PRUDENTIAL

CESR Secretariat
The Committee of European Securities Regulators
11-13 Avenue de Friedland
75008 PARIS
FRANCE

8 July 2005

Your ref CESR/05-178
Our ref

Dear Sir/Madam

Draft Recommendation on use of alternative performance measures

Thank you for providing the opportunity to provide comments on CESR's draft advice in the May consultation document on this subject

In general terms we agree with the sentiment of tightening up on the basis of explanation, consistency and other principles, but strongly disagree with the CESR draft advice as regards the recommendations on prominence, of alternative performance measures. In this regard we consider that a more balanced view of the use of alternative performance measures should prevail.

We would accept that there will always be some circumstances where the use of alternative performance measures by some companies may gave rise to genuinely misleading or inappropriate financial reporting. However, the use of alternative measures often arises because the statutory basis reporting is either misleading or inadequate at conveying the dynamics of a company's financial position and, irrespective of the legal framework, the investment community looks to companies to provide alternative, more meaningful information.

In our opinion, we would respectfully suggest that CESR reconsider the recommendation on prominence to take account of the genuine importance of such information in certain circumstances. Our detailed comments are as follows:

A. Background and objectives

<u>Question 1 (a) should additional elements be considered in terms of the background? (b) Do you agree that current practice of presenting alternative financial performance measures justifies CESR's initiative? If not please indicate why.</u>

(a) We note that the IOSCO identified terms relate to results that are derived from statutory basis earnings and are generic to commercial activities rather than the specific circumstances of insurers.

The European life insurance industry also provides financial information on Embedded Value bases. This information values the life insurance contracts in force and is derived from an alternative methodology to conventional accounting that is generally underpinned by regulatory basis reporting. This additional information has been provided for nearly 15 years in the UK and more recently in continental Europe. The major European companies in 2004 sought to achieve some harmonisation in the basis of publication of this supplementary information by the issuance of the European Embedded Value principles.

In our opinion any consideration of alternative performance measures needs to take into account this additional reporting that has become a fundamental and very significant feature of life assurers' reporting that has arisen from being responsive to the needs of investors.

We note also that in the UK there has been a long established aspect of financial reporting for insurers of distinguishing GAAP basis total profit into the components of operating profits based on longer-term investment returns from short-term fluctuations in investment returns and exceptional profits. The Statement of Recommended Practice issued by the Association of British Insurers in accordance with the code of practice of the UK Accounting Standards Board recommends this basis of presentation. On adoption of IFRS the formal GAAP status of the SORP no longer applies in this regard to the consolidated accounts of listed insurers. Nevertheless the market led imperative of publishing information that delineates results on this basis for insurers, and its relative importance, compared to defined measures, remains.

Finally we note that, as a consequence of the interaction between the change to IFRS and UK listing authority rules that require profit before tax to be published, the long-standing convention of accounting in the Schedule 9A formats of the 1985 UK Companies for tax borne by with-profits funds and the unit linked policyholders as an expense in deriving profit before tax will no longer be possible.

Technically the "profit before tax" will reflect profits determined after taxed transfers to unallocated surplus of with-profits funds but before taxes borne by with-profits policyholders and unallocated surplus and tax borne by unit linked policyholders - in short a meaningless figure of no intellectual merit. To address this issue it is expected that companies' IFRS income statements will be structured so that a profit before shareholder tax (but after policyholder tax) is also derived.

It is this profit before shareholder tax on which companies will provide explanation and, with the analysis described above, give prominence. This is entirely logical as it is the analysis that is both intellectually sound and of interest to investors. However, technically they can easily be argued by cautious lawyers as being non-GAAP or at least not "defined measures".

It is to be emphasised that these observations reflect the fact that large parts of performance reporting for insurers are, for good reason, supplementary to the defined measures considered by CESR and given a level of prominence, within existing listing rules, that reflects their worth. Given their importance we would urge a re-assessment of the approach by CESR to consideration of these issues, in particular with regard to the recommendations on prominence in paragraph 21.

(b) We agree that the current practice of presenting alternative performance measures justifies the CESR initiative but not the CESR conclusions or recommendations, particularly as regards prominence.

