OF AUSTRALIA

Mr David Boymal
The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

26 October 2007

Dear Mr Boymal

RESPONSE TO IASB "DISCUSSION PAPER: PRELIMINARY VIEWS ON INSURANCE CONTRACTS"

The Insurance Council of Australia (Insurance Council)[1] appreciates the opportunity to provide input to the Australian Accounting Standards Board's (AASB) consideration of the International Accounting Standards Board's (IASB) "Discussion Paper: Preliminary Views on Insurance Contracts" (the Discussion Paper). Our detailed comments on each of the questions posed by the IASB are set out at Attachment A. As the representative body for the general insurance industry in Australia, the views expressed in this submission are from the perspective of general insurers only.

The Insurance Council appreciates the IASB's work, and the support being given by the AASB, to develop an international standard for insurance contracts in what is recognised to be a complex area of accounting.

Any country specific divergences from the final standard will undermine the goal of international comparability of accounts between general insurers. Consequently, all jurisdictions should be subject to the same rules. As an example, we do not agree that the AASB should be mandating fair value through P&L as the basis of valuation of assets backing insurance liabilities.

There are many similarities with the model proposed in the Discussion Paper with the current accounting requirements for general insurance contracts under Australian accounting standards which have been used in practice in Australia for many years and that are accepted by preparers, auditors and users to produce reliably measured results. AASB 1023 and the associated guidelines produced by the Australian actuarial bodies may be a useful reference in drafting the final international standard in terms of measurement principles as well as disclosure.

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[1] The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. 2007 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross premium revenue of $28.2 billion per annum and has assets of $82.2 billion. The industry employs approx 60,000 people and on average pays out about $70 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

Ultimately, disclosure will be crucial to enabling transparency and useability of financial statements. The final standard should focus on establishing a principles-based approach rather than being overly prescriptive. The appropriate level of disclosure will ensure that users of financial statements are given relevant information about important areas such as the valuation of assets to support insurance liabilities and the recognition of day one profits.

Such disclosure, pitched at the right level, should avoid the IASB having to mandate outcomes that may not be conceptually consistent with the exit model (e.g. limits around the recognition of day one profits) or should avoid the need for amendments in the application of the standard in certain jurisdictions (e.g. due to mandating a valuation basis for assets backing insurance liabilities).

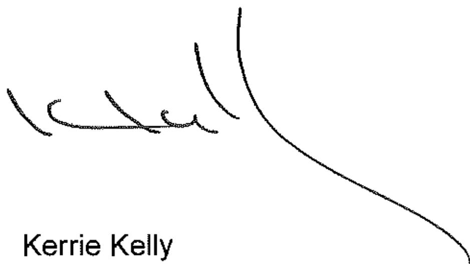
While the Insurance Council agrees with the theoretical principle of measuring liabilities at observed market prices, we question whether this will ever be possible in practice. The three building blocks approach, which is very similar to the approach currently applied to financial reporting by Australian insurers, is a suitable practical basis for determining such valuations. However, we question the IASB's approach in two main areas:

- In the absence of a true market for insurance liabilities, we believe that entity specific cash flows should be applied in the valuation process rather than "market-consistent" cash flows, the former being more readily available and producing more meaningful information.

- Diversification of risk is fundamental to how insurance businesses operate. It does not reflect economic reality to disallow diversification benefits in the determination of risk margins.

Please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on (02) 9253 5121 or janning@insurancecouncil.co.au if you would like to discuss any aspect of this matter.

Yours sincerely



Kerrie Kelly
Executive Director & CEO

ATTACHMENT A

QUESTION 1 - RECOGNITION AND DERECOGNITION REQUIREMENTS

Should the recognition and derecognition requirements for insurance contracts be consistent with those in IAS 39 for financial instruments? Why or why not?

Response: As an initial position, the Insurance Council supports the recognition and derecognition requirements for insurance contracts being consistent with those in IAS 39 for financial instruments. This is on the understanding that the IAS 39 requirement for recognition when the entity becomes a party to the contractual provisions of the instrument equates to recognition for insurance contract assets and liabilities from the attachment date (i.e. the date on which the contract or similar is agreed to as required by the current Australian general insurance accounting standard) and not the inception of risk date.

