earlier directives by requiring that a prospectus should be made available to investors when transferable securities were offered to the public for the first time. The second one was directive 2001/34/EC, the ‘codified listing directive’. It was approved in May 2001 and bundled all previous listing directives, without introducing substantive changes.

Under ‘prospectus directive’ 2003/71/EC, the approach was based on the principle of ‘single license, home country control’, as was the case in the third prudential insurance directives.

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270 Zeff et al. (2002).
272 Tweede Kamer (1999c), nr. 25732.
273 Haller (2002).
274 Bakker (2002).
275 Minister van Justitie (2005b), Staatsblad 2005, nr. 329.
276 European Commission (2003g).
278 European Commission (2001c).
279 See section 7.6.4.
The directive presented, in an indicative annex, a high level overview of the minimum information to be included in a prospectus. Detailed implementation measures would be adopted by the European Commission, but such measures should be based on the standards set out by international securities commissions’ organisations, and in particular the IOSCO disclosure standards for cross-border offering and initial listings. This requirement created, for the first time, a direct link between the listing requirements in the EU and the IOSCO developments. As could be expected, the directive included the requirement that a prospectus should be in compliance with the accounting directives and the IAS regulation, discussed earlier.

The last directive issued in the period was directive 2004/109/EC, the ‘transparency directive’. It was approved at the end of 2004 and included specific financial reporting requirements, such as pronouncements in respect of interim reporting. As the directive was not yet implemented in the Netherlands at the end of 2005, its contents are outside the scope of this dissertation.

8.4.6 Summary and conclusions
The legislative developments in respect of financial reporting requirements for Dutch insurance companies in the period were limited, but still had an important impact.

It started with the discussions on the findings and recommendations of the Traas committee on the financial statements of insurers prepared under a single-track reporting approach. The 2001 report of this advisory group observed that improvements were necessary in a number of areas, and the government prepared a bill to follow up. Since, however, around the same time the EU IAS regulation was adopted, a debate arose about compliance of the new requirements with IAS/IFRS and the potential need to make two sets of changes in a short period of time. As a result, the bill was substantially delayed, limited and led to new legislation only in 2006, i.e. outside the scope of this dissertation. Based on my knowledge of the ongoing developments at the time in respect of IAS/IFRS, I considered the arguments for the delay presented in Parliament invalid; in my view, it showed that Parliament had, in reality, no intention to implement short-term improvements in the reporting requirements for Dutch insurers: a missed opportunity.

A bill to allow early adoption of IAS/IFRS, submitted in February 2002, experienced an almost similar faith: it was overtaken by the IAS regulation. This bill addressed, however, also an issue which was not directly related to the implementation of IAS/IFRS: the government proposed to abolish the legal possibility to charge goodwill directly to the reserves, and to require capitalisation and amortisation instead. After a clear rejection of this proposal by the Second Chamber early 2005, the bill was withdrawn in its totality.

But a third important bill was adopted in the period: the implementation of the consequences of the IAS regulation and the related amendments in the accounting directives. As was usual in the Netherlands, all options in the European legislation were passed on to the companies, allowing them to report under IAS/IFRS if they wished to do so in cases that this was not already mandatory. To enable the continuation of the existing practice to report the same equity in the consolidated and the non-consolidated financial statements, Dutch companies were, ultimately, allowed, in their Dutch GAAP non-consolidated annual accounts, to use the accounting principles applied in their IAS/IFRS-based consolidated financial statements.

In my view, although this flexibility in the choice of reporting regimes was consistent with the usual Dutch approach to pass on member state options, as much as possible, to the companies, it did not contribute to the comparability of financial statements. Companies active in the same industry were allowed, if not listed, to make an almost unrestricted choice between IAS/IFRS and Dutch GAAP; the same applied to the non-consolidated accounts for listed companies. And since the guidelines of the RJ were not fully aligned to IAS/IFRS, this made comparison of financial statements more challenging and, therefore, in contradiction with the focus on the information needs of investors, on a domestic and on an international level.

The activities of the RJ continued to focus on the implementation of the pronouncements of the IASC/IASB, as far as they were considered to be acceptable in the Dutch financial reporting environment. Furthermore, it finalised, in 2000, its work on the development of a guideline of the financial statements of banks, which mainly codified existing practices and did not introduce significant new requirements. The main debates in respect of IAS/IFRS concerned financial instruments, pension accounting, and goodwill accounting.

On financial instruments, the RJ issued, early 2001, a discussion paper and an attached draft guideline to implement IAS 39 on the recognition and measurement of these items. This standard, which completed the IASC financial instruments project, was issued at the end of 1998 and required the classification of financial assets and liabilities in several categories. Some of these had to be measured on fair value with all movements reported in the profit and loss account, some with all fair value movements reported in the reserves followed by a transfer to the profit and loss account in the case of a sale, and other instruments were reported on an amortised cost basis. Subsequently, IAS 39 was amended several times before the end of 2005. As the responses to its 2001 discussion paper were, generally, not supportive, the RJ decided to adopt a wait-and-see position until the final IASB standard was completely clear. To address a number of Dutch legal financial reporting requirements in respect these assets and liabilities, the RJ issued a specific own standard in 2005 for companies that continued to report under Dutch GAAP.

On pension accounting, the RJ issued a draft guideline in 1999, which was almost fully based on IAS 19. It introduced a new method to determine the liabilities and annual expenses and, as a result, would create a significant change in the Dutch financial reporting requirements and practices. This triggered a large number of comments on the draft guideline, and the RJ issued, in response, a discussion paper in 2002 that enabled companies to use US GAAP for reporting its pension liabilities. In 2003, it returned to its previous position and issued a final guideline, effective as of 1 January 2005, which was almost completely based on IAS 19.

The last important topic dealt with by the RJ concerned goodwill accounting. In 2000, the RJ incorporated IAS 22 and IAS 36, determining that goodwill had to be capitalised, amortised and tested for impairment. It also stated that almost all acquisitions had to report using the purchase method, under which all acquired assets and assumed liabilities were measured at their fair values at the acquisition date. However, based on the political decision mentioned above, the RJ reintroduced, from 2005 onwards, the possibility to charge goodwill directly to the reserves, although it still preferred capitalisation and amortisation.
The above developments of the RJ guidelines show, in my view, that despite the growing recognition of the government and the courts, the RJ was unable to make timely progress in respect of a number of important topics. Without further detailed research in the archives of the RJ it is, in my opinion, not possible to assess whether this was related to the delegation structure of the RJ, the amount of freedom in the Dutch financial reporting legislation, or to other causes. But the fact of the matter is that decisions on financial instruments, pension accounting, and accounting for business combinations (including goodwill) were either not made or only with significant delays. And some of them were overtaken by the move to IAS/IFRS by a number of companies as a result of the adoption of the IAS regulation and the related changes in the accounting directives.

For those companies that, mandatorily or voluntarily, adopted IAS/IFRS as their reporting basis, the pronouncements of the RJ in respect of their financial statements lost their relevance in 2005. They were obliged to adopt all pronouncements of the IASB if they were endorsed within the EU. This meant that they also had to apply those IASB pronouncements that had not (yet) been incorporated in the guidelines of the RJ. Next to the standards on financial instruments, which concerned IAS 39 but also IFRS 7 dealing with disclosures on financial risks, this included in particular IFRS 1 (dealing with the first-time adoption of IAS/IFRS), IFRS 3 (dealing with business combinations and abolishing the requirement to amortise goodwill), and IFRS 4 (on insurance contracts).

The move to IAS/IFRS and the continuing freedom in the Dutch financial reporting legislation forced the RJ to reconsider its position of assisting to determine Dutch GAAP. In 2005, it decided, going forward, to incorporate the developments in IAS/IFRS only if they were considered adequate for the Dutch financial reporting environment. At the same time, it considered it desirable to avoid, as much as possible, discrepancies between IAS/IFRS and the guidelines by allowing, whenever possible, all options made available by the IASB and to expand them if necessary. And shortly after, based on the political decision not to prohibit a direct charge of goodwill to the reserves, the RJ decided not to limit options that were explicitly included in the civil code, although it could express a preference for one or more options.

8.5 Reporting developments in the US and the UK

8.5.1 Introduction
The reporting developments in the US were rather limited. Effectively, the only activity that had a direct impact on the reporting practices of US insurance companies concerned the issuance of two new FASB pronouncements, in respect of accounting for business combinations and for goodwill.

More happened in the UK, with the implementation of the IAS regulation, the amended accounting directives, and the new or revised pronouncements of the IASC/IASB. But the most important events were the publication of new SORPs, which, initially, moved away from the prevailing type 3 or type 4 single-track reporting approaches,\textsuperscript{281} by removing the prudential levels of prudence and reporting the investments and the insurance liabilities at their fair or realistic values. As a result of these new SORPs, UK reporting was now based on a type 7 or type 8 single-track reporting approach.

\textsuperscript{281} As is explained in section 6.5.3.1, I have not been able to determine which of these two types was applied.
However, a change in the prudential reporting requirements, at the end of the period, brought both reporting regimes together again and resulted, from 2004 onwards, in a reporting regime that was based on realistic instead of prudent assumptions to determine the insurance liabilities. In this development the prudential reporting regime was in the lead: the return to a type 3 or type 4 single-track reporting approach.

8.5.2 United States of America

8.5.2.1 Developments at the SEC

In February 2000, the SEC issued a concept release, seeking input to determine under what conditions it should accept financial statements of foreign private issuers that were prepared using IAS.\textsuperscript{282} The document noted that a foreign private issuer using accounting standards other than US GAAP should provide an audited reconciliation to US GAAP.\textsuperscript{283} However, some foreign companies cited a reluctance to adopt US accounting practices, even in the form as reconciliation, as a reason for not listing in the US. Therefore, accepting financial statements prepared under IAS without requiring reconciliation to US GAAP could be an inducement to cross-border offerings and listings in the US. The SEC explained that, to assess IAS, it would use the same criteria as included in its April 1996 statement regarding the IASC core standards project: do the standards constitute a comprehensive, generally accepted basis of accounting, are they of a high quality, and can they be rigorously interpreted and applied?\textsuperscript{284} The SEC noted it was assessing the quality of IAS according to these criteria, standard-by-standard as well as for the standards as a whole.

The next step in the debate was taken by Pitt, the SEC chairman, in November 2002.\textsuperscript{285} He noted that it could be appropriate for the SEC to reconsider the need for foreign private issuers from the EU member countries to continue reconciling from IAS/IFRS to US GAAP if, by 2005, there had been sufficient progress in the improvement and short-term convergence of accounting standards, in the development of a process and structure for consistent interpretation and application of IAS, and in the enhancement of financial reporting infrastructure. He further noted that the FASB and the IASB were committed to working together to produce high-quality accounting standards across the major international capital markets. They had recently announced the desire to undertake a project aimed at eliminating the key differences between existing US GAAP and IAS/IFRS.

This was the so-called ‘Norwalk agreement’, a memorandum of understanding between the FASB and the IASB, in which the boards pledged to make their best efforts to make their existing financial reporting standards fully compatible as soon as practicable, and to coordinate their future work programs to ensure that once achieved, compatibility was maintained.\textsuperscript{286} To achieve this goal, the boards agreed, as a matter of high priority, to:

- Undertake a short-term project aimed at removing a variety of individual differences between US GAAP and IAS/IFRS. This was the FASB-IASB convergence project;
- Remove other differences between US GAAP and IAS/IFRS that would remain at 1 January 2005, through coordination of their future work programs;

\textsuperscript{282} SEC (2000b).
\textsuperscript{283} See section 6.7.3.
\textsuperscript{284} See section 7.3.3.1.
\textsuperscript{285} Pitt (2002).
\textsuperscript{286} FASB (2002).
• Continue progress on joint projects that they were already undertaking; and
• Encourage their respective interpretative bodies to coordinate their activities.

The last development occurred in 2004, when the SEC made it clear that it would, if at all, accept only IAS/IFRS as established by the IASB as a basis for dropping the reconciliation requirement. If a company chose to report under IAS/IFRS, it should adopt all such standards: applying an amended version, such as one with carve-outs (as considered by the European Commission, described earlier in this chapter as part of the European reporting developments) would not be acceptable.287 At the end of 2005, no decisions had been taken.

8.5.2.2 The pronouncements of the FASB
The most important standards adopted in the period were FAS 141 ‘Business combinations’ and FAS 142 ‘Goodwill and other intangible assets’, both issued in June 2001,288 and FAS 154 ‘Accounting changes and error corrections’, issued in May 2005.289

Under FAS 141, virtually all business combinations should be accounted for in the same way as other asset acquisitions were accounted for, i.e. based on the values exchanged. In effect, it abolished the pooling of interests method. FAS 142 took a very different approach than its predecessor APB 17 to how goodwill was accounted for subsequent to its initial recognition: it would not be amortised, but tested for impairment.

FAS 154 was issued as part of the IASB-FASB convergence project. The standard changed the requirements for the accounting for a change in accounting principle, and aligned US GAAP to the revised IAS 8, described earlier in this chapter as part of the Dutch financial reporting developments.

The final FASB pronouncement in the period was an exposure draft, issued in April 2005, to incorporate the AICPA hierarchy in the accounting literature.290 It noted that the US GAAP hierarchy was currently presented in the auditing standard SAS 69 ‘The meaning of present fairly in conformity with generally accepted accounting principles’.291 The FASB believed that the hierarchy should be directed specifically to companies because it was the company (not its auditor) that was responsible for selecting accounting principles for financial statements that were presented in conformity with US GAAP. Accordingly, it concluded that the hierarchy should reside in its accounting literature. The FASB proposed to carry forward the hierarchy as set forth in SAS 69, subject to certain modifications that were not expected to result in a change in current practice.

8.5.2.3 Activities of the auditing profession
The only relevant initiative of the AICPA in the period was the issuance of SOP 03-1 ‘Accounting and reporting by insurance enterprises for certain non-traditional long-duration contracts and for separate accounts’ on 7 July 2003.292

287 De Accountant (2004a).
290 FASB (2005).
291 See section 7.5.2.3.
Under SOP 03-1, separate account assets (i.e. a group of assets, liabilities, income and expenses linked to a specific insurance contract, such as a separate pool of investments) representing contract holder funds should be measured at fair value and reported separately as a summary total, with an equivalent summary total for related liabilities, if certain specified criteria were met. If these criteria were not met, assets and liabilities should be presented under the normal accounting rules. The basis for determining the amount was the accrued account balance of the related contract. This equalled deposits net of withdrawals, plus amounts credited pursuant to the contract, less fees and charges assessed, plus additional interests (for example, persistency bonus), and plus or minus other adjustments. The accrued balance should not reflect any surrender adjustments.

8.5.2.4 US prudential reporting developments
There were no important developments to report regarding insurance supervision. At the end of 2005, the US system of insurance regulation could be summarised as follows:

- Only a state could charter an insurer. Once thus incorporated, an insurer should obtain a license in each state where it planned to sell policies. Its external business practices (marketing, advertising and policyholder services) were regulated separately in each state where it sold policies, under laws and rules that often varied state to state;
- In theory, only the state that chartered the insurer regulated its internal business practices. However, the largest states (such as New York) regulated the solvency and internal business practices of each insurer doing business in their territory (even when they were chartered in the US, but in another state) under their own laws and rules, that also varied from state to state; and
- The NAIC set standards for solvency margins, although individual states could modify or ignore any such a standard. All states but New York were NAIC-accredited.