Question 2; do you think that a recommendation is an appropriate tool for dealing with this issue?

We consider that a recommendation may be an appropriate tool for dealing with the issue. However, in our opinion the issuance of a recommendation that applies to all alternative performance reporting is a blunt instrument and likely to give rise to a recommendation that does not take account of the nuances of specific circumstances as illustrated in our response to question 1.

B. Definition of alternative performance measures

Question 3: Do you agree with this (IFRS related) definition of alternative performance measures? If not please state your reason.

As noted in our response we consider that the alternative performance reporting measures described in paragraphs 8 to 10 are insufficient. In practice the CESR recommendation would appear to apply to other measures that it appears CESR has not contemplated or at least described in its consultation paper.

C. Different types of financial information

Question 4: Do you agree that the principles described in this draft recommendation are valid for any kind of reporting to markets by issuers (with the exception of prospectuses)? If not, please state your reason.

We find question 4 to be somewhat ambiguous as to its intent. We agree with the observations that alternative performance measures may give rise to a "diversity of measures which do not contribute to transparency of the financial markets if they are not used appropriately" and that "a proper use of these measures is crucial for investors and transparent financial markets". However, our concern is not with the high level principle but the recommendations that CESR has drawn from their consideration - with which we disagree.

D. Recommendation for the presentation of alternative performance measures

Question 5: (a) Do you agree with the scope of this recommendation (paragraph 14) and (b) the content of this recommendation (paragraph 16 to 22)? If not, please state your reason.

(a) Scope - We agree with the scope

(b) Content

Paragraphs -16 - 20and 22 principles/definition/explanation of differences/comparatives/ consistency/explanation - we agree

Paragraph 21 - prominence

We disagree strongly with the recommendation that defined performance measures be presented with greater prominence than alternative performance measures.

Our response to question 1 illustrates the alternative performance measures applied by UK life assurers. The key point is that these measures are required by market analysts to perform appropriate performance analysis - it is not a case of companies forcing a format against analysts wishes. Furthermore, the publication of these useful alternative performance measures can be contrasted with the level of interest by users in defined measures. These defined measures are Revenue (which for an insurer would include investment return on invested assets and of little interest), profit or loss and basic EPS (which are of limited value without appropriate analysis). It is noticeable that the overwhelming balance of analyst interest arising from recent restatement exercises on new reporting bases by major life assurers have related to EEV results, or statutory (IFRS) basis operating profits based on longer-term returns rather than defined measures on the statutory basis. In our opinion it would be a very retrograde development if companies' reporting was required to give greater prominence to measures of little interest to the detriment of alternative performance measures which are the main area of interest to analysts.

We are aware that some commentators within the securities regulation sphere may argue that there is a danger of inconsistency of application between companies in the application of alternative accounting measures. This may be true to some extent - nevertheless transparency of financial reporting will not be achieved by forcing changed level of prominence against investors wishes in favour of measures that are of limited interest.

We understand that the phraseology of paragraph 21 may have been driven by concern at a less than equal level of prominence already given to alternative reporting measures, and a possibility that IFRS defined measures will be sidelined in future reporting, by some companies. We emphasise again that the prominence given by companies to alternative measures is for good reason and that strengthening the rule to require prominence of defined measures is unhelpful and not in line with investor needs.

E. Auditor involvement

<u>Question 6: Do you agree with CESR's recommendation to involve the auditor in relation to alternative performance measures? If not, please state your reason</u>

We agree with the CESR approach that the management of the company should consider involving the auditor in relation to alternative performance measures. In general we would suggest that the auditor should be more than "involved" where the alternative performance measure reflects an analysis of IFRS basis information. For results prepared on basis that does not draw on IFRS basis results, for example those prepared in accordance with methodologies that are outside conventional accounting frameworks (such as European Embedded Value) it may be appropriate for the information to be reviewed by auditors or other professionally qualified third parties. In these instances a statement should be included, where the methodology, assumptions and results have been subject to external review, stating the basis of the external review and who has performed it.

Yours faithfully

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