Any final judgement on the appropriateness of alignment should take into account the variety of ways in which an insurer and a policyholder can become a party to a contract, including:

(a) A premium received in advance of the inception date. At least in the Australian context, a renewal notice is not an offer but an invitation to treat. Normally the receipt by an insurer of a renewal notice together with payment would constitute an offer, whilst processing of that payment would be regarded as acceptance.

    Recognition of the contract would mean taking up the premium as revenue, even though the insurer would not be liable for any claim until the stated inception date.

(b) The contract is not finalised until some time after the inception date. If the insurer has not accepted the risk on the inception date and does not do so until some time after that date, there is no obligation on the insurer to recognise the contract until the contract is in place.

    On the other hand, when the risk is accepted, the insurer may be bound to cover claims with a date of occurrence back dated to the inception date of the policy.

(c) For proportional reinsurance contracts, it should be recognised that the contract approach requires recognition of reinsurance premiums in advance of the recognition of insurance premiums on the underlying risks. Further clarification is required in the draft in respect of this issue.

Further variations may occur, particularly in reinsurance.

IAS 39 also requires that derecognition take place when the contract is discharged, or cancelled or expires. This may be an adequate description of the derecognition of a financial asset or liability but we submit that it may not adequately reflect the nuances of an insurance contract. With a conventional policy of insurance the expiration of the policy period does not mean that an insurer's liability or potential liability is extinguished.

The Insurance Council submits that the above issues require further consideration and consultation before the issue of an Exposure Draft.

QUESTION 2 – THREE BUILDING BLOCKS

Should an insurer measure all its insurance liabilities using the following three building blocks:

(a) ***explicit, unbiased, market-consistent, probability-weighted and current estimates of the contractual cash flows;***

(b) ***current market discount rates that adjust the estimated future cash flows for the time value of money; and***

(c) ***an explicit and unbiased estimate of the margin that market participants require for bearing risk (a risk margin) and for providing other services, if any (a service margin)?***

If not, what approach do you propose, and why?

Response: The Insurance Council supports the use of the three building blocks despite having concerns regarding their proposed application. (Please see below.)

The Insurance Council supports the determination of an explicit margin representing the uncertainty in the cash flow estimates. The measurement of the liability should be independent of the assets held to back the liability. Consequently, it is agreed that the discount rate should reflect only the time value of money.

We understand that it is argued by some parties that not discounting in effect allows for a margin. However, the Insurance Council considers that the explicit determination and disclosure of the discount factor and the margin provide useful information for users.

We understand the concerns of some jurisdictions with the application of the three building blocks, in particular with the application of discounting. Australia was in a similar situation in 1992 when the Australian accounting standards for insurance entities were first amended to require discounting.

However, the Australian industry worked through all of the issues and now has robust processes that produce insurance liabilities in accordance with the three building blocks that are considered by the preparers, auditors and users (including the regulator and analysts) to be reliably measured.

We do however draw attention to a number of concerns we have with the proposed application of the three building blocks which principally relate to their application to produce a measurement output which purports to represent a fair value.

QUESTION 3 – LEVEL OF GUIDANCE

Is the draft guidance on cash flows (appendix E) and risk margins (appendix F) at the right level of detail? Should any of that guidance be modified, deleted or extended? Why or why not?

Response: The Insurance Council's position is that the accounting standards should remain principles based. It has been our experience in Australia that a significant body of professional standards and guidance have been developed by the relevant professional bodies to support the application of requirements of the accounting standards. We expect similar professional standards and guidance to be developed in the international arena. This allows for ongoing development of best practice in areas of professional expertise to be incorporated in meeting the requirements of the accounting standards.

QUESTION 4 – RISK MARGIN IMPLEMENTATION METHOD

What role should the actual premium charged by the insurer play in the calibration of margins, and why? Please say which of the following alternatives you support.