Regarding the activities of the NAIC, there were only a few areas to be reported. One concerned an increased level of cooperation between the NAIC and other national and international organisations, including those located in the EU. Also in the US itself the NAIC worked with the federal government and other organisations of state officials, such as the ‘National Conference of State Insurance Legislators’.

Regarding the statutory accounting principles, the NAIC published its ‘Codification’. The intention of this publication was to produce a comprehensive guide on this topic. In 2002, it covered 1,948 pages of accounting and was included in the NAIC ‘Accounting Practices and Procedures Manual’. According to this manual, financial reporting included annual statements, quarterly statements, the management discussion and analysis, an actuarial opinion, annual audited financial statements (including a report of significant deficiencies in internal controls), and a risk-based capital report.

293 Webel and Cobb (2005).
294 NAIC (2002).
296 NAIC (2002).
8.5.3 United Kingdom

8.5.3.1 Legislative developments in the period 2000-2005

In the period reviewed in this chapter, only a few legislative changes in the financial reporting requirements occurred. An amendment to the companies act was adopted on 11 November 2004, dealing with the implementation of the EU modernisation directive and the IAS regulation discussed in the previous section. Companies were allowed, but not required, to measure specified categories of financial instruments at fair value, and to adopt IAS/IFRS instead of UK GAAP in case this was not already mandatory. Furthermore, near the end of 2005 an amendment was made by removing the requirement in the relevant schedules of the companies act of 1985 to restate comparative figures in the balance sheet and the profit and loss account where they were not comparable, and the requirement to report the corresponding amount for items disclosed in the notes to the financial statements.

In the area of prudential reporting requirements, the first change occurred in May 2000 when the insurance companies’ regulations were amended in respect of the calculation of insurance liabilities for long-term business. The change required companies to take account of discretionary charges to policyholders, in so far as they did not exceed their reasonable expectations. Furthermore, regarding policyholder options, the calculation of the liabilities had to consider “the amount which would reasonably be expected to be paid if the option were exercised, having regard to the representations of the company”. Although the explanatory note did not mention the background of these amendments, it is, in my view, without doubt that they resulted from the fall of ‘Equitable Life Assurance Society’, discussed hereafter.

Another development concerned, as is noted in the previous chapter, the establishment of the ‘Financial Services Authority’ (the ‘FSA’) under the ‘Financial Services and Markets Act 2000’ (henceforth, the ‘FSMA’). The general functions of the FSA were the making of rules under the act, preparing codes under the act, the giving of general guidance, and the determination of the general policy and principles by which it would operate. The FSA focused on all participants in the financial sector. As under the insurance companies act, only authorised organisations were allowed to carry on regulated activities, such as long-term insurance business. The FSMA complemented the insurance companies act and regulations, but did not replace them.

Fairly soon after its creation, the FSA started to develop a supervision system, that focused on the real risks to which firms were exposed, and adopted a coherent risk-based approach across financial services whilst recognising the genuine differences that existed between the sectors. The key principle underlying this new system was to transpose the three pillar approach of the Basel II project (described earlier in this chapter as part of the global reporting developments) to the insurance industry, with particular emphasis on monitoring management behaviour, public information, and tests based on adverse scenarios (stress testing).

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299 ASB (2005a).
300 UK Government (2000a).
301 See section 7.5.3.1.
As is discussed in the next section describing the Dutch prudential reporting developments, this three pillar approach would have a major influence on the development of the European Solvency II project, described in the next section. The FSA solvency assessment model, which was published in 2004, identified specific risks applicable to life and non-life insurance companies, and, within life insurance, created separate regimes for different types of business.\(^\text{304}\) It was based on realistic liability valuations, without additional prudency, and showed considerable similarity with the Dutch financial assessment framework, described in the next section. The new FSA requirements were included in the ‘Integrated prudential sourcebook for insurers’.\(^\text{305}\)

### 8.5.3.2 The pronouncements of the ASB

In the period, the ASB issued a number of FRSs with particular relevance for insurance companies, which created further (but not complete) alignment between the UK standards and those issued by the IASB. They concerned retirement benefits (FRS 17),\(^\text{306}\) deferred tax (FRS 19),\(^\text{307}\) events after the balance sheet date (FRS 21),\(^\text{308}\) financial instruments (FRS 25 and FRS 26),\(^\text{309}\) and financial risk disclosures (FRS 29).\(^\text{310}\)

Another important standards was FRS 18 ‘Accounting policies’, which ruled that when an entity’s financial statements fell within the scope of a SORP, the entity should state whether its annual accounts had been prepared in accordance with such a statement.\(^\text{311}\) In the event of a departure, the entity should explain why this was the case. The effect of the standard was that the authoritative status of a SORP was significantly strengthened. One further standard was FRS 28 ‘Corresponding amounts’, as a response to the amendment of the 1985 companies act on this topic.\(^\text{312}\) It reinstated the former legal requirements, creating consistency with IAS and, effectively, overruling the existing legislation. In that sense, the ASB had an approach which was opposite to that of the RJ, described in the previous section. Finally, the ASB also issued FRS 27 on life insurance business. This standard is discussed hereafter.

### 8.5.3.3 Insurance company financial reporting developments

#### 8.5.3.3.1 The SORPs of 2001 and 2003

The first development was the issuance of the 2001 SORP on achieved profits by the UK insurance industry organisation the ABI in December 2001.\(^\text{313}\) It resolved the debate about the disclosures under embedded value accounting, discussed in the previous chapter,\(^\text{314}\) although the term embedded value was replaced by ‘achieved profits’: the document was entitled ‘Supplementary reporting for long-term insurance business (the achieved profits method)’.\(^\text{304}\) CEA and Mercer (2005).
\(^\text{305}\) FSA (2004).
\(^\text{306}\) ASB (2000a).
\(^\text{307}\) ASB (2000c).
\(^\text{308}\) ASB (2004a).
\(^\text{309}\) ASB (2004b) and ASB (2004c), respectively.
\(^\text{310}\) ASB (2005b).
\(^\text{311}\) ASB (2000b).
\(^\text{312}\) ASB (2005a).
\(^\text{313}\) O’Keeffe et al. (2005).
\(^\text{314}\) See section 7.5.3.3.2.
The objective and basic principles of the achieved profits method were to provide shareholders with more relevant information on the financial position and current performance of long-term business than that provided by the modified statutory basis under the 1998 SORP.\(^\text{315}\) Although the guidance in the SORP was optional, in practice nearly all listed UK life insurers adopted it. It was recognised that a minimum standard of disclosure was required.

In November 2003, the ABI issued a revised SORP.\(^\text{316}\) It replaced the one issued in 1998. The SORP contained recommendations on accounting for insurance business including accounting for investments. It did not address the topics covered by the SORP of 2001. The recommendations were made in the context of the modified statutory solvency basis for life insurance business, and within the constraints imposed by the companies act of 1985. Within those limitations, the provisions in the statement should be regarded as laying down best practice on accounting for insurance business in the UK.

Regarding non-life insurance business, the 2003 SORP, generally, required the annual basis of accounting to be used and prohibited the fund system (similar to what was proposed in the 2001 draft DSOP of the IASC, discussed in the previous section). For life insurance business, the gross premium method should be used for every class of insurance business except those for which the net premium method was used in the prudential returns. However, policyholder liabilities of overseas subsidiaries could, as before, be computed on a local basis.

In respect of investments, the SORP noted that whilst insurance companies had the option under the companies act of 1985 to take unrealised investment gains and losses to a revaluation reserve, the distinction between realised and unrealised gains and losses on readily marketable investments was largely irrelevant. Accordingly, all such realised and unrealised gains and losses should be taken to the profit and loss account. In assessing the performance and financial position of their operations, insurers would usually consider the longer-term investment performance to be more important than the investment return arising in the accounting period. Therefore, the SORP permitted, but did not require, a form of presentation which enabled the reader to identify operating results based on the longer-term rate of investment return. This return could be recorded within the technical accounts and could also be disclosed separately as part of the total operating profit. There was no requirement to allocate the investment return between the technical and non-technical accounts but listed companies should disclose technical results which reflected the longer-term rate of investment return.

### 8.5.3.3.2 The fall of the Equitable Life Assurance Society and the ‘Penrose’ report

In 2000, one of the largest insurance companies in the UK, the Equitable Life Assurance Society (henceforth, the ‘UK Equitable’) came into serious financial difficulties, which triggered a number of discussions and changes regarding insurance accounting and prudential supervision.\(^\text{317}\) In that sense, it was comparable to the Dutch developments after the fall of Vie d’Or.\(^\text{318}\)

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\(^{315}\) See section 7.5.3.3.3.

\(^{316}\) ABI (2003).

\(^{317}\) This was the same company that had been actively involved in the establishment of the UK life assurance companies act of 1870: see section 4.4.1.2.

\(^{318}\) See section 7.2.4.
Description of the issue
The UK Equitable had sold, during the period 1957 to 1988, a large amount of ordinary life insurance policies with a guaranteed annuity rate option. Under this option, the policyholder received the right to convert, at expiration date, the insured capital into an annuity at predetermined rates. The policyholder was thus protected against a change in annuity rates. It was based on a discount rate of 8%, while – in those days – the UK market interest rate was always (much) higher. As a result, the 8% was considered a prudent rate. Furthermore, there was no explicit charge to the policyholder for this option, and there was no investment differentiation for policies with and without the guarantee. The company applied a system of annual bonuses (under which the guarantee was not taken into account), and a system of terminal bonuses, to be paid at the expiration of the insurance contract.

At the end of the 1980s, it became clear to the UK Equitable that the options could possibly come ‘in the money’, since the market interest rate had decreased considerably. To address this problem, management decided, at the end of 1993, to make the terminal bonus dependent on the exercise of the option. If the policyholder did not exercise the option, he would receive the same terminal bonus as a policyholder without the guarantee. If the option was exercised, the terminal bonus would be decreased to the amount the policyholder would have received without the guarantee. Effectively, the value of the option was completely eliminated.

Soon after, some policyholders with guaranteed rates started to raise objections against the decisions of management and court cases were prepared. Management defended its position by reference to the articles of association, giving them absolute discretion to decide on policyholder bonuses (in the IASB terminology: the contracts included completely discretionary participation features). After several rulings in which the courts decided in favour of the company, the House of Lords ruled in July 2000 against the UK Equitable and decided that it had not met reasonable policyholder expectations: with the guarantee, the policyholder could expect an advantage in case it was in the money, and the applied treatment of the terminal bonus eliminated this advantage.

At the time of the final ruling, the UK Equitable had only reserved GBP 200 million for the options, an amount that had to be increased to an estimated GBP 1.5 billion. Its capital was insufficient to cover this liability, and management decided to search for buyers of the company. At the end of 2000, this proved to be unsuccessful, and the company went into run-off. In 2001, the business was transferred to another insurance company, after a considerable cut in the value of the insurance contracts with policyholders’ participation features (in the UK called ‘with-profit’ contracts).

The ‘Penrose’ report
As could be expected, the fall of the UK Equitable raised a high amount of attention, also on the political level. As a result, the government ordered an inquiry, to be conducted by Lord Penrose. At the end of 2003, he published his report, which described the history of the company, its products, the economic environment, and its reporting and supervisory environment. Penrose looked at the recommendations issued by the auditing profession, the actuarial profession, and the UK insurance supervisors, and came to the following conclusions:

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• The main reason for the financial weakness for the company was a longstanding policy to allocate a higher amount for policyholder’s distribution than was available from annual profits, gradually eroding equity;
• Terminal bonuses were not recognised in either the annual accounts or the prudential returns. That reflected the accepted view among actuaries;
• The company was not required by statute, or by recognised accounting or actuarial principle or practice, to value, set up or disclose reserves for accrued terminal bonus payments that were likely to be made in the future, notwithstanding the fact that the accrual of those future benefits were included in the internal valuations;\(^\text{321}\) and
• The published accounts became progressively less relevant as reflections of the actual conduct of the company. This state of affairs was consistent with contemporary accounting and actuarial practices. Those practices had failed to keep up with industry developments.

In assessing the conclusions of Penrose, it should, in my view, be kept in mind that he focused on the accounting and actuarial practices in force at the end of 1999, i.e. before the ruling of the House of Lords in July 2000. As is described before, the insurance industry had subsequently already taken some actions to improve its financial reporting practices by issuing new SORPs, developments that Penrose seemed to have ignored. But, as is described next, it was a matter of fact that the Penrose report initiated further developments.

### 8.3.5.3.3 FRS 27 ‘Life assurance’ and the SORP of 2005

The findings of Penrose resulted in a request of the government to the ASB to initiate an urgent study into accounting for with-profits business by life insurers. The ASB’s response was FRS 27, issued in December 2004.\(^\text{322}\) Being aware of the changes in the FSA’s regulatory regime, described earlier in this section, and the move to IAS/IFRS as a result of the IAS regulation, the ASB concluded that the project should comprise two parts:

• To consider what improvements could be made to life insurance accounting in time for the 2004 accounts and to develop a standard requiring those improvements; and
• To develop views on the direction in which insurance accounting more generally should develop over the next few years and on the key issues that would need to be addressed in securing the necessary changes.

FRS 27 was the result of the first part. The ASB decided to build on the FSA realistic capital regime, which, for the assessment of the solvency position of an insurer, required a realistic value of the life insurance liabilities. Therefore, for with-profit life funds falling within the scope of this regime, the liabilities to policyholders arising from with-profits life insurance business should be stated at the amount of the realistic value of the liabilities (this included amounts in respect of future bonuses, and policyholders’ options and guarantees), adjusted to exclude the shareholders’ share of projected future bonuses. Furthermore, acquisition costs should not be deferred, since they were already taken into account in the realistic value of the liabilities.

\(^{321}\) As described in section 7.6.4.2, the accounting principles regarding such bonuses had been a topic of intense discussion in finalising the third life insurance directive. It did not result in a requirement, but in an option to take terminal bonuses into account in the calculation of the insurance liabilities.

\(^{322}\) ASB (2004d).
In the ASB’s view, this approach would bring life insurance accounting very much in line with its general recognition and measurement principles for liabilities. Entities not falling within the scope of the FSA realistic capital regime would continue to measure liabilities for policyholder benefits on the modified statutory solvency basis.  

Additionally, FRS 27 introduced the following requirements:

- The separate presentation of the FFA in the balance sheet, and an explanation of a negative balance;
- A capital statement setting out the total available capital for the life insurance business of the entity, supported by information on regulatory capital requirements or management’s capital targets, similar to the 2005 amendment of IAS 1 described in the previous section;
- The disclosure of the assumptions used in the measurement of liabilities, and other information required by IFRS 4; and
- A movements schedule showing the changes in policyholder liabilities, analysed separately for specific businesses, and a schedule presenting the changes in available capital from one reporting date to the next.

As a result of this approach, the capital statement showed that the main difference between the shareholder’s fund and the regulatory capital concerned the FFA, which was recognised as a liability in the financial statements, but as capital for regulatory purposes, since this item was, in case of adverse conditions, available to absorb losses. In my view, this meant that the standard was based on a type 4 single-track reporting approach. The treatment of the FFA was, in a way, comparable to that of the VAR for Dutch banks, as is explained in the previous chapter.

