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15 October 2003

Mr Peter Clark
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Mr Clark

Exposure Draft ED5 Insurance Contracts

The Insurance Council of Australia (ICA) is the representative body of the general insurance industry in Australia. ICA members account for over 90 per cent of total premium income written by private sector general insurers.

ICA members, both insurance and reinsurance companies, are a significant part of the financial services system. Recently published statistics from the Australian Prudential Regulation Authority (APRA) show that the private sector insurance industry generates direct premium revenue of $19.8 billion per annum and has assets of $66.6 billion. The industry employs about 25,000 people.

CA members issue some 37.8 million insurance policies annually and deal with 3.5 million claims each year.

ICA welcomes the opportunity to provide comments on exposure draft ED5. This is attached as Appendix 1

The exposure draft raises issues in relation to life insurance. Responses have been framed within the context of general insurance only. In some instances no response to a particular question has been made, and these are clearly identified.

The Australian general insurance industry welcomes the Boards careful consideration of these issues, and fully supports the consultation process that should ensure that the benefits arising from the use of a common international financial reporting language are fully utilised.

Please do not hesitate to contact Peter Anderson on telephone (612) 9253-5100 or email panderson@ica.com.au if you require any further information.

Yours sincerely

Alan Mason
Executive Director

cc Australian Accounting Standards Board
International Association of Insurance Supervisors (IAIS)

Comments on ED 5 **Appendix 1**

Question 1-Scope

a) The Exposure Draft proposes that the IFRS would apply to insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds, except for specified contracts covered by other IFRSs. The IFRS would not apply to accounting by policyholders (paragraphs 2-4 of the draft IFRS and paragraphs BC4O-BC51 of the Basis for Conclusions).

The Exposure Draft proposes that the IFRS would not apply to other assets and liabilities of an entity that issues insurance contracts. In particular, it would not apply to:

i) assets held to back insurance contracts (paragraphs BC9 and BC1O9-BC114). These assets are covered by existing IFRSs for example, IAS 39 *Financial Instruments Recognition and Measurement* and IAS 40 *investment Property*

ii) financial instruments that are not insurance contracts but are issued by an entity that also issues insurance contracts (paragraphs BC115-BC117).

Is this scope appropriate If not, what changes would you suggest, and why?

b) The Exposure Draft proposes that weather derivatives should be brought within the scope of IAS 39 unless they meet the proposed definition of an insurance contract (paragraph C3 of Appendix C of the draft IFRS). Would this be appropriate? If not, why not?

(a)(i) ICA does not fully agree with this proposal.

ICA agrees with the use of a contract-based approach rather than an entity-based approach in the application of accounting standards. Assets held to back insurance contracts should be valued under other relevant IFRSs, specifically IAS32, IAS39, IAS40 and IAS16. However those IFRSs should be applied in a manner that results in consistent measurement bases for assets and liabilities.

The potential mismatch between the measurement bases for assets and liabilities is unacceptable and should not be allowed for even in the interim period before the release of phase II. The potential mismatch would result in increased, short-term volatility in an industry known for its long-term values and whose very survival is based on managing a portfolio of risks over time.

ICA proposes that IAS32 IAS39, IAS40 and IAS16 apply to assets held to back insurance liabilities but that those standards be applied so that assets are measured in a manner consistent with the measurement bases used for insurance liabilities. Specifically, assets held to back insurance liabilities should be carried at fair value where the related insurance liabilities are measured on a discounted basis, with fair value movements being recorded in the profit and loss.

(a)(ii) ICA agrees with this proposal.

(b) ICA agrees with this proposal.

Question 2 - Definition of insurance contract

The draft IFRS defines an insurance contract as a 'contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary' (Appendices A and B of the draft IFRS, paragraphs BC10-BC39 of the Basis for Conclusions and IG Example 1 in the draft Implementation Guidance).

Is this definition, with the related guidance in Appendix B of the draft IFRS and IG Example 1, appropriate? If not, what changes would you suggest, and why?