(a) ***The insurer should calibrate the margin directly to the actual premium (less relevant acquisition costs), subject to a liability adequacy test. As a result, an insurer should never recognise a profit at the inception of an insurance contract.***

(b) ***There should be a rebuttable presumption that the margin implied by the actual premium (less relevant acquisition costs) is consistent with the margin that market participants require. If you prefer this approach, what evidence should be needed to rebut the presumption?***

(c) ***The premium (less relevant acquisition costs) may provide evidence of the margin that market participants would require, but has no higher status than other possible evidence. In most cases, insurance contracts are expected to provide a margin consistent with the requirements of market participants. Therefore, if a significant profit or loss appears to arise at inception, further investigation is needed. Nevertheless, if the insurer concludes, after further investigation, that the estimated market price for risk and service differs from the price implied by the premiums that it charges, the insurer would recognise a profit or loss at inception.***

Response: The Insurance Council supports alternative (c). It is considered that the calibration of margins should be based on the latest available information and should not be locked into the price charged. We accept that conceptually, even weight should be given to the acceptability or otherwise of day one profits and day one losses. We would expect however that it would be very common for the practical outcome upon inception of a contract to be the same as alternative (b).

However, we have significant practical concerns with the recognition of day one profits and consider that they should be recognised only after recognition of a risk margin which provides a high level of certainty regarding the likelihood of the profit. This view is not based on a reluctance to recognise day one profits but rather what Insurance Council members consider to be an appropriate reflection of the uncertainty involved in predicting the future and that the implications for the value of financial reports to readers of getting day one profits wrong is greater than getting day one losses wrong.

The Insurance Council expects that, if the final standard allows for the recognition of day one profits, it would note that they are not expected to be the norm and they should only be recognised after careful consideration of the high level of uncertainty surrounding the development of future claims.

As insurance markets are generally competitive, profits on inception, where they arise, would be expected to fall away in at least the medium term. We also note that the general insurance industry is subject to marked pricing cycles and we would expect the standard to note that the profit on inception to be recognised should relate to underlying characteristics of the product and not simply the timing of an external market cycle.

QUESTION 5 – CURRENT EXIT VALUE?

This paper proposes that the measurement attribute for insurance liabilities should be the amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity. The paper labels that measurement attribute 'current exit value'.

(a) Is that measurement attribute appropriate for insurance liabilities? Why or why not? If not, which measurement attribute do you favour, and why?

(b) Is 'current exit value' the best label for that measurement attribute? Why or why not?

Response (a): The Insurance Council has strong concerns with the feasibility and appropriateness of applying a theoretical exit value model to insurance contracts. It is widely accepted that there is no ready market to trade and hence determine exit values for insurance contracts.

Insurance contracts do not have secondary markets and hence fair values would have to be estimated by management. This reality is embedded in the first building block but is then ignored in the third. There are also legal and regulatory restrictions relating to exiting insurance contracts early.

The measurement requirement should reflect the significant amount of judgement that will need to be applied to measure the insurance liabilities. Economic substance should always take precedence over form.

Regardless of the measurement objective of the model and also of the label it is given, many of the inputs to the model will by necessity be entity specific, either because there simply is no market data available or because the underlying risk profile of the liability is insufficiently comparable to warrant use of the market data available. In the language of FASB Statement 157, a significant portion of the inputs to the measurement would be classified into Level 3 and therefore the measurement output would be classified as Level 3. Could the core liability of a whole industry classified into Level 3 still be referred to as fair value?

Accordingly, the Insurance Council considers that there are two options:

1) Establish the measurement objective of the model to be an entity-specific measurement using market consistent data where available which would provide a clear understanding between preparers and users about what the measurement represents, or
2) Establish the measurement objective of the model to be fair value (or a proxy thereof) while recognising that many of the inputs to the model will by necessity be entity specific estimates of what a hypothetical third party would use, creating a divergence between the presentation of the measurement and its in substance calculation.

There are several references in the Discussion Paper indicating that the IASB was struggling to find a balance between conceptual soundness and operationality. The Insurance Council considers that the Discussion Paper comes down too heavily on the theoretical side placing preparers in a difficult situation when signing financial reports. To require preparers to measure a liability using entity specific information for a significant portion of the inputs to the model but to then sign off financial reports that hold that measurement to be a fair value (or proxy thereof) places significant pressure on those signing the financial report including the auditors. The technical committees of the auditing

firms may by default become the arbiters in resolving uncertainties around such concepts. This is not a practical or welcome outcome.