The original intention of the ASB was to introduce an effective date which would require the standard to be applied in the 2004 financial statements. Based on comments on an exposure draft, it decided to set this date at 23 December 2005, with some transitional relief regarding certain disclosures. However, to address the issues raised in the Penrose report and to meet the government’s request, the ASB, the ABI and the leading members of the life insurance and bankassurance sectors concluded an agreement, under which these companies volunteered to provide most of the information required by FRS 27 in a statement attached to but separate from their financial statements for the year 2004. Furthermore, these companies and their UK subsidiaries would, if they would report under IAS/IFRS in 2005, also treat FRS 27 as if it was mandatory, with only a few minor exceptions. The ABI agreed to encourage life insurers that were not a party to the agreement to act as if they were, and to revise its SORP to eliminate any inconsistencies with FRS 27. Regarding compliance with IAS/IFRS, the statement noted that, given the flexibility granted by IFRS 4, applying FRS 27 would enable companies to comply with IAS/IFRS as well. However, companies continuing to report under the modified statutory solvency basis would not meet all requirements of IFRS 4.

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323 As is described in section 7.5.3.3.3, this basis required the capitalisation and amortisation of acquisition costs and prohibited the inclusion of certain reserves in the life insurance provision.

324 This was the ‘Fund for future appropriations’. As is explained in section 6.5.3.1, this liability included amounts the allocation of which to policyholders or to shareholders had not yet been determined. In other words, it still included discretionary participation features.

325 See section 7.4.2.1.1.

326 ASB (2004e).
Following up the agreement with the ASB, the ABI issued, in December 2005, a revised SORP.\(^{327}\) Although it did not fundamentally change the reporting requirements for insurers not reporting under IAS/IFRS, it did implement a number of provisions in FRS 26 and FRS 27 for those companies falling within the scope of these standards. Furthermore, it implemented a number of provisions included in IFRS 4, such as the treatment of insurance contracts not meeting the IFRS 4 definition of an insurance contract, and provided guidance for contracts containing discretionary participation features. In contrast to the usual procedures, the statement was effective retrospectively to 1 January 2005, which can, in my view, be explained by the ABI-ASB memorandum mentioned above.

In my view, these developments show that, after the introduction of embedded value in the 1980s,\(^{328}\) once again the UK took the lead in improving the financial reporting practices of insurers by requiring them to calculate their technical provisions on realistic instead of prudent assumptions, in line with the approach of the FSA. In this case, however, the trigger was the introduction of revised prudential requirements to determine the solvency margins of insurers, not the desire to better meet the information needs of investors.

8.5.4 Summary and conclusions

In the US, the developments impacting the reporting requirements and practices of insurance companies were limited. The only important events concerned the publication of two important standards by the FASB, on business combinations and on goodwill accounting, enhancing the alignment of US GAAP and IAS, and several announcements of the SEC that it was considering accepting financial statements of foreign issuers prepared under IAS/IFRS, and dropping the existing reconciliation requirements. However, no decisions were made at the end of 2005.

The developments in respect of prudential reporting requirements were virtually absent.

In the UK, the companies act was amended to implement the IAS regulation and the related changes in the accounting directives, and the ASB continued to incorporate, as much as possible, IAS/IFRS in its own standards. For insurance companies, the most important developments concerned the issuance, in 2001 and 2003, of two new SORPs to improve their financial statements, introduce much more fair value accounting for their investments, and abolish an amount of prudence, which had traditionally been included in the determination of the insurance liabilities under the prudential reporting requirements. In other words, a movement away from the longstanding habit of a type 3 or type 4 single-track reporting approach to a type 7 or type 8 approach. Soon after, however, a type 4 approach was restored when the FSA introduced its requirement to base the technical provisions on realistic assumptions when assessing the solvency position of insurers, an approach that was, as is explained next, followed by the ASB and the ABI.

An important event occurred in 2000: the fall of the UK Equitable, one of the largest insurance companies in the UK. Subsequent research revealed that it had underestimated significantly the bonuses to be allocated to policyholders, and this triggered a government request to the ASB to initiate an urgent study into accounting for with-profits business by life insurers. In December 2004, this resulted in a new standard FRS 27, introducing realistic valuation methods for insurance liabilities based on the FFA approach and a number of disclosures.

\(^{327}\) ABI (2005).

\(^{328}\) See section 7.5.3.3.2.
These disclosures included the difference between the amount of equity in the financial statements and the capital required by the insurance supervisors: a type 4 single-track reporting approach. The ASB and the insurance industry subsequently concluded an agreement, making FRS 27 already applicable to the 2004 financial statements. One year later, the financial reporting practices were even further enhanced by the introduction of a new SORP, aligning the requirements not just with the pronouncements of the ASB, for also, for a large part, with those of the IASB. With these developments, the UK led, in my view, the way of improving the financial reporting requirements of insurers once again.

8.6 Prudential reporting developments in the Netherlands and the European Union

8.6.1 Introduction
As this section shows, the finalised developments in respect of the Dutch prudential reporting in the period were limited: they focused on the incorporation of two European directives, none of which had a significant impact in the Netherlands.

But the section also shows that several new Dutch initiatives were taken to create a fundamentally changed supervisory regime, both in respect of the overall approach and of its contents. The government submitted several bills to build an integrated supervisory legislative framework focusing on all financial institutions (with some interim steps already implemented in the period), and the insurance supervisor started to develop a new approach to assess the financial position of insurers based on fair value accounting for both assets and liabilities. This new approach was not yet implemented at the end of the period, because similar developments occurred at the European level and it was decided to await the outcome of this Solvency II project before implementing potentially different Dutch requirements. Under both approaches, the existing single-track reporting approach was maintained and strengthened. It enabled the introduction of the possibility for Dutch banks and insurers to prepare, from 2005 onwards, their prudential returns under IAS/IFRS or, consistent with the choice they made for their financial statements, under Dutch GAAP. Prudential filters could be applied in both cases to determine and disclose the available solvency margin, but these filters had only a limited impact in practice: a type 8 single-track reporting approach. All these decisions were taken at the time that the total package of IAS/IFRS was not yet completed or stable.

8.6.2 Amendments of the insurance business supervision act 1993 and supporting legislative documents
In the period reviewed in this chapter, the insurance business supervision act 1993 and the supporting legislative documents were amended several times.

8.6.2.1 The implementation of the directive on the supplementary supervision of insurance groups
The first time occurred in April 2000 to implement directive 98/78/EC on the supplementary supervision of insurance groups. The related Administrative Decree, detailing the calculations of the required and available solvency margins, was published shortly after.

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329 Minister van Justitie (2000a), Staatsblad 2000, nr. 168.
330 Minister van Justitie (2000b), Staatsblad 2000, nr. 197.
The underlying bill was submitted mid-1999, adopted by the Second Chamber in February 2000, and by the First Chamber one month later. Directive 98/78/EC addressed the problem that, under the existing directives, prudential supervisors could only assess the licensed insurance company and could not supervise a parent company and other related non-insurance companies. As a result, it was difficult or impossible to oversee the full position of the group and the interrelations between group members, which could jeopardise the solvency position of the supervised insurance company. The directive introduced the concept of supplementary supervision, which focused on the group as a whole. Parent companies, subsidiaries and participating interests were defined according to the fourth and seventh accounting directives. This link is, in my view, another example of the relationship between the prudential and the financial reporting directives, which was very much supported by the CEA. The supplementary supervision focused on intra-group transactions and introduced an adjusted solvency requirement on group level to avoid double-gearing. It was the same concept as the solo-plus approach, already introduced in the Netherlands in 1990.

The directive resulted in the signing of a new protocol by the Conference of the European Insurance Supervisory Authorities. This protocol was not just based on this directive, but also took into account the recommendations of the IAIS and the Joint Forum on Financial Conglomerates where they did not go beyond the scope of the directive. It identified the need to form a ‘Coordination committee’ to deal with multinational groups, and to give particular attention to the supervision of intra-group transactions and positions. However, the exercise of the (supplementary) supervision remained the responsibility of the authority of the country in which the head office of the insurer was located. Insurance groups should, therefore, submit to their supervisor at least annually a report containing all such significant transactions and positions.

The contents of both the directive and the protocol were very similar to the covenants concluded between the supervisors when Fortis was created in 1990.

8.6.2.2 The implementation of the Solvency I directives
In April 2003, the government submitted a bill to implement the so-called ‘Solvency I’ directives. These directives 2002/12/EC for life insurance companies and 2002/13/EC for non-life insurance companies were published in March 2002. They were known as the Solvency I directives, since they did not fundamentally change the methodologies to determine these requirements, introduced by the first insurance directives in the 1970s, but only resulted in limited amendments.

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331 Tweede Kamer (1999d), nr. 26696.
335 See sections 6.4.2.2.2 and 6.4.2.3.2.
337 See section 7.6.2.2.
338 European Commission (2000b). For a description of the Conference, see section 5.4.1.3.
339 For a description of these organisations, see section 7.3.3.2.
340 See sections 7.6.2.2 and 7.6.6.
341 Tweede Kamer (2003b), nr. 28838.
342 European Commission (2002a) and European Commission (2002b), respectively.
343 See sections 6.6.4.1 and 6.6.7.1.
The fundamental change would be covered by the Solvency II project, which is discussed at the end of this section. Both directives were based on the ‘Müller report’, issued in April 1997 by the Conference of European Insurance Supervisory Authorities.\textsuperscript{344} This report was prepared at the request of the ‘Insurance Committee’ in April 1994, and resulted from the development of the third insurance directives in 1992.\textsuperscript{345}

This committee was created at the end of 1991 by directive 91/675/EEC.\textsuperscript{346} It was composed of representatives of the member states, and should cooperate closely with the Conference of European Insurance Supervisory Authorities. The committee would deliver to the European Commission an opinion on proposals for implementation measures concerning the insurance sector, in particular on the directives on direct insurance. The Müller report concluded that the existing system, with a distinction between the available and the required solvency margin based on the annual accounts, had, in essence, proven its worth, but that a number of improvements were necessary to update the system to new developments over time, including inflation.

Compared to the first life insurance directive 79/267/EEC,\textsuperscript{347} the Solvency I directive for life insurers limited the use of future profits in the available solvency margin, with a complete abolishment at the end of 2009. Additionally, it stated that own shares should be deducted from the available solvency margin. In substance, the directive maintained, in my view, the existing Dutch type 4 single-track reporting approach for life insurers. The directive also increased the minimum guarantee fund and introduced a mechanism for automatic future increases based on a European price index, and gave supervisors the possibility to decrease the reduction of the solvency margin requirements for reinsurance arrangements in certain circumstances. Finally, the directive clarified that its requirements were minimum standards and that national supervisors were allowed to lay down stricter rules for companies under their supervision.

For non-life insurers, the directive was similar to that for life insurers, apart from the change regarding the inclusion of future profits in the solvency margin (which was never permitted for non-life insurance companies). Additionally, it included specific requirements for companies discounting their technical provisions, which was allowed, under certain circumstances, by the insurance accounts directive.\textsuperscript{348} The directive stated that the impact of discounting should be deducted from the available solvency margin, in effect eliminating this impact. The main reason for this prudential filter was that discounting was an option, not a requirement, so this elimination would make the technical provisions between insurance companies comparable for solvency purposes. With this system, it was, in my view, possible to maintain the prevailing type 8 single-track reporting approach, since all adjustments for the calculations of the available solvency margin were made outside the prudential returns.

\textsuperscript{344} Müller (1997).
\textsuperscript{345} See section 7.6.4.
\textsuperscript{346} European Commission (1991c).
\textsuperscript{347} See section 6.6.7.1.
\textsuperscript{348} See section 7.4.2.2.2.
After having issued directive 2002/12/EC, the European Commission combined all existing directives for life insurance business in one new directive 2002/83/EC. This recast procedure did not introduce any substantive changes to the existing requirements.

The April 2003 Dutch bill clarified that the proposed amendments to the insurance business supervision act 1993 referred only to those that followed from the Solvency I directives. While some changes, such as increasing the minimum solvency requirements, would be implemented in revised Administrative Decrees, others would be introduced in the act itself. These were:

- The requirements on the solvency margins were minimum thresholds, and the ‘Pensioen- & Verzekeringkamer’ (the ‘Pensions and Insurance Chamber’, the new name of the Insurance Chamber, introduced early 2001) was authorised, in individual cases, to set higher levels;
- The chamber had the possibility to interfere in the management and activities of an insurer at an earlier stage, i.e. before an insurer no longer met the minimum requirements; and
- The chamber was able to reject, on an individual basis, the measurement of certain assets in determining the available solvency margin, and the way in which reinsurance arrangements were included in these calculations. Because of the prevailing single-track reporting approaches, I assume that this would be done by the application of prudential filters. However, there was no discussion in the bill on the methods to implement this power of the Insurance Chamber.

Without substantive discussions, the Second Chamber adopted the bill on 4 September 2003, and the First Chamber on 7 October 2003. The final act was published on 4 November 2003. The related Administrative Decrees, among others introducing a change in the prudential returns regarding the required and available solvency margins, were amended simultaneously.

8.6.2.3 Other amendments of the insurance business supervision act 1993 and supporting legislative documents

Most other amendments in the period were the result of non-supervisory legislation and did not bring substantive changes in the prudential reporting requirements.

However, a few changes need to be mentioned. The first was the introduction, early 2001, of an act to introduce a shelter instrument for life insurance companies in financial difficulties. It was based on the recommendations of the Ybema committee, which had assessed the fall of the life insurer Vie d’Or, and included the incorporation of a special joint stock company available to accept, either by reinsurance or by portfolio transfers, the risks of a life insurance portfolio of a Dutch insurer.

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349 European Commission (2002g).
350 Minister van Justitie (2001a), Staatsblad 2001, nr. 21.
351 As section 7.2.4 describes, all these issues had been particularly relevant in the fall of Vie d’Or.
354 Minister van Justitie (2003a), Staatsblad 2003, nr. 427.
355 Minister van Justitie (2003b), Staatsblad 2003, nr. 483.
356 Minister van Justitie (2001b), Staatsblad 2001, nr. 73.
357 See section 7.2.4.
Another change in the 1993 act concerned the replacement, in a large number of laws, of the Dutch guilder by the euro.\textsuperscript{358} The amendments act was accompanied by an Administrative Decree, amending all prevailing Administrative Decrees under the insurance business supervision act 1993 to replace the guilder by the euro.\textsuperscript{359} Finally, the practice of annual updating the regulations on health insurance provisions was continued.\textsuperscript{360}

### 8.6.3 IAS/IFRS in the prudential returns

Following the legal initiatives to require or enable companies to report under IAS/IFRS, described as part of the global and Dutch financial reporting developments, the Pensions and Insurance Chamber issued in August 2003 a letter to all Dutch insurers on this topic.\textsuperscript{361} It explained that the prudential returns, according to the guidance notes to the models, had to be prepared under the Dutch financial reporting requirements. Since this included, in the future, IAS/IFRS, it would be possible in the future to prepare these returns using these international standards, maintaining the existing single-track reporting approach.

This was confirmed in a letter was issued early 2005.\textsuperscript{362} As a result, insurers using Dutch GAAP for their financial statements should use this basis also for their prudential returns, and the same applied when IAS/IFRS was chosen as the basis.\textsuperscript{363} The supervisor announced the introduction of specific returns for IAS/IFRS-applicants and of prudential filters and separate, publicly available, calculation schedules to determine the required and available solvency margins. Regarding these adjustments and filters, areas to be considered were, in particular: available-for-sale financial instruments, differences in the definition of an insurance contract, and equalisation provisions.