The definition is appropriate.

ICA recommends that stronger guidance be included in relation to the use of the word "significant", as terms such as "plausible" and "extremely unlikely" are too broad for practical application.

ICA agrees with the approach of not using quantitative guidance, as this would create an arbitrary dividing line.

Question 3 - Embedded derivatives

(a) IAS 39 *Financial Instruments: Recognition and Measurement* requires an entity to separate some embedded derivatives from their host contract, measure them at fair value and include changes in their fair value in profit or loss. This requirement would continue to apply to a derivative embedded in an insurance contract, unless the embedded derivative:

(a) meets the definition of an insurance contract within the scope of the draft IFRS, or

(b) is an option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate)?

However, an insurer would still be required to separate, and measure at fair value:

(i) a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in an equity or commodity price or index; and

(ii) an option to surrender a financial instrument that is not an insurance contract. (paragraphs 5 and 6 of the draft IFRS, paragraphs BC37 and BC118 BC123 of the Basis for Conclusions and IG Example 2 in the draft Implementation Guidance)

Are the proposed exemptions from the requirements in IAS 39 for some embedded derivatives appropriate? If not, what changes should be made, and why?

(b) Among the embedded derivatives excluded by this approach from the scope of IAS 39 are items that transfer significant insurance risk but that many regard as predominantly financial (such as the guaranteed life contingent annuity options and guaranteed minimum death benefits described in paragraph BC123 of the Basis for Conclusions) Is it appropriate to exempt these embedded derivatives from fair value measurement in phase I of this project? If not, why not'? How would you define the embedded derivatives that should be subject to fair value measurement in phase I?

(c) The draft IFRS proposes specific disclosures about the embedded derivatives described in question 3(b) (paragraph 29(e) of the draft IFRS and paragraphs IG54 IG58 of the draft Implementation Guidance) Are these proposed disclosures adequate'? If not, what changes would you suggest, and why?

(d) Should any other embedded derivatives be exempted from the requirements in IAS 39? If so, which ones and why?

ICA agrees with these proposals.

Question 4 -Temporary exclusion from criteria in IAS 8

(a) Paragraphs 5 and 6 of [the May 2002 Exposure Draft of improvements to] IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors specify criteria for an entity to use in developing an accounting policy for an item if no IFRS applies specifically to that item However, for accounting periods beginning before 1 January 2007, the proposals in the draft IFRS on insurance contracts would exempt an insurer from applying those criteria to most aspects of its existing accounting policies for

i) insurance contracts (including reinsurance contracts) that it issues, and

ii) reinsurance contracts that it holds.

(paragraph 9 of the draft IFRS and paragraphs BC52-BC58 of the Basis for Conclusions).

Is it appropriate to grant this exemption from the criteria in paragraphs 5 and 6 of [draft] IAS 8? If not, what changes would you suggest and why?

(b) Despite the temporary exemption from the criteria in [draft] IAS 8, the proposals in paragraphs 10-13 of the draft IFRS would:

(i) eliminate catastrophe and equalisation provisions.

(ii) Require a loss recognition test if not such text exists under an insurer's existing accounting policies

(iii) Require an insurer to keep insurance liabilities in its balance sheet until they are discharged or cancelled, or expire , and to report insurance liabilities without offsetting them against related reinsurance assets (paragraphs 10-13 of the draft IFRS and paragraphs BC58-BC75 of the Basis for Conclusions).

Are these appropriate? If not, what changes would you propose, and why?

(a) ICA considers that it is appropriate to grant this exemption from the criteria in paragraphs 5 and 6 of [draft] IAS 8.

(b) ICA considers that these proposals are appropriate.

Question 5 - Changes in accounting policies

The draft IFRS:

(a) proposes requirements that an insurer must satisfy if it changes its accounting policies for insurance contracts (paragraphs 14 17 of the draft IFRS and paragraphs BC76 BC88 of the Basis for Conclusions).

