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21 September 2004

Ms Andrea Pryde  
Assistant Project Manager  
International Accounting Standards Board  
30 Cannon Street  
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UNITED KINGDOM

Dear Ms Pryde

**Exposure Draft – Proposed Amendments to IAS39 Financial Instruments: Recognition and Measurement, and IFRS 4 Insurance Contracts – Financial Guarantee Contracts and Credit Insurance**

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.

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

ICA disagrees with the proposals set out in the exposure draft to remove financial guarantees and credit insurance contracts that meet the definition of insurance contracts from the scope of IFRS 4 "Insurance Contracts" and to prescribe a measurement basis under IAS 39 "Financial Instruments: measurement and recognition". We believe that all contracts meeting the definition in IFRS 4 of an insurance contract should continue to be accounted for under IFRS 4.

The objective of Phase 1 of the Insurance contracts project was to introduce certain limited improvements to the accounting for insurance contracts, whilst avoiding major changes until finalising Phase II. Under these proposals, entities in a number of jurisdictions will be required to change their accounting policies for these specific insurance contracts, especially with respect to the adjustment of their insurance liabilities for risk margins and the time value of money and the treatment of deferred acquisition costs (DAC). An international consensus over these issues will not be reached until the final outcome of Phase II. We do not believe that certain types of insurance contracts should be scoped out of IFRS 4, with the accounting treatment prescribed under another standard, until Phase II is completed.

The practical purpose of the proposals is to require entities to determine whether an additional liability should be recognised under IAS 37 Provisions, contingent liabilities and contingent assets. IFRS 4 requires a liability adequacy test to be applied to financial guarantees and credit insurance contracts that meet the definition of insurance contracts. We believe this test is at least as appropriate as the requirements under IAS 37.

The proposals would lead to changes in the way insurance liabilities and DAC are accounted for (ie discounting insurance liabilities at a risk adjusted discounted rate and changing the criteria for determining the level of acquisition costs capitalised). This would require many insurance companies to fundamentally change their accounting processing and disclosure requirements for one category of insurance products in advance of Phase II.

ICA agrees with the overall aim of the IASB, that of issuing high quality principle based standards. We believe that the board will not achieve this aim with the proposals set out in this exposure draft which introduce unwarranted scope exceptions in the case of certain insurance contracts.

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

Yours sincerely



Carolyn Conner  
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Encl.

cc. Australian Accounting Standards Board

## Responses to IASB questions

### Question 1 – Form of contract

The Exposure Draft deals with contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs if a specified debtor fails to make payment when due under the original or modified terms of a debt instrument (financial guarantee contracts). These contracts can have various legal forms, such as that of a financial guarantee, letter of credit, credit default contract or insurance contract. Under the proposals in the Exposure Draft the legal form of such contracts would not affect their accounting treatment (see paragraphs BC2 and BC3).

Do you agree that the legal form of such contracts should not affect their accounting treatment?

If not, what differences in legal form justify differences in accounting treatments? Please be specific about the nature of the differences and explain clearly how they influence the selection of appropriate accounting requirements.

ICA agrees with the above proposal, on the basis that there is no reason to depart from the general rule, i.e. IAS 8 Para 10 (b), that an accounting policy should "reflect the economic substance of transactions, other events and conditions, and not merely the legal form".

### Question 2 – Scope

The Exposure Draft proposes that all financial guarantee contracts should be within the scope of IAS 39 (see paragraph 2 of IAS 39 and paragraph 4 of IFRS 4), and defines a financial guarantee contract as "a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument" (see paragraph 9 of IAS 39).

Is the proposed scope appropriate?

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

ICA disagrees, and contends that financial guarantees and credit insurance contracts meeting the definition of an insurance contract should remain within the scope of IFRS 4. ICA believes that the definition of an insurance contract is set out clearly in IFRS 4 and that the scope exclusions set out in this exposure draft compromise the principles of IFRS 4. Two examples of this include:

1. Application of the IAS 37 requirements would require insurance liabilities to be discounted at a risk adjusted rate. This would require insurance entities in a number of jurisdictions, for example UK insurance companies, to change their current accounting

treatment ahead of Phase II of the Insurance Contracts project resulting in an inconsistent set of accounting treatments across the portfolio of insurance contracts.

2. Application of the proposals would require "transaction costs" incurred in establishing the contract to be deducted from the liability under IAS 39. This contrasts with current generally accepted practice by insurers in a number of jurisdictions whereby certain costs are recognised as a deferred acquisition cost (DAC) asset. In addition the criteria for determining which costs are capitalised under IAS 39 may differ from criteria currently applied by insurance companies to capitalise DAC.

The resolution of these different accounting treatments will not reach international consensus until finalisation of Phase II of the Insurance Contracts project. ICA believes it is inappropriate to pre-empt the outcome of Phase II by prescribing specific accounting requirements to one class of insurance contracts.

ICA therefore proposes that IAS 39 should continue to specifically scope out all insurance contracts.

#### Question 3 – Subsequent measurement

The Exposure Draft proposes that financial guarantee contracts, other than those that were entered into or retained on transferring financial assets or financial liabilities within the scope of IAS 39 to another party, should be measured subsequently at the higher of:

- a) the amount recognised in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
- (b) the amount initially recognised (ie fair value) less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue* (see paragraph 47(c) of IAS 39).

Is this proposal appropriate? If not, what changes do you propose, and why?

ICA disagrees with the proposal in question 3.

ICA believes that **financial guarantees meeting the IFRS 4 definition of an insurance contract** should be dealt with by IFRS 4, so that an insurer applies a consistent set of accounting policies to all insurance contracts.

The practical purpose of this exposure draft is to require entities to determine whether an additional liability should be recognised under IAS 37 *Provisions, contingent liabilities and contingent assets*. IFRS 4 requires a liability adequacy test to be applied to financial guarantees and credit insurance contracts that meet the definition of insurance contracts. ICA believes this test is at least as appropriate as the requirements under IAS 37. It is noted that the liability adequacy test set out in IFRS 4 applies to all entities issuing contracts that meet the definition of insurance, whether these entities be insurers or banks.

#### Question 4 – Effective date and transition

The proposals would apply to periods beginning on or after 1 January 2006, with earlier application encouraged (see paragraph BC27). The proposals would be applied retrospectively.

Are the proposed effective date and transition appropriate? If not, what do you propose, and why?

ICA does not agree that the proposals for financial guarantees that meet the definition of insurance contracts should be implemented. ICA believes that the application date for any amendments to IFRS 4 should be deferred to Phase II when international consensus has been reached over the accounting treatment for all insurance projects.

If there is a significant change to the definition of a financial guarantee, then we urge the IASB to expose the new definition, due to the potential impact. If this happens, the effective date of these proposals may need to be deferred.

#### Question 5 – Other comments

Do you have any other comments on the proposals?

Under IFRS 4, entities are required to present a ten year claims development table (CDT) in respect of their insurance contracts. Insurance contracts that are scoped out of IFRS 4 would also be required to be excluded from the CDT. The requirement to disaggregate this information for preparation of the CDT would impose further practical issues in aggregating data for presentation in the CDT and increase the compliance burden on insurers. Changes to the scope of IFRS 4 should be rare and carefully considered, and preferably should not be made until the principles underlying Phase II are agreed.