In my view, in particular the last two items make it clear that the intention was to require a type 8 single-track reporting approach. The adjustments and filters amended the technical provisions calculated under IAS/IFRS and, effectively, brought them back under the prudential requirements. This approach was reconfirmed mid-August 2005, when the amendments to the guidelines for the prudential returns were made public: the only change was the postponement of the development of separate models for insurers reporting under IAS/IFRS.\textsuperscript{364} Banks were also allowed to make an irrevocable choice to apply IAS/IFRS in their prudential returns.\textsuperscript{365}

The need to apply prudential filters, when insurers reported under IAS/IFRS, was also identified by the CEIOPS.\textsuperscript{366} It noted the following areas that could have an impact on prudential supervision: the definition of an insurance contract, financial derivatives, intangible assets, equalisation provisions, discretionary participation features, and the valuation of financial assets, property, insurance liabilities, financial liabilities, subsidiaries and participating interests, and pension commitments. The follow up of the CEIOPS recommendations is presented hereafter when discussing the fundamental reform of the Dutch system of supervision of financial institutions.

\textsuperscript{358} Minister van Justitie (2001d), Staatsblad 2001, nr. 481.
\textsuperscript{359} Minister van Justitie (2001c), Staatsblad 2001, nr. 415.
\textsuperscript{361} PVK (2003b).
\textsuperscript{362} DNB (2005a).
\textsuperscript{363} As is noted in the introduction to this chapter, in this case Dutch GAAP excludes IAS/IFRS.
\textsuperscript{364} DNB (2005c).
\textsuperscript{365} DNB (2005b).
\textsuperscript{366} CEIOPS (2005c).
8.6.4 The prudential requirements for banks
The Dutch legal prudential requirements for banks were not changed in the period. On the European level, the only directive on the banking area issued in the period described in this chapter was directive 2000/12/EC, the consolidated banking directive.\(^{367}\) It combined all earlier directives in a single text, but did not introduce changes to existing requirements. No further amendments were made, although, in 2004, the European Commission published a draft directive to implement the Basel II requirements described earlier as part of the global reporting developments.\(^{368}\) The CEBS was actively involved in this development and issued several consultations in 2004 and 2005.\(^{369}\) The revised banking directive 2006/48/EC and the revised capital adequacy directive 2006/49/EC were adopted in June 2006,\(^{370}\) and are therefore outside the scope of this dissertation.

8.6.5 The fundamental reform of the system of supervision of financial institutions
In the period described in this chapter, important steps were taken to introduce a fundamental reform of the system of supervision of financial institutions. This sector covered credit institutions, insurance companies (including funeral-in-kind insurance companies), investment companies and securities firms. For each of these groups, a separate supervisory act was applicable.\(^{371}\)

The process had started in 1996, when the Minister of Finance submitted a letter to the Second Chamber, explaining the level of cohesiveness as well as the differences between the five acts applicable to these industries.\(^{372}\) The letter concluded that most differences could be explained and accepted by the sector-specific characteristics of the financial institutions, but that future legislation would eliminate those variations that were unnecessary or did not result in an equal treatment of similar issues.

A next step occurred in 1999, when the same Minister sent another letter to the Second Chamber, announcing the creation of the ‘Raad van Financiële Toezichthouders’, henceforth, the ‘Council of Financial Supervisors’, in which the DNB, the STE,\(^{373}\) and the Insurance Chamber participated.\(^{374}\) This Council had to make joint and binding decisions for issues which were not sector-specific, such as the delivery of sufficiently transparent and detailed information on financial products to consumers, insider trading, and the integrity of management. Furthermore, the letter presented a future development, under which there would be a clear distinction between prudential supervision and the supervision of the conduct of business, i.e. all activities focusing on the relationship between a financial institution and its clients. The letter also described developments in some other countries, such as the UK where, as is described in the section on the US and UK reporting developments, both types of supervision were now concentrated within one authority, the FSA.

\(^{368}\) CEBS (2005).
\(^{369}\) CEBS (2006).
\(^{370}\) European Commission (2006a) and European Commission (2006b).
\(^{371}\) The supervisory act in respect of investment companies was adopted in 1990: see Minister van Justitie (1990b), Staatsblad 1990, nr. 380.
\(^{372}\) Tweede Kamer (1996b), nr. 24843.
\(^{373}\) As is explained in section 7.4.4.2, the STE was responsible for the supervision of securities trading. But it also supervised investment firms and securities firms.
\(^{374}\) Tweede Kamer (1999a), nr. 26466.
For the Netherlands, the main driver behind the establishment of the Council of Financial Supervisors and the potential future split of supervisory activities was the growth of financial conglomerates, such as Fortis and ING. The letter described that, at the end of 1997, such conglomerates had a market share of 90% in banking business, 80% in securities transaction business, and 70% in insurance business, with about half of the Dutch market being covered by so-called mixed financial conglomerates.\textsuperscript{375} Next to these dominant market shares, which, according to the Minister, already required changes in the organisational structure of supervision of financial institutions, further complications had occurred as a result of blurring boundaries between different financial products and of the organisational integration within the conglomerates, creating differences between legal and organisational structures.

As a result of these activities, the insurance business supervision act 1993 was amended at the end of 2001 as part of an act amending all five supervision acts on financial institutions.\textsuperscript{376} The Minister of Finance would cooperate with the authorities exercising supervision of financial institutions, to establish common policies and regulations on areas to be decided by the Minister. The act was based on a bill, submitted to Parliament mid-September 2000,\textsuperscript{377} which was adopted by the Second Chamber one year later,\textsuperscript{378} and by the First Chamber near the end of November 2003.\textsuperscript{379}

Subsequent amendments to the insurance business supervision act 1993 in 2004 resulted from an act simplifying the approval procedures for participations in several types of financial institutions.\textsuperscript{380} It was based on a bill, submitted in November 2003, which explained that the main reason for such simplifications was cost savings for all parties involved.\textsuperscript{381} At the same time, the bill made it clear that the approval procedures would not just focus on the impact for an individual sector of the financial services industry, but on the consequences for the financial system as a whole. This was related to the continuing expansion of the role of financial conglomerates, described above. Without much discussion, the bill was approved by the Second Chamber on 3 June 2004,\textsuperscript{382} and by the First Chamber on 28 June 2004.\textsuperscript{383}

Finally, an act was published near the end of 2004, effective immediately, to merge the DNB and the Pensions and Insurance Chamber into one organisation, by integrating the latter into the first.\textsuperscript{384} The bill for this act was submitted to the Second Chamber at the beginning of 2004, and clarified that this merger was part of the fundamental reform the Dutch system of supervision of financial institutions.\textsuperscript{385} Furthermore, the merger was initiated by the two supervisors themselves, following up their positive experiences under a cooperation agreement (the ‘covenant’) concluded in April 2002.\textsuperscript{386}

\textsuperscript{375} For the definition of such a group, see section 7.6.2.2.
\textsuperscript{376} Minister van Justitie (2001e), Staatsblad 2001, nr. 596.
\textsuperscript{377} Tweede Kamer (2000b), nr. 27290.
\textsuperscript{378} Tweede Kamer (2001a), Handelingen 13 september 2001.
\textsuperscript{379} Eerste Kamer (2001), Handelingen 20 november 2001.
\textsuperscript{380} Minister van Justitie (2004a), Staatsblad 2004, nr. 441.
\textsuperscript{381} Tweede Kamer (2003d), nr. 29348.
\textsuperscript{382} Tweede Kamer (2004b), Handelingen 3 juni 2004.
\textsuperscript{384} Minister van Justitie (2004b), Staatsblad 2004, nr. 556.
\textsuperscript{385} Tweede Kamer (2004a), nr. 29411.
\textsuperscript{386} DNB and PVK (2002).
Under this covenant, the DNB and the Pensions and Insurance Chamber agreed to intensify their cooperation in supervising financial conglomerates by amending the existing protocol concluded in 1990.\footnote{See section 7.6.2.2.} Without much debate, the Second Chamber adopted the bill early September 2004,\footnote{Tweede Kamer (2004d), Handelingen 7 september 2004.} and the First Chamber followed several weeks later.\footnote{Eerste Kamer (2004b), Handelingen 12 oktober 2004.}

In parallel with these developments, the government had started the legislative process for the fundamental reform, by submitting a memorandum to Parliament in 2001.\footnote{Tweede Kamer (2001b), nr. 28122.} It included a proposal to split prudential supervision and conduct-of-business supervision. The first would be allocated to the DNB and the Pensions and Insurance Chamber, while the second would be executed by the AFM, which was, as is explained in the section on the Dutch financial reporting developments, the legal successor of the STE. From the very start, it was clear from the parliamentary discussions that the Second Chamber fully supported the proposed directions, and the first part of a bill for the new act was submitted in August 2004.\footnote{Tweede Kamer (2004c), nr. 29708.}

The new ‘Wet financieel toezicht’ (the ‘financial supervision act’) was published at the end of October 2006,\footnote{Minister van Justitie (2006b), Staatsblad 2006, nr. 475.} and is therefore outside the scope of this dissertation. It is, however, relevant to describe one part of this new legislation, as it provides an insight in the prudential filters for insurers reporting under IAS/IFRS.

The application of such filters was included in the ‘Besluit prudentiële regels Wft’ (the ‘Decree on the prudential regulations under the financial supervision act’).\footnote{Ministerie van Justitie (2006c), Staatsblad 2006, nr. 519.} This document explained that, to determine the required solvency margin, the definition of an insurance contract in IFRS 4 should be ignored and that, as a result, all contracts that met the Dutch legal definition of an insurance contract should be treated as such. To determine the available solvency margin, the equity of an insurer had to be adjusted for subsidiaries and participating interests not measured at equity value, reserves from unrealised gains and losses on own debt instruments of the insurer, the equalisation reserve for credit insurance business, unallocated losses, treasury shares and related derivatives, and intangible assets (the latter had to be deducted already under the old regime as a prudential filter, so the Decree introduced no changes).\footnote{See section 7.6.5.} And to determine the amount of equity, the technical provisions had to be of such a level that they were still sufficient if all assets covering these liabilities were measured at fair value and if the prescribed Dutch supervisory methods and assumptions in respect of the discount rate, the mortality rate, and the morbidity rate were applied.

The explanatory memorandum, part of the published Decree, noted that an important objective was to strengthen and, where necessary, restore a single-track reporting approach. For this reason, the prudential regulations were, as much as possible, aligned to IAS/IFRS. The application of prudential filters enabled compliance with the European prudential directives as well.
The Dutch government was, however, of the opinion that not all changes as a result of the adoption of IAS/IFRS should, automatically, result in prudential filters, since this would be in conflict with the objective of the continuing application of a single-track reporting approach. Therefore, it had chosen a restrictive approach and only required those filters that were inevitable.

Although the Decree was only effective from 2006 onwards, i.e. in the years outside the scope of this dissertation, I consider it, given the 2005 pronouncements of the DNB, highly likely that the 2006 filters were applied in 2005 as well. In respect of the contents of the filters, my assessment is that they will not have had much impact, apart from the requirement to apply the legal definition to insurance contracts and the elimination of intangible assets. The other adjustments were, if applicable at all, generally immaterial.

8.6.6 Outstanding developments at the end of 2005

8.6.6.1 The development of the financial assessment framework

Early 2000, the Insurance Chamber started a process to develop a new approach to assess the financial position (i.e. the available and required solvency margins) of insurance companies. The first step was a consultation on new actuarial principles for insurers. To determine the available solvency margin, the following approach was proposed:

- The assets and the liabilities were measured at market value;
- The level of the required technical provisions was based on the actual risk profile of these liabilities in connection with assets covering them;
- In case of a mismatch between assets and liabilities in respect of market risk (including interest rate risk) or credit risk, the insurer had to establish a mismatch provision; and
- The required technical provisions were explicitly built up from the following three components: the expected value of the liabilities, a ‘prudence’ provision, and a ‘mismatch’ provision.

The second step occurred in 2001 with the publication of a brochure, detailing the concepts of a new supervisory regime, called the ‘financieel toetsingskader’ (the ‘financial assessment framework’). It would replace the existing actuarial principles issued in August 1994. Based on the risk profile of an insurer and, for the purpose of assessing the solvency margin, the consistent measurement of the assets and liabilities at fair value, an insurer would have to meet three tests, focusing on the balance sheet date, a one year time horizon, and on the long term. The Insurance Chamber noted that it had the intention to base the measurement principles in its solvency test on the future IASB standard for insurance contracts, which was, as is described earlier in this chapter as part of the history of IFRS 4, at the time heading in the direction of fair valuing the insurance liabilities. However, since this project was still ongoing, the Insurance Chamber had decided to start with its own definition of the fair value of these liabilities, based on the transfer of the insurance portfolio to an independent third party. In my view, this is another example of the intention, in 2001, to align, to the maximum extent, the prudential reporting requirements with the (future) financial reporting requirements, even when the latter were still uncertain, and to maintain a single-track reporting approach.

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396 PVK (2001a).
397 See section 7.6.5.
The timing and next steps in the project were clarified in the beginning of 2002: the aim was to have the new system effective as of 1 January 2006, based on subsequent consultation drafts to be issued from May 2003 onwards. Next to the developments at the IASB, the results were also intended to be aligned with the discussions at the level of the EU regarding the Solvency II project, which is described hereafter. In 2003, indeed two white papers were issued, requesting comments on proposals regarding a ‘solvency’ test, and a ‘continuity’ test.

None of the publications mentioned above discussed specifically the measurement bases to be applied in the financial statements, the prudential returns, or both, or whether the Insurance Chamber considered it desirable or necessary to maintain or abolish the prevailing single-track reporting approach. Instead, the focus was completely on the methods to determine the available and required solvency margins by adjusting the measurement bases of certain assets and liabilities. In my view, this means that, at the time, the chamber had not yet made up its mind whether to require a single-track reporting approach or to move away from this approach and adopt the supervisory system in the US, under which there was a complete separation of the financial statements and the prudential returns. As is described earlier in this section, the ultimate choice was the first approach, since insurers should apply either Dutch GAAP or IAS/IFRS in their prudential returns, depending on the reporting regime applicable to their financial statements, and, therefore, introducing or strengthening a type 8 single-track reporting approach.

Regarding the contents of the financial assessment framework, I find it remarkable that it was based on the tentative views of the IASC steering committee on insurance, which were, as is described earlier in this chapter when presenting the Dutch financial reporting developments, focused on the information needs of investors and not on those of prudential supervisors, and which were not uncontroversial. Furthermore, it was already known in 2003 that it would take a number of years before a final standard on insurance contracts would be issued by the IASB, and that it was not certain at all which direction this project would take. The only explanation I consider likely for the initiatives of the Insurance Chamber is that they were strongly influenced by the international developments in respect of insurance supervision, such as those at the UK FSA (described in the previous section) and those at the level of the EU on Solvency II (described hereafter).

The final consultation document on the financial assessment framework in the period was published near the end of 2004. It explained that, based on the comments received on the white papers, several changes had been made, but the objective was still to test the financial position of an insurer based on its risk profile. For this purpose, the measurement basis of the assets and the liabilities continued to be fair value. As soon as there would be a final IASB standard for insurance contracts, the Pensions and Insurance Chamber would consider its applicability in the prudential returns, where necessary accompanied by prudential filters. At the end of 2005, the framework was not yet finalised, awaiting the outcome of the Solvency II project.