(b) proposes that, when an insurer changes its accounting policies for insurance liabilities, it can reclassify some or all financial assets into the category of financial assets that are measured at fair value, with changes in fair value recognised in profit or loss (paragraph 35 of the draft IFRS)

Are these proposals appropriate? If not, what changes would you propose and why?

ICA considers that these proposals are appropriate. However, refer to the response to question 1 regarding the potential mismatch between the measurement bases for assets and liabilities. Reclassification of financial assets should result in the assets being measured in a manner consistent with the measurement bases used for insurance liabilities

Question 6 - Unbundling

The draft IFRS proposes that an insurer should unbundle (ie account separately for) deposit components of some insurance contracts, to avoid the omission of assets and liabilities from its balance sheet (paragraphs 7 and 8 of the draft IFRS, paragraphs BC30 BC37 of the Basis for Conclusions and paragraphs IG5 and IG6 of the proposed Implementation Guidance)

(a) Is unbundling appropriate and feasible in these cases? If not, what changes would you propose and why?

(b) Should unbundling be required in any other cases? If so, when and why?

(c) Is it clear when unbundling would be required'? If not, what changes should be made to the description of the criteria?

ICA considers that:

(a) Unbundling is appropriate and feasible in these cases.

(b) Unbundling should not be required in any other cases.

(c) It is clear when unbundling would be required.

Question 7— Reinsurance purchased

The proposals in the draft IFRS would limit reporting anomalies when an insurer buys reinsurance (paragraphs 18 and 19 of the draft IFRS and paragraphs BC89-BC92 of the Basis for Conclusions).

Are these proposals appropriate? Should any changes be made to these proposals? If so, what changes and why?

ICA considers that these proposals are appropriate.

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Question 8 — Insurance contracts acquired in a business combination or portfolio transfer

IAS 22 Business Combinations requires an entity to measure at fair value assets acquired and liabilities assumed in a business combination and ED 3 Business Combinations proposes to continue that long-standing requirement The proposals in this draft IFRS would not exclude insurance liabilities and insurance assets (and related reinsurance) from that requirement However, they would permit, but not require, an expanded presentation that splits the fair value of acquired insurance contracts into two components

(a) a liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues; and

(b) an intangible asset, representing the fair value of the contractual rights and obligations acquired, to the extent that the liability does not reflect that fair value This intangible asset would be excluded from the scope of IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets.* Its subsequent measurement would need to be consistent with the measurement of the related insurance liability. However, IAS 36 and IAS 38 would apply to customer lists and customer relationships reflecting the expectation of renewals and repeat business that are not part of the contractual rights and obligations acquired

The expanded presentation would also be available for a block of insurance contracts acquired in a portfolio transfer (paragraphs 20 23 of the draft IFRS and paragraphs BC93 BC101 of the Basis for Conclusions)

Are these proposals appropriate? If not, what changes would you suggest and why?

ICA considers that these proposals are appropriate.

Question 9 — Discretionary participation features

The proposals address limited aspects of discretionary participation features contained in insurance contracts or financial instruments (paragraphs 24 and 25 of the draft IFRS and paragraphs BC102-BC108 of the Basis for Conclusions) The Board intends to address these features in more depth in phase II of this project

Are these proposals appropriate'? If not, what changes would you suggest for phase I of this project and why?

These proposals are not applicable to general insurance contracts and so no comment is provided.

Question 10 — Disclosure of the fair value of insurance assets and insurance liabilities

The proposals would require an insurer to disclose the fair value of its insurance assets and insurance liabilities from 31 December 2006 (paragraphs 30 and 33 of the draft IFRS, paragraphs BC138-BC140 of the Basis for Conclusions and paragraphs IG60 and IG61 of the draft Implementation Guidance).

Is it appropriate to require this disclosure? If so, when should it be required for the first time? If not, what changes would you suggest and why?

ICA does not consider that it is appropriate to require this disclosure.