A theoretical goal, as represented by the 'current exit value' for insurance contracts, is of value when there are forums and timeframes that allow ongoing discussion and debate and even the use of ranges for an answer or disagreements on an answer. However, within the context of the financial report, a single figure must be arrived at within tight timeframes which must be agreed upon by different parties with different viewpoints and responsibilities and the determination of which parties will be legally liable for.

If the IASB proceeds with the use of the 'current exit value' model, then the practical implementation of the measurement attribute could be tempered by describing it in terms of 'the best estimate of' the attribute or a measurement 'consistent with' the attribute. The valuation of the insurance liabilities should be based on the Directors best estimate of a true and fair view and should not be based simply on an amount that a hypothetical third party might value the liability at.

Response (b): To the extent that the 'current exit value' label infers a fair value based on market consistent inputs resulting in liabilities that are comparable between insurers, we disagree. As a significant component of the measurement of the liability will by necessity be based on entity specific information, holding the resultant measurement output to be fair value (or a proxy thereof) would create a divergence between the presentation of the measurement and its in substance calculation.

However, if the IASB is comfortable with noting in the standard that a significant portion of the inputs to the calculation will be entity specific and still considers labelling the resulting output as current exit value can be justified, then the Insurance Council has no substantive issue with the label applied.

QUESTION 6 - BENEFICIAL POLICYHOLDER BEHAVIOUR

Response: Not applicable to general insurance contracts. No response.

QUESTION 7 - BENEFICIAL POLICYHOLDER BEHAVIOUR

Response: Not applicable to general insurance contracts. No response.

QUESTION 8 – ACQUISITION COSTS

Should an insurer recognise acquisition costs as an expense when incurred? Why or why not?

Response: The Insurance Council supports a fully prospective model of accounting and so supports the expensing of acquisition costs as incurred.

QUESTION 9 - BUSINESS COMBINATION OR PORTFOLIO TRANSFER

Do you have any comments on the treatment of insurance contracts acquired in a business combination or portfolio transfer?

Response: The requirements set out in IFRS 4 relating to business combinations or portfolio transfers allow for compliance with the fair value measurement requirement for

business combination accounting while allowing insurers to continue to apply existing measurement accounting policies for insurance liabilities through the use of an expanded presentation option.

If the final insurance contract standard incorporates measurement criteria that represent fair value or the best available interpretation of fair value, then there would no longer be a need for the expanded presentation option.

QUESTION 10 - ASSETS HELD TO BACK INSURANCE LIABILITIES

Do you have any comments on the measurement of assets held to back insurance liabilities?

Response: The Insurance Council supports the requirement for assets backing insurance liabilities to be measured at fair value through profit or loss where available when the insurance liabilities themselves are measured using a current value measurement with movements through profit or loss. The IASB should mandate the treatment for assets and so reduce an accounting mismatch that would otherwise arise. This would limit the ability of insurers to choose different treatments at different times in order to manage the recognition of movements through profit.

We understand that there is some concern regarding how to determine which assets of an insurer are held to back insurance liabilities. It is currently a mandatory requirement under Australian accounting standards for assets backing insurance liabilities to be measured at fair value where available. The implementation of this requirement in Australia was managed smoothly with insurers applying judgement and working through any grey areas without any serious problems.

Where fair value through profit or loss is not available, it is recognised that it is inappropriate for an insurer to apply a measurement treatment for assets that is not available to other entities. However, the Insurance Council recommends that the IASB incorporate consideration of the accounting mismatch into future work on the other standards that deal with asset measurement.

In relation to standards set by the AASB, if the IASB does not mandate the fair value measurement of assets backing insurance liabilities in the final insurance contracts accounting standard then the Insurance Council does not support the equivalent Australian accounting standard including such a requirement. The Insurance Council does not support Australian accounting standard setters mandating a fair value through profit and loss valuation of assets backing insurance liabilities when preparers of financial statements elsewhere have other options available to them. Transparency and comparability of performance can be achieved through appropriate levels of disclosure.