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398 PVK (2002a).
399 PVK (2003a).
400 PVK (2003c).
401 See section 7.5.2.6.
8.6.6.2 Directive 2002/87/EC: the financial conglomerates directive

Directive 2002/87/EC was adopted to respond to new developments in financial markets.\(^{403}\) These had led to the creation of financial conglomerates, which were not covered by the existing prudential directives. In such groups, special areas of importance were, in particular, the solvency position and risk concentration at the level of the conglomerate, and the intra-group transactions and the use of own funds instruments for multiple-gearing purposes. In line with other international activities, such as the Joint Forum on Financial Conglomerates,\(^{404}\) the directive sought to address these issues. Its contents were very similar to the arrangements already made in the Netherlands in 1990 between the DNB and the Insurance Chamber, presented in the previous chapter.\(^{405}\) The directive was not yet implemented in the Dutch legislation at the end of 2005.

8.6.6.3 Directive 2005/68/EC: the reinsurance directive

Another outstanding development concerned the Dutch implementation of the directive 2005/68/EC dealing with reinsurers, published at the end of 2005.\(^{406}\) The directive introduced prudential supervision of all reinsurance companies established in the EU, and was heavily based on the already existing supervisory directives on direct insurance business. It included similar requirements in respect of ‘single license, home country control’, prudential returns, technical provisions in accordance with the rules in the insurance accounts directive, and required and available solvency margins. The directive was not yet applicable at the end of 2005.

8.6.6.4 The Solvency II project

8.6.6.4.1 The preparatory work

The last prudential reporting development described in this dissertation concerns the so-called Solvency II project. During the development of the Solvency I directive, described earlier in this section, it became clear that, compared to the focus of the existing directives,\(^{407}\) a more fundamental and wider ranging review of the overall financial position of an insurance undertaking was required, looking at the overall financial position of an insurance undertaking instead of only at the technical provisions, and taking into account current developments in insurance, risk management, finance techniques, and international financial reporting and prudential standards. This conclusion was, among others, based on the 1997 Müller report, but also on the 2000 ‘Manghetti report’.

The latter report, issued in October 2000 by the Conference of the European Insurance Supervisory Authorities, focused on the technical provisions for non-life insurance business.\(^{408}\) Based on an EU-wide survey, it noted that there were particular problems to determine the provisions for claims outstanding in respect of so-called ‘latent claims’ (i.e. losses whose causes were not known at the moment of issuing the insurance cover, such as asbestosis). Given the nature of such claims (they were unknown), there were objective difficulties in identifying a list of these claims as it would vary over time and no calculation rules existed. Furthermore, differences existed as far as discounting was concerned: the option to discount provisions for claims outstanding was admitted in 50% of the member states but rarely used, mainly because of the restrictions on the rate that might be chosen.

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\(^{403}\) European Commission (2002i).

\(^{404}\) For a description of this organisation, see 7.3.3.2.

\(^{405}\) See section 7.6.2.2.


\(^{407}\) See sections 6.6.4.1 and 6.6.7.1.

\(^{408}\) Manghetti (2000).
Regarding equalisation provisions (exclusive of credit insurance), the report observed a poorly harmonised sector. There were notable differences both as regards the legislation on prudential accounting and the tax arrangements. A similar conclusion was reached for catastrophe provisions, which could be linked to specific rules that regulated relations between the governments and the insurance market for the coverage of such risks. As far as provisions for unexpired risks were concerned, only a minority of countries had instituted a detailed regulation, although most countries regulated an ageing provision with a method of calculation similar to the techniques used in life insurance.

While the work on the Manghetti report was being performed, the European Commission distributed, already in December 1999, to the member states a document entitled ‘The review of the overall financial position of an insurance undertaking (Solvency II review).’ The paper identified six key aspects to examine in the context of a future solvency regime: technical provisions, asset/investment risk, asset-liability management, reinsurance, the methodology for solvency margin requirements and the accounting system. A study would be carried out by a third party to provide input on the existing methodologies and developments.

The discussions continued in the spring of 2001, based on a document presenting the proposed work. This document supplemented the 1999 document, made reference to an assignment given to KPMG to perform the study, and mentioned that the Solvency II project should naturally take account of the international developments (by the IASC) concerning accounting standards, since – at that time – most member states use a single set of accounts both for financial reporting and supervision. To avoid the production of multiple sets of accounts, it was considered important that this common approach (a single-track reporting approach) should persist as far as possible.

In June 2001, a new document was distributed by the European Commission, explaining the proposed three pillar approach in the future Basel II accord (mentioned in the beginning of this chapter when presenting the reporting developments on a global level). It noted that it should be kept in mind that the objectives of banking and insurance supervision differed. In the banking sector, the prudential objective was to reinforce the soundness and stability of the international banking system. In the insurance sector, the purpose of prudential supervision was to protect policyholders against the risk of (isolated) bankruptcy facing every insurance company. However, the document also concluded that the draft new Basel accord could, nevertheless, provide ideas or useful concepts for the Solvency II project.

In May 2002, KPMG issued the results of its study. The report noted that the prevailing European prudential insurance directives only laid down minimum requirements and that the member states were allowed a high degree of freedom to establish more stringent rules. In some areas, the directives did not lay down any prescriptive requirements. The insurance accounts directive also permitted a choice of the valuation techniques. This flexibility had resulted in some countries having a solvency regime that was super-equivalent, i.e. the implementation of rules over and above the minimum required by the directives.

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411 The report did not specify to which member states it referred.
412 European Commission (2001h).
413 KPMG (2002). I participated in the finalisation of this report.
This flexibility had led to significant differences in approach adopted towards prudential supervision between the member states. Additionally, there was a close link to accounting and actuarial practices, and these varied significantly both between countries due to different local implementation of the directives and also between individual insurers in the same country in a way that was not necessarily transparent.

To resolve these issues, a large number of recommendations were presented, focusing on a variety of topics, such as risks and risks models, the determination of the technical provisions, the measurement of the assets, reinsurance, advanced risk reduction techniques, future accounting changes, the role of rating agencies and market mechanisms, and a comparative analysis of the advantages and disadvantages of the US, Canadian and Australian insurance supervisory systems. According to KPMG, a three pillar approach, as proposed in the new Basel accord, should be considered as a possible approach for insurance. Furthermore, the activities of the IASB should be taken into account in developing a future system, as a sound and consistent accounting basis using best estimates and provisions for risk and uncertainty was an important feature in establishing technical provisions.

8.6.6.4.2  The view on the link between financial statements and prudential returns

Shortly after KPMG had issued its report, the European Commission issued a note on the links between the financial statements and the prudential returns of insurance undertakings. The paper described the existing situation in the EU, where financial reporting by insurance companies was regulated by the fourth and the seventh directives, but more specifically by the insurance accounts directive. Although the latter broadly harmonised accounting for insurance undertakings in the EU, the existence of numerous options sometimes clouded the comparability. The prudential directives stated that the member states should require every insurance undertaking to produce prudential returns. However, they included no requirement to do this in accordance with the insurance accounts directive, although in specific areas, such as the valuation of non-life technical provisions, the prudential directives made specific reference to the rules in the insurance accounts directive. On the other hand, the prudential directives on life insurance business included more specific rules on the establishment of technical provisions than the insurance accounts directive.

According to the document, the member states had to a large extent linked financial and prudential reporting requirements to arrive at a situation where the same accounting rules were used for both purposes (a single-track reporting approach). Consequently, many member states used the bulk of the rules in the insurance accounts directive also for the prudential returns, and all member states seemed to use the valuation specifications in the prudential directives also for the financial statements. In other words, the prudential requirements were leading in respect of the technical provisions, and the financial reporting requirements in all other areas of the financial statements.

In contrast, the US system was completely different, since this used separate reporting under a nearly complete set of statutory accounting principles.

416 See section 7.4.2.2.2.
417 See section 6.5.2.8.
Subsequently, the paper gave an overview of current and future developments, such as the upcoming IAS regulation, the modernisation of the fourth, seventh and the insurance accounts directives, the developments at the IASB and the IAIS, and several national developments such as the future financial assessment framework in the Netherlands and the fundamental reform in the UK, all described earlier in this chapter. Given all these developments, the key question was whether or not the link between the financial statements and the prudential returns should be maintained or eliminated. Advantages and disadvantages of six different scenarios were discussed, and the ultimate proposal by the European Commission was that the future prudential reporting rules should not be built on the current insurance accounts directive, but should be developed in the direction of IAS and result in changes in the directive as well. In other words, the European Commission proposed, as was the case in the Dutch developments on the financial assessment framework, to use the, yet uncertain, future financial reporting requirements of the IASB, focusing on the information needs of investors, as the basis to determine its prudential reporting requirements, focusing on the information needs of supervisors. The potential role of prudential filters was not discussed.

The proposed move in the direction of IAS was strongly and consistently supported by the CEA in several notes issued in 2002 and 2003. In its view, the aim should be to have a single set of accounts for accounting and prudential supervision (a single-track reporting approach), but if this would not be achievable, financial reporting requirements should form the basis with a minimum number of amendments for supervisory purposes. Whether this should be achieved by a separate set of prudential returns or by prudential filters was not discussed.

8.6.6.4.3 The next steps toward a directive

A next important step was the delivery of two working group reports in September 2002, on life and non-life insurance technical provisions.

The working group on life insurance was set up to study two major issues: the rules for calculating the technical provisions and asset-liability management methods. The group identified a series of common prudential concerns for which it made sense to try to supply a European solution, but also believed that the directives contained most of the necessary prudence principles to serve as a platform for improvement. Regarding accounting, the group mentioned the existence of strong links between accounting rules and the solvency regime. It noted that the current international IAS project for insurance was still at an early stage and that it would be difficult to design a new solvency framework if the accounting basis was not fully defined. To resolve this issue, it recommended consideration of an acceptable level of double reporting (i.e. a delinking of the financial and prudential reporting requirements, moving away from a single-track reporting approach), if needed. In my view, this meant that the working group was of the opinion that a single-track reporting approach was the preferred solution and that any level of double reporting should only be temporary, awaiting the final outcome of the IASB discussions. This was, however, not specifically addressed in the working group’ report.

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The working group non-life technical provisions based its work on the Manghetti report and the KPMG report. It focused on two main issues: provisions for claims outstanding and equalisation provisions. Regarding the first, the group adopted both a quantitative and a qualitative approach. It concluded that diverging provisioning practices in the different member states led to diverging average levels of prudence in the provisions. The solution should be found in an attempt to make companies’ practices converge towards a common level of prudence and to develop European principles for sound claims management and provisioning practices. As far as equalisation provisions were concerned, the group noticed an extreme diversity in the size of these provisions between national markets. It would make sense to take these provisions into account when assessing the solvency position. Furthermore, the scope of these provisions should be extended and equalisation provisions should be explicitly linked to the volatility of the business.

8.6.6.4.4 The structure of a future directive

A proposal, summarising the work done so far and presenting the future design of the Solvency II system, was issued by the European Commission in November 2002.\[420\] It stated that a structure modelled on the Basel project would seem to be a good basis for completing the work. The new system should be risk-adjusted and should encourage sound risk management. Furthermore, the Solvency II project should be considered in a context of radical developments of accounting standards. Despite the uncertainties still associated with the IASB project on insurance contracts, the best solution in the long term would appear to be for the prudential system to be based on international standards applicable to all insurance companies in the EU. The statements required by supervisors would thus be the company’s financial accounts (a single-track reporting approach) plus additional information or simple reworking. Although the document did not provide a description of ‘reworking’, I assume, based on the contents of all previous documents, that it meant the use of prudential filters (a type 8 approach). The solution of developing and updating an autonomous set of ‘prudential’ accounting rules was not considered realistic. It would be necessary to revise the accounting directives, to ensure that the same accounting treatment (based on the final IFRS for insurance contracts) was applied to listed and unlisted companies and to establish a common prudential system.

A follow-up paper, to be discussed in the Insurance Committee in April 2003, noted that the previous proposals should be supplemented.\[421\] It recommended that the general layout of a Solvency II system should, to the extent necessary, be compatible with the approach and rules used in the banking field, and that it should aim at more efficient supervision of insurance groups and financial conglomerates. Regarding accounting, the intention should be to implement accounting rules, which were compatible with the likely outcome of the IASB work. However, where the supervisors’ need for information would not be met, adjustments or additions might be necessary. Again, the document was not specific in respect of the contents of these adjustments.

The principle to align, to the extent possible, Solvency II developments with the ongoing work by the IASB was further elaborated on in a paper issued in August 2003.\[422\] Its purpose was to analyse how the proposals in ED 5 as well as the revised IAS 32/39, all described earlier in this chapter as part of the Dutch financial reporting developments, could influence the existing EU directives.

\[420\] European Commission (2002h).
\[421\] European Commission (2003c).
\[422\] European Commission (2003c).
The document identified the following six major issues: the definition of an insurance contract, the valuation of financial assets and liabilities, changes in accounting policies and redesignation options, equalisation provisions, the classification of unallocated surplus arising from discretionary participation features, and disclosures. Subsequently, several proposals were presented by the European Commission, based on the tentative ideas presented earlier and following the now endorsed three pillar approach. Areas and mandates for further technical work were proposed, discussed and decided on, specifically involving the CEIOPS, which activities regarding Solvency II are discussed next. However, at the end of 2005, there was still a long way to go before a directive would be implemented in EU legislation.

8.6.6.4.5 The involvement of the CEIOPS
As is explained earlier in this chapter as part of the European reporting developments, the CEIOPS was created as a level 3 committee under the Lamfalussy approach. One of its roles was to develop advice to the European Commission. To structure this work, the European Commission published on 14 July 2004 its ‘Framework for consultation’ on Solvency II. It set out the policy principles and guidelines within which the CEIOPS should develop its advice and served as the ‘umbrella’, under which the CEIOPS would be requested to provide advice on detailed aspects of the new solvency system through specific ‘calls for advice’. In the years 2004 and 2005, three ‘waves’ of such calls were submitted by the European Commission, in July 2004, in August 2004, and in April 2005.

The first wave addressed mainly pillar II issues (i.e. the supervisory review process), on which the CEIOPS provided its answers in June 2005. Since none of the requests in the first wave had specific relevance for this dissertation, they are not discussed.

The second wave included 12 requests, and the CEIOPS submitted its answers in October 2005. On life insurance provisions, the request had made it clear that the European Commission was determined to take the IASB proposals for a future standard on insurance contracts (based on the DSOP, described earlier) as the basis for its own rules. The provisions should be calculated as the expected present values (or best estimates) plus risk margins. The discount rate should be risk-free, valuation methods of profit-sharing policies should be explicit, differences between the discount rate and guaranteed interest rates should be addressed and options embedded in life insurance contracts should be taken into account. In its response, the CEIOPS supported this approach. On non-life insurance provisions, the CEIOPS recommended separate risk margins for the different types of provisions, to be determined by line of business: diversification effects would be considered in the future. It had not yet developed a view on discounting.

426 European Commission (2004g).
428 CEIOPS (2005b).
429 CEIOPS (2005d).
430 European Commission (2004g).
According to the CEIOPS, equalisation provisions should be shown as liabilities, but to measure the available capital for prudential supervision they would be classified as equity.