The appropriateness of such disclosure should only be considered after the question of how those fair values should be measured is determined. It is not possible to separate consideration of the appropriateness of the disclosures from consideration of the related valuation issues. It is understood that the Board intends to complete the phase II standard before this proposal comes into force, which would provide the measurement basis. However there is also considerable debate in regard to the timing for phase II and ICA considers it premature to set disclosure requirements before methods and firm timetables are set.

Question 11 — Other disclosures

(a) The Exposure Draft proposes requirements for disclosures about the amounts in the insurer's financial statements that arise from insurance contracts and the estimated amount, timing and uncertainty of future cash flows from insurance contracts (paragraphs 26 29 of the draft IFRS, paragraphs BC124-BC137 and BC141 of the Basis for Conclusions and paragraphs IG7-IG599 of the draft Implementation Guidance).

Should any of these proposals be amended or deleted? Should any further disclosures be required? Please give reasons for any changes you suggest.
To a large extent, the proposed disclosures are applications of existing requirements in IFRSs, or relatively straightforward analogies with existing IFRS requirements If you propose changes to the disclosures proposed for insurance contracts, please explain what specific attributes of insurance contracts justify differences from similar disclosures that IFRSs already require for other items

(b) The proposed disclosures are framed as high-level requirements, supplemented by Implementation Guidance that explains how an insurer might satisfy the high level requirements.

Is this approach appropriate? If not, what changes would you suggest, and why?

(c) As a transitional relief, an insurer would not need to disclose information about claims development that occurred earlier than five years before the end of the first financial year in which it applies the proposed IFRS (paragraphs 34, BC134 and BC135)

Should any changes be made to this transitional relief? If so, what changes and why?

ICA has concerns in relation to the disclosure proposals. Both general comments and comments on specific proposed disclosures are provided.

General concerns in relation to the proposed disclosure requirements.

Information overload — ICA considers that there is significant risk that the volume of information to be disclosed could result in information overload. In practical terms there is concern that the physical size of the proposed level of published financial information will become excessive. Readers would be presented with a large volume of data rather than clear information useful in their understanding of the financial statements.

For most insurers, the variety of products comprising the business and variations by region will mean that to achieve the objectives set out in the draft IFRS will require volumes of data. The inferred level of disaggregation is a serious concern.

Inappropriate for the financial statements - Some of the information may be appropriate for inclusion in an annual report but is not appropriately disclosed in the general purpose financial statements. Not all of the proposed disclosures are required to understand the financial statements. Some of the information may be relevant to assist the market in understanding the business. It is appropriate that each business make its own decision about the provision of such information upon which the market will make its own assessments about the transparency and value of an organisation. Some of the proposed disclosures are more relevant to special purpose financial reports such as a due diligence report. Such consideration is particularly relevant to non listed entities.

Understandability — An important element of the IASB framework is that the information provided in financial statements should be useful to users. Disclosures must be meaningful, easily understood and presented in proper context. In this regard there is an assumed level of *reasonable* knowledge needed by the reader. ICA considers that the level of knowledge required to understand much of the information that it is proposed to be disclosed exceeds a *reasonable* level and that in practice only people with a high degree of specialist insurance knowledge would be able to understand the information.

Not analogous — ICA recognises that some of these proposals work towards requiring disclosures for the insurance industry analogous to existing requirements in IFRSs. However the analogy is not appropriate. The business of insurance involves significant levels of uncertainty, in particular the uncertainty of cash flows. The nature of insurance business does not lend itself to prescribed disclosures to the level proposed.

In relation to specific proposed disclosures, the following comments are provided:

Explanation of reported amounts

Draft IFRS 27(a)

ICA considers these disclosures to be appropriate.

Draft IFRS 27(b)

ICA considers these disclosures appropriate, however we disagree with:

IG 12

This proposal is based on the premise that the amount shown for reported claims is more accurate, or has a more factual base than estimated claims IBNR. However there is a substantial degree of subjectivity in both.

IG16(a)

If it is required that insurers have to disclose the balance sheet DAC and the income statement expense then it is unnecessary to disclose the movement in the deferral as this can be easily calculated by the reader.