The Insurance Council considers that the benefits of international convergence of financial reporting obligations outweigh the benefits of maintaining the status quo for measuring asset values in Australia. This would be in line with recent initiatives of the AASB to better align Australian accounting standards with IFRS principally through the release of AASB 2007-4. It is expected that at least the majority of general insurers in Australia would continue to fair value assets backing insurance liabilities and for the few, if any, that choose not to, this should be clear from financial reporting disclosures.

QUESTION 11 – UNIT OF ACCOUNT

Should risk margins:

(a) ***be determined for a portfolio of insurance contracts? Why or why not? If yes, should the portfolio be defined as in IFRS 4 (a portfolio of contracts that are subject to broadly similar risks and managed together as a single portfolio)? Why or why not?***

(b) ***reflect the benefits of diversification between (and negative correlation between) portfolios? Why or why not?***

Response (a): The Insurance Council considers that the accounting standards should require determination of the risk margin at the entity level. While an insurer may group liabilities into sub-groups for the calculation process, the risk margin to be presented in the financial report of the entity should be that determined for the entity.

Insurance is based on the concept of grouping risk. This does not mean that all insurers group risk in the same way. For two insurers to benefit from risk aggregation and so be able to provide competitive insurance products, they do not have to aggregate risk in the same way. The benefits arising from the grouping of risks which allow for the existence of insurance can be assessed, used, relied upon, in many different ways.

One insurer may consider products closely linked because they are sold to the same customer base, while another insurer may assess aggregated risks based on the use of brand names and yet another insurer may use geography as the key risk aggregator assessment tool.

To force the determination of risk margins based on a definition that looks to create consistency between insurers where it does not exist would potentially require additional reporting processes and force the establishment of risk margins based on aggregations that are not representative of how the business is managed.

If the IASB is determined to require risk margins to be set at below the entity level, then it is considered that at most the accounting standards should require risk margins to be determined for a portfolio of insurance contracts defined on the basis of internal management strategy. The determination of risk margins should be aligned with the management of the business. An insurer may group the underlying policyholder liabilities in a variety of ways depending on their management structure, local jurisdiction approach to regulating products or their perception based on local circumstances of the relationships between products.

If it is agreed that the risk margins are to be determined at some portfolio level, then the financial report should still incorporate an additional allowance which may be negative to rebalance the risk margin to that of the entity allowing for diversification and negative correlations between the portfolios where they exist – refer to (b).

Response (b): The Insurance Council considers that where diversification and/or negative correlation between portfolios exists, it should be recognised. Consequently we support recognition of entity-wide diversification and negative correlation where it exists.

Diversification is real and measurable and should be recognised.

If the unit of account is set at the portfolio level, we still consider that the recognition and measurement of the economic substance of an entity should not be limited by the use of portfolios as a tool for the establishment of the preliminary level calculations.

An accounting system that does not recognise diversification and negative correlation where they exist, does not capture the economic substance of insurance, and therefore is of limited value. The economic substance of a group of insurance contracts cannot be captured by a simple aggregation of individual transactions.

The IASB appears to recognise this by proposing to allow recognition of diversification and negative correlation where they exist within a portfolio. However, it then goes on to propose disallowing recognition of the same items beyond the arbitrary level of a portfolio of contracts.

The financial reports still need to be representative of the entity to which they purport to relate. The recognition and measurement of this diversification is very important information for users of the reports. In simple terms, the market value of an insurer with diversified insurance liabilities is greater than another similar insurer that holds insurance liabilities that are less diversified. If the financial reports do not demonstrate this then they are of reduced value to the readers of the reports.

The ability of readers to compare liabilities between insurers should not outweigh the importance of the financial report being representative of the entity.
We understand that the IASB proposes that risk margins exclude recognition of the benefits of diversification between portfolios and negative correlation between portfolios on the basis that the current exit value should be independent of the entity that holds the asset or liability.

The Insurance Council considers that this apparent inconsistency between recognition of diversification and negative correlation between portfolios and the current exit value, rather than leading to the position that these items should not be recognised, provides evidence of how the conceptual current exit value model as described in the Discussion Paper is not appropriate for application to insurance contracts.