The third wave dealt with the supervisors’ overall need for information, and how well existing (or coming) reporting standards would serve this purpose. In addition, the CEIOPS was asked to formulate a general supervisory reporting approach and a general concept for public disclosure (i.e. the disclosure of information by an insurer to the public to reinforce market mechanisms and discipline) for the Solvency II system. The last request included the links between supervisory and financial reporting and the need and formulation of prudential filters. The response of the CEIOPS was published in May 2006, and is, therefore, outside the scope of this dissertation.

8.6.7 Summary and conclusions
The main developments that were finalised in the period reviewed in this chapter all concerned the implementation of European directives, in respect of the supplementary supervision of insurance groups and an update of the existing solvency requirements. The latter, the so-called Solvency I project, was a first step in a fundamental overhaul of the European solvency requirements for insurers. This Solvency II project started at the end of 1999, was based on the three pillar approach adopted by the Basel committee for banking supervision, and focused on the measurement of all assets and liabilities at fair value. To align with the financial reporting developments, i.e. IAS/IFRS (even though a number of those developments were still uncertain), it was explicitly based on a single-track reporting approach accompanied by prudential filters to eliminate certain assets (such as goodwill) or adjust certain components of equity or liabilities in the calculation of the available capital of an insurance company. At the end of 2005, the project had not yet been finalised.

Preparations for fundamental changes in the supervisory environment of insurance companies also occurred in the Netherlands. One step was to start developing an integrated supervisory act applicable to all financial institutions, a process that was completed in 2006, i.e. outside the scope of this dissertation. Interim steps concerned the creation of a Council of Financial Supervisors, the elimination of a number of differences in the supervisory acts focusing on segments of the financial services industry, and, in 2004, the merger of the DNB and the Pensions and Insurance Chamber. Another interim step was, in 2003, the announcement that the banking and insurance supervisors would enable prudential reporting on a Dutch GAAP basis or an IAS/IFRS basis, with prudential filters where necessary, to maintain and even strengthen the existing single-track reporting approach. And for insurance companies, the Insurance Chamber took this approach even one step further, when it started, early in 2000, to develop a new system to assess the financial position of insurance companies. The approach was based on the early IASC proposals for insurance contracts accounting, which moved in the direction of fair value accounting for assets as well as liabilities. At the end of 2005, the Dutch developments were still outstanding, awaiting the final outcome of the Solvency II project, which, as is noted above, moved in the same direction.

Compared to the past, the Dutch insurer supervisor showed a much more proactive mode by its initiatives in respect of IAS/IFRS in the prudential returns and the developments of the financial assessment framework. And it even went further than ever before by basing its future prudential requirements on financial reporting standards which were still under developments and of which the final outcome was far from certain.

In my view, it is clear that it was, both at the European and at the Dutch level, the intention to maintain and even strengthen a single-track reporting approach. This was the case when the prudential returns were prepared under IAS/IFRS as well as under local GAAP. The use of prudential filters (the contents and impact of which would, almost certainly, differ in both cases) would enable the insurers and their supervisors to determine the available solvency margins in a comparable manner. As I have stated earlier in the previous chapter,\(^ {432}\) I support this approach. In my view, it possible to serve the information needs of investors and of the prudential supervisors by the application of a type 8 single-track reporting approach: the financial reporting requirements are leading, and additional information is presented to meet the prudential requirements, including the available and required solvency margins and all related prudential filters. This view was, in 2004, supported by two employees of the Bank for International Settlements, who argued that prudential supervision would benefit from unbiased information in the financial statements (prescribed by accounting standard setters), enabling prudential supervisors to instil their legitimate desire for conservatism through other instruments.\(^ {433}\)

8.7 Reporting in practice

8.7.1. Introduction
This section discusses the actual reporting developments of AEGON, Fortis and ING. As in the previous chapter, it is primarily based on the data extracted from the financial statements, which are presented in annex 13.\(^ {434}\) The analysis is again organised by individual topic selected for review, in the following order:

- The size of the financial reports;
- General comments regarding the financial statements, which include the balance sheets, the profit and loss accounts, the cash flow statements, and the movement schedules of reserves;
- The accounting treatment of investments;
- The accounting treatment of technical provisions;
- The accounting treatment of long-term employee benefits (the provision for pensions and similar obligations);
- The accounting treatment of taxes (the provision for (deferred) tax and tax on profit or loss);
- The presentation of segment information; and
- The accounting treatment of business combinations.

Furthermore, as in the previous chapter,\(^ {435}\) separate discussions are presented in respect of the US GAAP reconciliations of AEGON and ING. The descriptions and analysis of (changes in) accounting policies are, as usual, included in the discussions of the individual topics. However, the impact of the transition to IAS/IFRS in 2005 is presented separately.\(^ {436}\)

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\(^ {432}\) See section 7.4.3.4.
\(^ {433}\) Borio and Tsatsaronis (2004).
\(^ {434}\) See annex A13.4.
\(^ {435}\) See section 7.7.11.
\(^ {436}\) See annex A13.5. This annex includes extracts of the financial statements of the three selected companies, showing their primary financial statements and the accounting principles, including the transition to IAS/IFRS.
I have already explained in the previous chapter that the financial statements of the Dutch insurance subsidiaries of the three groups were not (all) available for my review, as not all could be retrieved from the archives.\footnote{See section 7.7.1.} Therefore, this section focuses on the accounts of the holding companies and the analysis does not provide comments or draws conclusions on the financial statements or the prudential returns of the subsidiaries. However, I can provide an observation on the 2005 reporting practices of the Dutch insurance subsidiaries of large Dutch insurance groups from my past activities as an auditor or advisor of these companies. In my recollection, all prudential returns I have seen still served as the financial statements (a single-track reporting approach), but also, from 2005 onwards, all of them were based on IAS/IFRS (a type 8 approach), which was, as is explained in the previous section, possible under the regulations of the supervisor. The main reason to use IAS/IFRS in the prudential returns was that this was aligned with the consolidation packages the companies had to submit to their parent companies, keeping the administrative burden as limited as possible. As a result, it is, in my view, safe to assume that the prudential returns of the Dutch insurance subsidiaries of AEGON, Fortis and ING were also based on IAS/IFRS.

### 8.7.2 The size of the financial reports

The developments in the size of the financial reports are summarised in the next table.

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<tbody>
<tr>
<td>AEGON</td>
<td>111</td>
<td>109</td>
<td>118</td>
<td>156</td>
<td>160</td>
<td>208</td>
</tr>
<tr>
<td>Fortis</td>
<td>220</td>
<td>222</td>
<td>211</td>
<td>224</td>
<td>245</td>
<td>320</td>
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<tr>
<td>ING</td>
<td>187</td>
<td>191</td>
<td>220</td>
<td>224</td>
<td>180</td>
<td>199</td>
</tr>
</tbody>
</table>

The table shows a gradual increase for AEGON and Fortis, with a significant one in 2005. This is, undoubtedly, related to the adoption of IAS/IFRS, which, as is described in the previous chapter,\footnote{See section 7.4.3.1.} required, in general, significantly more disclosures than Dutch GAAP. On the other hand, the size of the financial reports of ING remained rather stable, with a small increase in 2002 and a decrease in 2004; the adoption of IAS/IFRS had only a limited impact. I have not been able to find explanations for these differences.

### 8.7.3 General comments regarding the financial statements

The structure of the consolidated balance sheet of the three groups in the years 2000-2004 was not changed in comparison with the previous period. Changes did occur in 2005 related to the adoption of IAS/IFRS. One concerned the presentation of the reinsurers’ shares in the technical provisions by AEGON and ING, which did not anymore deduct these amounts from the technical provisions, but showed them as an asset. Fortis already applied this practice.

In 2005, all three groups developed their own approach to present the composition of the investments and the technical provisions. AEGON showed separately the investments for its own account and those for the account of policyholders, and the distinction between insurance contracts and investments contracts, both split between amounts for its own account and those for the account of policyholders.
Fortis, on the other hand, showed the investments for its own account split into financial instruments (by measurement category), investment properties, and participating interests; additionally, there was a separate line for unit-linked contracts. The technical provisions of Fortis were split in liabilities arising from insurance and investments contracts, and liabilities related to unit-linked products. Finally, ING showed separately its financial assets and liabilities reported at fair value through profit and loss, with a subdivision by nature, and a split of the other investments by measurement category. On the other hand, it presented all liabilities from insurance and investment contracts in one line. All companies provided further details on the investments and the technical provisions in the notes.

Concerning the consolidated profit and loss account of AEGON, the structure was not changed. In 2004, it showed a special item after the line ‘income before tax and special item’, concerning a loss from the settlement of a dispute on a subsidiary sold in 2000. The impact on presentation of AEGON’s transition to IAS/IFRS was minor: the most important change was that separate lines were presented for gains and for losses on investments for the account of policyholders. Overall, AEGON maintained its type 10 single-track reporting approach.

Fortis, on the other hand, introduced several changes to the structure of its consolidated profit and loss account in the period 2001-2004. It showed a separate set of lines of non-operating items after the subtotal ‘net operating profit’, concerning, in particular, realised gains on the sale of participating interests and additions to reorganisation provisions. In the period 2002-2004, it also showed, as part of operating profit, a separate line for valuation differences in its equity portfolio; other value adjustments were shown for the full period. And, from 2003 onwards, Fortis disclosed a separate line for the net results of financial transactions for the account of policyholders. There was no significant change in 2005.

ING also maintained its existing structure, but showed, in the period 2000-2002, amounts for non-operational items below the line ‘operational net profit’. This concerned in 2000 the gains on the sale of shares and participating interests to finance acquisitions and the release from the previously created provision for millennium risks, in 2001 the gains on the sale of shares to finance acquisitions, and in 2002 the gains on the sales of participating interests. The additions to provisions for loan losses were consistently presented in a separate line. The most important impact of ING’s transition to IAS/IFRS was that the previous top line, called ‘interest result from banking operations’, was preceded by separate lines for interest income and interest expenses for these activities.

Overall, I conclude that both Fortis and ING maintained their type 12 single-track reporting approach.

The contents of the non-consolidated balance sheets were no different than in the earlier period. AEGON and ING measured their subsidiaries at equity value, determined under Dutch GAAP until 2004, and under IAS/IFRS in 2005. Fortis used equity value under Dutch GAAP in the period 2000-2002, but cost in 2003 and 2004, to align the accounting policy with Belgian GAAP. In 2005, it returned to equity value, now determined under IAS/IFRS. The structure of the non-consolidated profit and loss account was consistent with that of the earlier period: all companies limited it to the result from subsidiaries and the result of their own activities, as was allowed under Dutch GAAP. As a result, the amounts of equity and result were identical in the consolidated and the non-consolidated financial statements.
Cash flow statements were provided by all three groups, consistently prepared under the indirect method and showing non-cash adjustments as separate lines.

Regarding the reserves in the consolidated financial statements, AEGON showed three types: the share premium reserve, the revaluation reserve, and a reserve for retained earnings, also called other reserve. Movement schedules were disclosed in 2000 and in 2005, but not in the interim years. In 2005, AEGON also presented a consolidated statement of changes in equity, showing the distinction between net income directly recognised in equity and net income recognised in the profit and loss account. Fortis made a distinction between other reserves, unrealised gains and losses, and (negative) goodwill for the full period, and, in 2005, a separate foreign currency reserve. The movements were presented each year, and showed in 2001 a large transfer from the share premium reserve to share capital, related to the unification of the shares. Fortis also showed, for the period 2000-2005, a movement schedule of equity, separating the net profit from the other movements. ING did not disclose a split of its consolidated reserves, but presented, similar to Fortis, an overview of the movements in equity, detailing the amounts directly recognised therein.

In the non-consolidated financial statements, AEGON showed a similar split as in the consolidated annual accounts. The movements showed, before 2005, goodwill and the gains on the sale of participating interests as the most important amounts. Fortis presented no details of the non-consolidated reserves, nor a schedule of movements. ING applied a similar practice as AEGON.

Regarding solvency information, ING was the only company which presented, in the financial statements, the required and available amounts for the full period. AEGON followed in 2002, while Fortis did not provide such information in its annual accounts at all.

Finally, only ING disclosed embedded value information in its financial statements. On this topic, it became clear in the beginning of the period that there was no harmonised practice. A survey among a number of Dutch life insurers revealed that they used different discount rates. At the end of 2001, the risk-free rate varied between 3.0-4.8%, and the total discount rate, for a similar product, between 8-10%. To overcome this problem, the CFO Forum published, in May 2004, a report on ‘European Embedded Value’ principles. Its members had agreed to adopt these for, at the latest, accounts published in respect of the 2005 financial year. The new principles included clear guidance on calculating or providing information on the cost of options and guarantees, the assumptions in respect of future investment returns, risk margins and key sensitivities, and the margins of new sales of insurance contracts. Any non-compliance with the principles should be explicitly disclosed. The document issued in 2004 was complemented by a paper issued in 2005, giving further guidance on disclosures.

Empirical research showed that, in the 2004 financial statements, the new RJ requirement to show a statement of comprehensive income, as is described under the Dutch financial reporting developments introduced in 2003, was not yet widely followed.

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439 See section 3.3.3.
441 CFO Forum (2004).
442 CFO Forum (2005).
443 Blommaert and van Offeren (2005).
Out of 47 companies listed at the Amsterdam Stock Exchange, 12 presented the statement of comprehensive income as a separate schedule, 10 combined it with the movement schedule of equity, and 7 showed the information in a different way. In respect of the contents of the schedule, foreign currency translation amounts were, by far, the most reported items, followed by revaluations of assets, transferred realised gains and losses on assets to the profit and loss account, movements in the provision for pensions, and goodwill. On average, the total comprehensive income was 35% lower than the net profit, with a very wide variety of causes. The remaining 18 companies did not show the contents of a statement of comprehensive income at all.

Comparing these practice developments to the Dutch financial reporting requirements, I observe a divergent and inconsistent practice in respect of the movement schedules of the reserves. All companies reviewed in this dissertation complied with Dutch GAAP, but in different ways and on different levels, in particular whether these schedules were part of the consolidated or the non-consolidated financial statements. Regarding the profit and loss account, all companies avoided, in compliance with the RJ requirements introduced mid-2002, the use of the term ‘extraordinary’, but, at the same time, presented certain gains and losses as separate lines after a subtotal indicating ‘operating profit’ or something similar. In my view, this is a clear indication that they considered these items as ‘non-operating’. In other words, at least of an exceptional, non-core or non-recurring nature. On the other hand, the separate presentation was fully disclosed to all users of the financial statements. On balance, my conclusion is that the separation of specific items was necessary to achieve the legally required ‘sufficient insight’, although the detailed requirements under Dutch GAAP were, in form, not complied with and there were no references to the ‘true and fair override’, introduced in the fourth directive. In respect of the solvency information, ING was the only company that complied with the RJ guideline to disclose this information in the annual accounts. Finally, it can be noted that all companies used, in their 2005 non-consolidated financial statements, the legal option to determine the net equity of their subsidiaries under IAS/IFRS.