Draft IFRS 27(c)

ICA considers these disclosures to be appropriate.

Draft IFRS 27(d)

ICA considers these disclosures to be appropriate.

Draft IFRS 27(e)

ICA does not consider these disclosures to be appropriate. Many of the proposed disclosures as set out in IG27 are superfluous as they are easily determined from other figures presented in the financial statements.

IG27(d)

To disclose the unused amounts reversed during the period separately for different insurance liabilities may mislead readers. A negative result in one or more areas may be misinterpreted and raise concern. However from an overall perspective, which is the way the business is managed using portfolio theory, the results may be as expected or acceptable. It should be sufficient to disclose any material changes within the liabilities for prior period claims.

IG29

IG 29 proposes a fairly detailed reconciliation disclosure for what is a fairly straightforward balance.

Amount, timing and uncertainty of cash flows

Draft IFRS - 29(a) and 29(b) ICA does not consider these disclosures to be appropriate.

ICA considers that it is inappropriate that this information be disclosed in the financial statements. These disclosures relate to business and regulatory matters which may be included more appropriately in the annual report and/or regulatory reports.

Draft IFRS 29(c)

ICA does not consider these disclosures to be appropriate.

Draft IFRS 29(c)(i) and IG41 — Sensitivity analysis

ICA agrees with the principle of the disclosure, but we are concerned with the degree to which disclosures would be required. For example would an international insurer need to list the sensitivities by country?

Draft IFRS 29(c)(ii) and IG44 — Material concentrations of insurance risk

Dealing with concentrations of risk is one of the basic functions of an insurer. ICA does not believe that it should be necessary for financial statements to contain a rationale for an insurer's risk management policies and procedures. It should be sufficient to document that the insurer takes account of issues of concentration in both buying reinsurance and in setting the risk margins in the valuation of expected claims. Alternatively this requirement could be replaced with a requirement to disclose an insurer's maximum net retention on one event.

Draft IFRS 29(c)(iii) and IG48 — Claims development tables

Claims development tables are not easily understood. Such a table loses much of its value in a system where insurance liabilities are inflated and discounted, which is current practice in Australia and where the IFRS are moving. These elements, while being appropriate to valuing insurance liabilities, distort the information being presented in a claims development table.

ICA recommends that a more appropriate disclosure would be to compare the expected undiscounted net central estimate incurred cost to the actual incurred cost, and to incorporate a reconciliation back to the net incurred cost per the profit and loss account. This will show separately the amount relating to risks borne in the current financial year and the amount relating to a reassessment of risks borne in all previous financial years. While this is not as detailed in relation to the effect of prior individual years, it is far more comprehensible for the reader. Where there are material individual elements in the movement in prior year reserves, the material elements should be explained.

Draft IFRS 29(d)

ICA considers these disclosures are appropriate.

Draft IFRS 29(e)

ICA considers these disclosures are appropriate.

(b) The approach of framing the proposed disclosures as high-level requirements is appropriate.

(c) ICA considers the transitional relief to be inadequate. We refer to our comments to (a) above. However, presuming that claims development tables do become a required disclosure, we recommend that the table be required to be built up year by year up to a maximum of ten years, commencing with only one year in the first period.

Question 12 – Financial guarantees by the transferor of a non-financial asset or liability

The Exposure Draft proposes that the transferor of a non-financial asset or liability should apply IAS 39 Financial Instruments: Recognition and Measurement to a financial guarantee that it gives to the transferee in connection with the transfer (paragraphs 4(e) of the draft IFRS, C5 of Appendix C of the draft IFRS and BC41-BC46 of the Basis for Conclusions).
IAS 39 already applies to a financial guarantee given in connection with the transfer of financial assets or liabilities.

Is it appropriate that IAS 39 should apply to a financial guarantee given in connection with the transfer of non-financial assets or liabilities? If not, what changes should be made and why?

This proposal is appropriate.

Question 13 – Other Comments

Do you have any other comments on the draft IFRS and draft implementation Guidance?