We also see an issue with the inconsistency of the Discussion Paper between proposing an exit value approach and then proposing to exclude recognition of the diversification and/or negative correlations between portfolios when these are critical factors in the transactions involving acquisition of an insurer.

If the financial report provides a measurement of one of, if not the key, liability of an insurer that does not reflect the entity that financial report purports to represent, then this by definition means the financial reports are of reduced value.

There are standardised techniques for the measurement of diversification and negative correlations that have been used in practice in Australia for many years that are accepted by preparers, auditors and users to produce reliably measured results.

QUESTION 12 - REINSURANCE ASSETS

(a) ***Should a cedant measure reinsurance assets at current exit value? Why or why not?***

(b) ***Do you agree that the consequences of measuring reinsurance assets at current exit value include the following? Why or why not?***

(i) ***A risk margin typically increases the measurement of the reinsurance asset, and equals the risk margin for the corresponding part of the underlying insurance contract.***

(ii) ***An expected loss model would be used for defaults and disputes, not the incurred loss model required by IFRS 4 and IAS 39.***

(iii) ***If the cedant has a contractual right to obtain reinsurance for contracts that it has not yet issued, the current exit value of the cedant's reinsurance asset includes the current exit value of that right. However, the current exit value of that contractual right is not likely to be material if it relates to insurance contracts that will be priced at current exit value.***

Response (a): The Insurance Council considers that the measurement of the reinsurance assets relating to outstanding claims should be consistent with the measurement of the underlying liability. We note that we have similar concerns, as we do for the underlying liability, with the application of the current exit value for reinsurance assets for which there is no ready market to trade and thus determine the value.

Response (b)(i): The Insurance Council agrees that a risk margin should be used to typically increase the measurement of the reinsurance assets on outstanding claims and should equal the risk margin for the corresponding part of the underlying insurance contract.

Response (b)(ii): Reinsurance assets comprise reinsurance recoverables on paid claims and on outstanding claims. The reinsurance recoveries on outstanding claims by the very nature of the measurement of the underlying liability cannot be measured on an incurred loss model.

Response (b)(iii): Presumably the contractual right would not qualify as an asset unless there is a contract by which a reinsurer is committed to sell reinsurance to the cedant and no party can cancel or opt out. If such a contractual right was booked, there would also then need to be recognition of the reinsurance payable.

The Insurance Council notes that the alternate situation is also quite common where there is a pre-claims liability that is expected to be incurred after the expiry date of the current reinsurance contract but which would, if it were renewed, mitigate the liability.

Currently in Australia an insurer is able to assume that reinsurance cover will be renewed, providing there are no reasons to believe this will not eventuate. This is considered a sensible response to this issue and is consistent with an expected cash flows approach. The IASB should consider this issue for reference in the exposure draft.

QUESTION 13 - DEPOSIT OR SERVICE COMPONENTS

If an insurance contract contains deposit or service components, should an insurer unbundle them? Why or why not?

Response: No response at this time.

The Insurance Council considers that deposit components are not applicable to general insurance contracts. There has been confusion about the application of the service component to a general insurance contract and we await further discussion or more information before adopting a position.

QUESTION 14 – CREDIT RISK

(a) ***Is the current exit value of a liability the price for a transfer that neither improves nor impairs its credit characteristics? Why or why not?***

(b) ***Should the measurement of an insurance liability reflect (i) its credit characteristics at inception and (ii) subsequent changes in their effect? Why or why not?***

Response: The Insurance Council considers that credit characteristics should not be considered in the valuation of insurance liabilities.

The Insurance Council recognises the conceptual argument that credit characteristics should be treated in the same manner as all other characteristics but does not see a practical manner for this to be applied to insurance contracts. For a financial instrument, such as a debt instrument issued by an entity that is traded in a liquid market, there is a case for the recognition and measurement of the impact of the credit characteristic. However, we do not consider that credit risk exists for an insurance liability the same way as it does for traded debt instruments. Policyholders do not generally differentiate between insurers based on credit quality in the way debt holders differentiate between issuers of debt instruments which is based on risk adjusted returns.

It is recognised that the Discussion Paper refers to the credit standing of the insurance liability and not the credit quality of the insurer but we do not see a practical separation of the two.