8.7.4 The accounting treatment of investments

Until 2004, the measurement bases of the investments of the three groups were identical: land and buildings and shares were consistently measured at their (estimated) fair value, and fixed-income instruments at amortised cost less impairment losses. Unrealised gains and losses on investments were reported in the reserves. Regarding impairment testing, Fortis disclosed that it abolished its portfolio approach in 2000, and, from that year onwards, performed the test on an instrument/object-basis. Fortis maintained its fund for general banking risks until 2002; however, it stopped adding amounts to this fund in 2002.

Until 2004, both Fortis and ING reported realised gains and losses on investments in the profit and loss account. On the other hand, AEGON maintained, until 2003, its structural indirect return method, although it capped the total return in the profit and loss account to 7% from 2001 onwards, to “align the current general practice”. The method was abolished in 2004, in which year all realised gains and losses were included in the profit and loss account. The change was explained by referring to IAS/IFRS (under which such a practice was prohibited) and the new Dutch financial reporting requirements. This change was the only example in my research of an explicit accounting policy change in anticipation of the transition to IAS/IFRS before this was mandatory.

444 See section 6.4.2.2.2.
The practice of ING was, in 2002, commented on by Oosenbrug.\textsuperscript{445} Quoting from an interview, in December 2001, with the CEO of ING,\textsuperscript{446} he observed that it also smoothed, as AEGON, its realised gains and losses over the years: according to the CEO, ING had a deliberate policy to realise predetermined amounts, which increased by 15% every year. In March 2002, the CFO of ING noted that the amount of unrealised gains was large enough to maintain this policy for at least five years. According to Oosenbrug, this proved the validity of the recommendation of the Traas committee (of which he had been a member) to mandate the inclusion of a statement of other comprehensive income in the financial statements. In my view, there is, however, a clear distinction between the practices applied by AEGON and by ING. Although they are both examples of income-smoothing, ING did this by, what Hoogendoorn called,\textsuperscript{447} ‘real smoothing’, i.e. executing real transactions earlier or later in time, while AEGON achieved its goal by ‘accounting smoothing’, i.e. a specifically chosen accounting policy.

In 2005, all companies applied IAS 39 to their financial instruments, and both AEGON and ING measured their land and buildings at (estimated) fair value. In contrast, Fortis elected to measure these investments as cost minus depreciation less impairment losses. I have not been able to find an explanation of this different choice.

In my view, these reporting practices complied with the Dutch financial reporting requirements, with a gradual harmonisation of the way to account for realised gains and losses on investments and the abolition of practices that started to be considered less appropriate or acceptable.

\subsection*{8.7.5 The accounting treatment of technical provisions}

In respect of the technical provisions, all three groups continued their accounting practices of the previous period.

For the life insurance provisions, the accounting treatment continued, generally, to be the net premium method with capitalisation and amortisation of acquisition costs and deduction of capitalised interest rate rebates. Only AEGON presented the deferred acquisition cost as a visible deduction of the liabilities; the others reported this item as an asset. Furthermore, AEGON’s balance sheet showed a separate line for the technical provisions for life insurance policies where the investment risk was borne by the policyholder. And foreign traditional life insurance liabilities were measured at the accumulated amounts of the benefits. In 2004, the level of disclosure of the measurement methods increased for AEGON and ING: both clarified that the technical provisions included guaranteed minimum benefits. In 2005, all companies expanded their disclosures further as a result of the transition to IAS/IFRS: they made specific reference to margins for adverse deviation in case of locked-in assumptions (AEGON), discretionary participation features and liability adequacy tests (all), and all showed separately the liabilities from insurance contracts and investment contracts. On the other hand, in line with the practice started in the previous period,\textsuperscript{448} the (average) discount rates were not disclosed.

\textsuperscript{446} Gunther and Schipper (2001).
\textsuperscript{447} See section 2.3.6.
\textsuperscript{448} See section 7.7.6.
Concerning the non-life technical provisions, there was not much change. The groups continued to show the split between the provision for unearned premiums, the provision for claims outstanding, and funds for marine and aviation insurance business. However, their accounting policy disclosures were still rather generic, using terms such as “case-by-case basis”, “statistical methods”, and “based on experience”.

Regarding the non-life technical provisions, I consider the accounting policy descriptions to be as vague as before. Since there were, however, no detailed Dutch financial reporting requirements, they complied. On the other hand, the descriptions of the life insurance provisions became gradually more specific and transparent, although I could not assess, before 2005, whether and, if so, how discretionary participation features were taken into account.

8.7.6 The accounting treatment of long-term employee benefits
The accounting treatment of long-term employee benefits by AEGON was, until 2004, similar to the previous period: the liabilities of the Dutch plans were included in the life insurance provision, and those related to the non-Dutch plans were based on the US standard FAS 87 with a corridor of 10%. In the period 2002-2004, the amounts included in the life insurance provision were disclosed. From 2005 onwards, IAS 19 with a 10% corridor was applied, as was the case for Fortis and ING. Until 2004, Fortis applied FAS 87, and ING IAS 19, both with a 10% corridor. At the transition to IAS/IFRS, all three groups charged their deficits directly to retained earnings, as was allowed by IFRS 1.

In my view, the reporting practices complied with the Dutch requirements.

8.7.7 The accounting treatment of taxes
All companies provided for the full deferred tax liability, although neither AEGON nor Fortis explicitly disclosed the treatment of the fiscal equalisation reserve. ING stated that its liability covered all tax-permitted reserves.

Until 2004, AEGON maintained its policy to discount the provisions, with the tax rates varying between nil and the actual rates. In 2005, it used the expected tax rates at the estimated time of settlement. On the other hand, Fortis used consistently the (substantially) enacted tax rate. And ING used the expected rates until 2004, and the (substantially) enacted rates in 2005.

In my view, it is difficult to assess the level of compliance with the Dutch requirements, since two of the three companies did not explicitly disclose the treatment of their tax-exempt reserves. An important difference between the companies was that AEGON, apparently, discounted its deferred tax provisions until 2004, while the others did not. Both practices were allowed under the Dutch financial reporting requirements.

8.7.8 The presentation of segment information
In respect of segment information, all companies continued to provide information by primary and secondary segment. These changed over the year to adapt to the geographical or business structure of the groups, as is described in chapter 3.449

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449 See sections 3.2.5, 3.3.3 and 3.4.5.
Regarding the contents of the segment information, AEGON presented technical and non-technical accounts until 2004. For the full period, it provided profit and loss accounts per segment, and, from 2001 onwards, also separate balance sheets. In 2000, AEGON limited itself to presenting separate balance sheets for the life and non-life insurance activities, but did not expand this practice to the individual insurance segments. Fortis maintained its practice of providing balance sheets and profit and loss accounts by business segment (banking, insurance, and general) until 2004; in 2005, it continued this practice, but on a lower level, since in that year it moved from three to seven business segments. Finally, ING presented separate balance sheets for its banking and insurance activities until 2003, and separate profit and loss accounts until 2004. In 2005, no separate balance sheets were provided anymore, but it presented profit and loss accounts by business segment under a revised segment structure.

A survey on the actual reporting practices in 2000 by companies listed at the Amsterdam Stock Exchange showed a high level of compliance with the requirements: out of the 42 companies included in the survey, 88% provided information on business segments, 95% on geographical segments, and 83% on both categories of segments.\footnote{450 Dijksma and Schoonderbeek (2001).}

Comparing the general practice findings on segment information with those on the three groups reviewed in this dissertation, I continue to believe that the Dutch insurers provided (significantly) more information than the rest of the Dutch business community, and fully complied with the financial reporting requirements.

### 8.7.9 The accounting treatment of business combinations

As in the previous period, all companies charged, until 2004, goodwill directly to the reserves. The amount was adjusted on a pro-rata basis if an acquired participating interest was sold within five years. AEGON and Fortis reported that the amount of goodwill at acquisition date was determined based on its own accounting policies, taking VOBA into account;\footnote{451 As is explained in section 6.5.2.5, VOBA referred to the difference between the fair value of an assumed insurance liability and its higher book value, and was presented as an asset.} ING provided no details in this respect. From 2005 onwards, all companies capitalised goodwill and tested it for impairment for all business combinations having occurred after 1 January 2004. As allowed under IFRS 1, previous acquisitions were not restated. Fortis continued its practice to present a separate line in equity representing the cumulative amount of goodwill paid since its creation in 1990.

Empirical research showed that the 2000 guideline of the RJ requiring the capitalisation and amortisation of goodwill, described earlier as part of the Dutch financial reporting developments, was widely followed in practice.\footnote{452 Hau and Knoops (2003).} While in 1999, only 33% of 48 companies listed at the Amsterdam Stock Exchange applied such a policy, 88% did so in 2001. In 1999, 65% of the companies charged goodwill directly to equity, which decreased to only 10% in 2001. Of the five companies that continued to do so (also in 2002), four were financial institutions, including AEGON, Fortis and ING. The researchers provided no explanation why these companies maintained their old practices.
Regarding the accounting treatment of goodwill, it is, in my view, remarkable that none of the three companies reviewed in this dissertation followed the 2000 guideline of the RJ, against the general trend observed in the Dutch business community. Their reporting practices were, however, compliant with the Dutch legislation, and I have not been able to find an explanation for their diverging position. It is, however, possible that they considered the accounting treatment an integral part of their type 10 or type 12 single-track reporting approaches, under which the accounting policies of the holding companies were similar to those applied by their Dutch insurance subsidiaries. Although it was not possible to collect evidence that this was also the case in the period reviewed in this chapter, the previous chapters have shown that this approach had always been applied in practice, so I consider it highly likely that goodwill was not capitalised and amortised in the prudential returns of the Dutch insurance subsidiaries either. Since intangible assets were eliminated from the balance sheet for the purpose of determining the available solvency margin, it is possible that the subsidiaries had decided to avoid such a prudential filter by not capitalising goodwill in the first place. Whether or not this hypothesis is true could not be tested because of the lack of the necessary prudential returns.

8.7.10 US GAAP reconciliations
Both AEGON and ING provided reconciliations of their equities and net profits to US GAAP.

For AEGON, equity under US GAAP was always higher than reported in its financial statements. The amount of Dutch equity was increased for goodwill, and, in most years, the technical provisions and the fixed-income securities. It was decreased for land and buildings and for deferred acquisition costs, including VOBa. In 2005, US GAAP equity also increased for employee benefits. There was no general trend in respect of net profit: the amount under US GAAP was significantly higher or lower during the year, in particular caused by realised gains and losses on investments. Other adjustments concerned, in particular, goodwill and, in 2005, employee benefits.

For ING, US GAAP equity was also consistently higher. Upwards amendments related to goodwill, fixed-income securities, catastrophe provisions, and, in 2005, employee benefits. Negative differences concerned land and buildings, employee benefits (2000-2004), and, in most years, insurance liabilities. Net profit under US GAAP was generally lower. Negative components related to goodwill, land and buildings, and, in 2005, employee benefits. The adjustments in respect of fixed-income securities, insurance liabilities and catastrophe provisions varied over the period, while those concerning employee benefits were positive for the years 2000-2004. In 2002, the reconciliation showed a very large negative impact caused by accounting policy changes in respect of goodwill accounting, related to the adoption of FAS 141 and FAS 142 described earlier in this chapter as part of the US and UK reporting developments.

Empirical research over the period 1995-2002 of the financial statements of 31 Dutch companies listed in the US showed that changes in US GAAP were, often, also implemented under Dutch GAAP. A total of 15 companies reported 72 accounting policy changes, 64 of which were made to align the policies more to US GAAP. The review included AEGON and ING: the first implemented five changes, two of which concerned alignment with US GAAP; and the figures for ING were six out of seven changes.

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Bakker and Vergoossen (2004).
8.7.11 IAS/IFRS conversions

In 2005, all three companies presented reconciliations from Dutch GAAP to IAS/IFRS, as at 1 January and 31 December 2004. AEGON and Fortis early adopted IAS 39 and IFRS 4, restating their comparative figures for 2004, while ING did not. All companies introduced shadow accounting under IFRS 4 for the policyholders’ share of unrealised gains on investments and charged the deficits on their employee benefits plans directly to equity. As is explained in the section on the Dutch financial reporting developments, under shadow accounting the policyholders’ share in unrealised gains reported in equity was transferred, outside the profit and loss account, to the technical provisions. The impact of the IAS/IFRS conversions on any prudential statements is unknown, since the prudential returns of the Dutch insurance subsidiaries were unavailable for my review and any consolidated reports of the groups were confidential.

The main differences in equity for AEGON concerned investments, derivatives, insurance liabilities, employee benefits, and the classification of perpetual capital securities. As a result of the transition, AEGON’s group equity increased by 6.4% as at 1 January 2004 and by 23.2% as at 31 December 2004. The 2004 profit of AEGON under IAS/IFRS was 35.7% higher, mainly related to adjusted investment income, technical provisions, and net gains on investments minus impairment charges.

For Fortis, the main differences in equity concerned land and buildings, investments, the fund for general banking risks, and employee benefits. Its equity increased by 6.9% as at 1 January 2004 and by 6.8% as at 31 December 2004. Fortis’ 2004 profit decreased by 30%, mainly resulting from financial instruments and the elimination of a capital gain on the sale of a participating interest.

For ING, the main adjustment in 2004 concerned employee benefits: its group equity decreased by 8.0% as at 1 January 2004 and by 6.1% as at 31 December 2004. The adjustment related to employee benefits was also reported in 2005, but was accompanied by adjustments in investments, derivatives, insurance provisions, loan loss provisions, and the classification of equity instruments. As a result, group equity as at 1 January 2005 increased by 3.1%. ING’s 2004 profit was mainly impacted by land and buildings, resulting in a decrease of 3.6%.

In respect of the year 2004, KPMG conducted a survey on the impact of the IAS/IFRS adoption on equity as at 31 December 2004 and net profit for the year 2004 of 13 large European insurers. The findings showed that the impact differed considerably between companies: regarding equity, it varied between 23% negative (for Skandia) and 23% positive (for AEGON); regarding net profit the difference varied between 68% negative (Skandia) and 37% positive (AEGON). In general, financial instruments had the largest impact on the changes because of an increased use of fair value measurement (apart from the UK companies, who already reported their investments at fair value). This was also the case for AEGON and for Fortis, but not for ING, as the latter adopted IAS 32/IAS 39 only in 2005. Other adjustments related to insurance liabilities, employee benefits, goodwill and miscellaneous factors. Almost all companies used the exemptions available in IFRS 1.

454 KPMG (2005).
The survey on the adoption of IAS/IFRS was repeated in 2006, based on the annual accounts for the year 2005.\textsuperscript{455} This time, it included 17 large European insurers, including AEGON, Fortis and ING. The findings showed that Anglo-Saxon companies applied fair value through profit and loss for their investments, since the UK companies had to report their insurance liabilities under FRS 27 (discussed earlier in this chapter as part of the UK reporting developments) and continued to do so. The items with most impact on equity were IAS 39 and IFRS 4. The combination of both resulted, on balance, in a positive impact for eight of the 17 companies. ING and Prudential applied IAS 32 and IAS 39 only for the first time per 1 January 2005, using the available exemptions. IAS 39 and IFRS 4 also had the largest impact on net profit, next to the abolishment of goodwill amortisation.

There were no significant differences between the first-time adoption impact, disclosed in the 2004 financial statements, and those disclosed in the 2005 financial statements, apart from the use of the fair value option in IAS 39 and the possibility of recognising actuarial gains and losses under IAS 19 in equity. As is described in the section on the Dutch financial reporting requirements, both possibilities were created only shortly before year-end 2005. Most insurers chose to use the corridor approach under IAS 19, but several indicated they would use the possibility to recognise actuarial gains and losses in equity in the future.

Regarding investments in financial instruments, most insurers used the available-for-sale category. The held-to-maturity category was only used sporadically because of the tainting rule. The fair value option was used by almost all insurers to classify investments for the account of policyholders. In addition, several insurers used this option for hybrid financial instruments. Occasionally, the fair value option was used to measure liabilities at fair value. Mortgages and debt instruments were usually classified as loans and receivables and measured at amortised cost. Investment properties were mostly measured at fair value, although about 25% used cost minus depreciation.

Regarding insurance liabilities, a number of insurers decided to unbundle insurance contracts in an investment and an insurance component, or to separate embedded derivatives. Insurers showed different kinds of split of their insurance liabilities, there was no uniform approach. Some disclosed this breakdown in the balance sheet, others in the notes. Several insurers applied shadow accounting, but not all. The amount of policyholder participation (whether or not discretionary) was not always disclosed.

\textsuperscript{455} KPMG (2006).
8.8 Summary and conclusions for the period 2000-2005

8.8.1 Introduction
As in the previous chapters, this section provides the answers to the four remaining research questions:

1. What were the developments in respect of financial reporting requirements applicable to Dutch insurance companies against the background of developments in society and in the industry, and how have these developments been influenced by developments in the UK, the US, the EU and its predecessors, and from international organisations?
2. What were the developments in respect of prudential reporting requirements applicable to Dutch insurance companies, and how have these developments been influenced by developments in the UK, the US, the EU and its predecessors, and from international organisations?
3. What were the relationships between financial and prudential reporting requirements in the Netherlands and the other selected countries or regions, and how did the Dutch developments differ from those in these other countries or regions? And, more specifically, which positions were adopted in respect of a single-track reporting approach?
4. What were the actual reporting developments within and reporting choices made by the selected companies, both at the level of individual companies and at group level (if applicable), and how can these be explained from the above developments and events? How did companies, in practice, address the potential conflict between financial and prudential reporting objectives within their application of a single-track reporting approach?

8.8.2 The global and European reporting developments
In my view, the most important event in the period was, without any doubt, the conclusion of a debate, started in the early 1990s, on the future of the financial reporting standards in the EU, i.e. the future of the accounting directives and their implementation on the national legislation of the member states. After a decade of debate and step-by-step decision making, the European Commission issued, in 2002, a regulation (the IAS regulation) requiring all companies listed in the EU to prepare their consolidated financial statements, from 2005 onwards, under IAS/IFRS. Furthermore, these companies were also allowed to prepare their non-consolidated accounts under this reporting regime, and non-listed companies could choose to transition from local GAAP to IAS/IFRS for both sets of financial statements as well. These developments were aligned with the recommendations of the IOSCO, which, with some exceptions, endorsed in 2000 the then existing pronouncements of the IASC and recommended its members to allow the use of IAS for cross-border listings, supplemented, if necessary, by additional requirements or guidance to resolve regional or national issues. These developments finally opened, in my opinion, the door to bring true comparability in the financial statements of European companies, including insurers.

However, the EU support for IAS/IFRS was not unconditional: the European Commission created an endorsement mechanism, comprising of the EFRAG and the ARC, to assess the pronouncements of the IASB (which had, in the meantime, succeeded the IASC) on their technical and political merits before it could officially endorse the standards and interpretations for the use of European companies. Apart from one detail in IAS 39, in particular relevant for banks, all standards and interpretations were endorsed in time for their application in 2005.
With these decisions, IAS/IFRS was directly applicable to all European companies (including insurers) which were required to apply this reporting regime or chose to do so.

The European adoption of IAS/IFRS was, in my view, not just an important but also a bold move, since it occurred at a time when a number of standards were still under improvement or even development (such as the one on insurance contracts) and there was not yet a stable financial reporting platform. In fact, the standards applicable to the 2005 financial statements were only finalised mid-2005.

8.8.3 The developments in the US and the UK
The reporting developments in the US were limited in the period. Although the SEC announced that it would consider allowing the application of IAS/IFRS by foreign filers, it took no decisions before the end of 2005, and the FASB issued only a few new statements. The developments in respect of prudential supervision were even more restricted: the only relevant activity of the NAIC was the codification, i.e. the bringing together, in one publication, of its existing pronouncements.

In the UK, the government amended its legislation to incorporate new or revised European legislation, and the ASB continued to incorporate, as much as possible, the pronouncements of the IASC/IASB. For insurance company reporting, the fall of one the largest UK insurers, the UK Equitable, triggered a move to a new financial and prudential reporting regime: at the request of the government, the ASB issued a new standard requiring the measurement of the assets and liabilities on fair (or realistic) value, with all movements in these values reported in the profit and loss account. It was based on a revised set of prudential reporting requirements, to assess the financial position of insurers, developed by the new insurance supervisor the FSA. This development was actively supported by the ABI (the UK insurance industry organisation), by the issuance of revised SORPs, and the conclusion of an agreement with the ASB that the new financial reporting requirements would already be applied in 2004 and be taken into account after the transition to IAS/IFRS in 2005. As a result of these developments, the UK, ultimately, maintained its type 3 or type 4 single-track reporting approaches. Overall, in my view the UK was, compared to other countries, again ahead in improving the reporting practices of insurance companies.

8.8.4 The Dutch financial reporting developments
In the Netherlands, the government undertook several failed attempts to introduce improvements to the Dutch financial reporting environment, by the submission of bills to improve the financial statements of insurers, to prohibit a charge of goodwill directly to the reserves or to the profit and loss account, and to enable the early adoption of IAS/IFRS. All proposals encountered severe resistance in Parliament, mainly because of the, in my view unjustified, fear to mandate several changes in the financial reporting requirements in a short period of time, given the mandatory transition to IAS/IFRS by listed companies in 2005. In the end, the government limited itself to the incorporation of the 2002 IAS regulation and the related amendments in the accounting directives. These amendments reduced the number of differences between these directives and IAS/IFRS and allowed certain IAS/IFRS accounting practices, such as fair valuing a number of assets and certain liabilities, also by companies that chose not to apply this reporting regime. The revised directives included a large number of member state options, which were, in line with the usual Dutch approach, passed on to the reporting companies.
However, the government added one option that was not included in the directives themselves: it enabled companies, in their non-consolidated financial statements prepared under Dutch GAAP, to apply the accounting policies adopted in their IAS/IFRS-based consolidated financial statements, to maintain the equilibrium between equity in the two sets of financial statements and to continue this longstanding Dutch financial reporting practice.

As the UK ASB, also the Dutch RJ kept its approach to incorporate, as much as possible, IAS/IFRS and the supporting interpretations in its own guidelines. This did not occur, however, for a number of important standards issued by the IASC/IASB that were either finalised rather late in the period, or were considered to be not fully acceptable in the Dutch financial reporting environment. The best example was IAS 39 on financial instruments, for which, instead of IAS, the RJ issued a different standard specifically focusing on the Dutch situation.

The last controversial topic that the RJ tried to address related to goodwill accounting. In line with IAS 22, revised mid-1998, it required the capitalisation and amortisation of goodwill in 2000, as had already been suggested in the 1999 discussion memorandum. Although empirical research revealed that the proposal was widely applied (with the notable exception of the financial institutions, including AEGON, Fortis and ING), the RJ decided, in 2005, to withdraw its 2000 guideline based on the political decisions described above. However, it explained that its preference still was to capitalise and amortise instead of a direct charge to equity, and declared a direct charge to the profit and loss account not acceptable.

Next to the incorporation of IAS/IFRS, the RJ also issued some pronouncements that were not directly related to these activities. One concerned RJ 600 on the financial statements of banks, issued in 2000, which, however, did not introduce new requirements but merely codified existing practices. And from 2004 onwards, the RJ guidelines in respect of the financial statements themselves were only applicable to the companies not reporting under IAS/IFRS. At the end of 2005, most of the IASB pronouncements were included in Dutch GAAP, generally with only minor differences. The important exceptions were IAS 39, described above, and IFRS 1 on first-time adoption, IFRS 3 on business combinations and goodwill accounting, IFRS 4 on insurance contracts, and IFRS 7 on financial risks disclosures, all part of endorsed IFRS and, therefore, applicable to the 2005 financial statements of those companies that used IAS/IFRS as their financial reporting regime.

The move to IAS/IFRS and the continuing freedom in the Dutch financial reporting legislation forced the RJ to reconsider its position of assisting to determine Dutch GAAP. In 2005, it decided, going forward, to incorporate the developments in IAS/IFRS only if they were considered adequate for the Dutch financial reporting environment. At the same time, it considered it desirable to avoid, as much as possible, discrepancies between IAS/IFRS and the guidelines by allowing, whenever possible, all options made available by the IASB and to expand them if necessary. And shortly after, based on the political decision not to prohibit a direct charge of goodwill to the reserves, it decided not to limit options that were explicitly included in the civil code, although it could express a preference for one or more options.
The fact that there were, at the end of 2005, two financial reporting regimes that were not (fully) aligned, combined with the options in the Dutch legislation on the choice of accounting regime (the Dutch civil code combined with the guidelines of the RJ, or IAS/IFRS), meant, in my view, that there was a serious risk that the comparability of financial statements within the Dutch business community as a whole decreased. On the other hand, the fact that all listed companies had to apply a regime that included much fewer options and flexibility than Dutch GAAP, and other companies were allowed to do so, created, in my opinion, an opportunity for improved comparability, although the voluntary exceptions to the general transition rules in IFRS 1 could impair comparability, at the transition date and over time, again. The answer to the question on what actually happened in practice is outside the scope of this dissertation, except for the reporting practices of insurance companies, described later in this summary.

8.8.5 The Dutch prudential reporting developments

In the area of prudential reporting developments, the main Dutch activities concerned the implementation of European directives in respect of the supplementary supervision of insurance groups and an update of the existing solvency requirements. None of these had any impact of significance in the Dutch insurance environment, because the first was, effectively, already in place, and the second was irrelevant for the vast majority of the Dutch insurance companies, including those reviewed in this dissertation, since it resulted only in a modest increase of the required solvency margin which was already fully met. Another development was related to the forthcoming introduction of IAS/IFRS as the possible or mandatory reporting regime for Dutch insurers and banks. To enable the continuation of the existing single-track reporting approach, the supervisors announced that, if an insurer or bank applied IAS/IFRS in their financial statements, they should adopt IAS/IFRS as the reporting regime for the prudential returns as well, where necessary complemented by disclosed prudential filters to assess the financial position of the reporting companies: a type 8 approach. Subsequent legislative documents showed, however, that the actual impact of these filters was only very limited.

But the main focus in the period was on the development of a completely new and fundamentally revised supervisory regime, not only merging all existing supervisory acts on financial institutions into one, but also eliminating redundancies and differences where possible. At the same time, the Insurance Chamber started to develop a new financial assessment framework to assist it in its review of the solvency position of insurers. It was initially designed to be aligned with the future IASB standard for insurance contracts, and took fair value accounting for all assets and liabilities, including those arising from insurance contracts, as the starting point. It was, in my view, a bold and innovative approach since it was based on a future standard of which the ultimate outcome was, at the time, far from certain. However, after several consultation rounds the project came to a temporary standstill, awaiting the outcome of a similar project that had started at the European level. This was the so-called Solvency II project, which was modelled on the approach for the new capital regime for banks (the Basel II project) and, as in the Dutch proposals, took the IASB developments and full fair value accounting at its starting point. This approach was, in the meantime, also adopted on the international level by the IAIS. At the end of 2005, both projects were still not finalised, and the final outcome is, therefore, outside the scope of this dissertation.
Overall, these summaries show, in my view, that a single-track reporting approach was still legally supported and even required. Apparently, the legislators and the insurance supervisors, on both the European and the Dutch level, considered the alternative (a complete separation of the financial and the prudential reporting practices, as was the case in the US) not an appropriate way forward and had chosen, despite the uncertainties on the final standards (in particular the one on insurance contracts) to base both their financial and their prudential reporting requirements as much as possible on IAS/IFRS. As I have stated before, I fully support a leading position for the financial reporting requirements, if additional information is presented to meet the prudential requirements, including the available and required solvency margins and all related prudential filters: a type 8 single-track reporting approach.

8.8.6 Reporting developments in practice

Regarding the reporting developments by the companies reviewed in this dissertation, the period showed a clear trend to further harmonisation of the accounting policies and reporting practices, even before the introduction of IAS/IFRS in 2005. The measurement bases of the investments were, until 2004, identical, and when AEGON abolished, in 2004, its structural indirect return method to account for its realised gains and losses on investments, all companies reported unrealised amounts in the reserves and realised amounts in the profit and loss account. The methods to account for the technical provisions were also described in a similar way, although it was, because of the lack of disclosures of the discount rates, not possible to assess the level of prudence applied by the three companies. The previous differences between the reporting practices for employee benefits and business combinations disappeared as well, but, until 2004, AEGON seemed to still measure its deferred tax provisions on a discounted basis, a practice that was not applied by Fortis and ING. On the other hand, only ING disclosed that it had taken its tax-exempt reserves fully into account in determining its deferred tax provision; the other two companies were silent on this issue.

After the transition to IAS/IFRS, the financial statements showed even more harmonisation, although Fortis elected to measure its land and buildings on cost minus depreciation, while AEGON and ING continued their practice to report on a fair value basis. And, in contrast to AEGON and Fortis, ING chose not to early adopt the standards on financial instruments and insurance contracts, and only showed their impact for the first time in its 2005 financial statements.

Another similarity concerned the presentation of some special items in the profit and loss account. All companies reported, for some or all years until 2005, certain gains and losses as separate lines below a subtotal titled ‘operating result’ or a similar term. In my view, this practice revealed that certain gains and losses were not considered to be part of their normal business activities or were designated as non-core or non-recurring, and the companies wanted to exclude these amounts from their normal results. Since the financial reporting requirements did not anymore allow the use of the category ‘extraordinary items’, this was their solution. Although such practices were not compliant with the details in Dutch GAAP, the chosen treatment improved, in my view, the legally required ‘insight’ in the financial results of the companies.
I have not found any evidence in the literature that the debate on the acceptability of a single-track reporting approach, led by Oosenbrug in the previous decade, continued. A possible explanation is, in my view, that it was now absolutely clear that such approach was maintained and even strengthened, based on IAS/IFRS, which reporting regime was applicable to both the financial statements and the prudential returns. Although this meant an increased focus on the information needs of investors (versus the insurance supervisors), it had only limited in practice since IFRS 4 grandfathered local GAAP for the determination of the technical provisions and underwriting results. Consequently, the influence of the prudential requirements was not fully eliminated.

Overall, the reporting practices in the period reviewed in this chapter improved, in my opinion, although the disclosures of the deferred tax liabilities and the technical provisions, in particular those of the non-life insurance business, could still be enhanced. On the other hand, in respect of goodwill accounting the companies reviewed in this dissertation clearly deviated from the general trend.

Whether or not this is related to their single-track reporting approach is not known, but it is, in my view, likely, since capitalised goodwill would, in order to assess the available solvency margin, be adjusted against the reserves anyway. Finally, in respect of segment information, the reporting practices of the Dutch insurers were, in my view, still ahead of those generally applied in the Dutch business community.

456 See section 7.8.4.