The Insurance Council does not consider that the measurement of the insurance liabilities is the appropriate place for consideration of credit risk and it is not a useful means of providing information to users. The Insurance Council therefore recommends that credit risk should be excluded from the measurement.

If the IASB continues with its proposal to require consideration of credit characteristics, the standard should include wording to the effect that in a regulated environment where there are reasonable minimum capital requirements the impact of considering the credit characteristics would be expected to be immaterial.

QUESTION 15 – CONSISTENCY WITH IAS 39

Appendix B identifies some inconsistencies between the proposed treatment of insurance liabilities and the existing treatment under IAS 39 of financial liabilities. Should the Board consider changing the treatment of some or all financial liabilities to avoid those inconsistencies? If so, what changes should the Board consider, and why?

Response: The Discussion Paper in Part 2 Appendix B notes a number of inconsistencies with IAS 39. For some of these, it is unclear whether their application would result in a different outcome. The Insurance Council has no response at this time other than to note general support for consistency where achievable and to note that the driver for consideration of the differences, being insurance products that fall outside of the insurance contract definition, has little impact on the general insurance industry.

We understand that the IASB expects to complete a review of IAS39 in due course, particularly given the rules-based nature of the standard. It would be appropriate to consider these issues of consistency at that time rather than as part of the insurance contracts project.

QUESTION 16 - PARTICIPATING CONTRACTS

Response: Not applicable to general insurance contracts. No response.

QUESTION 17 - UNIT-LINKED CONTRACTS

Response: Not applicable to general insurance contracts. No response.

QUESTION 18 – INCOME STATEMENT PRESENTATION

Should an insurer present premiums as revenue or as deposits? Why?

Response: The Insurance Council considers that insurers should present premiums received in relation to general insurance contracts as revenue.

The question is more relevant to the life insurance industry where there can be a differentiation between products that transfer risk and those that do not. We consider that wherever risk is transferred, the premiums should be recognised as revenue.

Insurers are not under an obligation to return the premiums or even to hold the premiums aside. The insurer is able to meet its obligations under a contract to pay claims (if any) from whatever resources it has available. The amount of claims to be paid is not in any way limited by the premium paid. One of the things clear at the beginning of a contract is that it is very unlikely that the amount to be paid to the policyholder will be the same as the premiums provided.

Even where a contract allows for a policyholder to cancel a contract prior to the expiry of the period of risk and receive a pro-rata refund, the occurrence of this is insignificant to the overall contracts underwritten.

QUESTION 19 - INCOME STATEMENT PRESENTATION

Which items of income and expense should an insurer present separately on the face of its income statement? Why?

Response: In Australia, an accounting model for insurance contracts comprising of the three building blocks has been in place for many years. We would recommend consideration of the detailed disclosure requirements that have been standard practice in Australia noting that the disclosures relate to Australia's current accounting system which uses an unearned premium liability for the pre-claims period.

QUESTION 20 - INCOME STATEMENT PRESENTATION

Should the income statement include all income and expense arising from changes in insurance liabilities? Why or why not?

Response: The Insurance Council supports the inclusion in the income statement of all income and expense arising from changes in insurance liabilities. The immediate recognition of all movements is the most transparent recognition method and is current practice in Australia.

QUESTION 21 – OTHER COMMENTS

Do you have other comments on this paper?

Response: Yes

Insurance Contracts definition
Some insurance products require specified payments to be made to reimburse the holder for a loss it incurs if a specified debtor fails to make payments when due under the original or modified terms of a debt instrument and so meet the definition of an insurance contract. Such a contract would also meet the definition of a financial guarantee contract.

Current accounting standard requirements provide that where an insurance product meets the definition of both an insurance contract and a financial guarantee contract, it is to be treated as a financial guarantee contract unless the issuer of the contract has previously asserted explicitly that it regards such contracts as insurance contracts, and has applied to them accounting applicable to insurance contracts, in which case the issuer may elect to treat the contract as an insurance contract or a financial guarantee contract.

The Insurance Council considers that all insurance products should be treated the same. Where an issuer provides a product as an insurance contract, it should be accounted for as an insurance contract.