

Exposure Draft

ED 1XX
December 2008

Amendment to AASB 139 – Reclassification of Financial Assets backing Insurance Liabilities or Life Investment Contract Liabilities

Prepared by the
Australian Accounting Standards Board

Draft ED 1XX Amendment to AASB 139 - Reclassification of Financial Assets backing Insurance Liabilities or Life Investment Contract Liabilities will be considered by the Board at its meeting on 17-18 December 2008. Please note that the Draft ED does not reflect settled positions by the AASB and may change or be modified by the AASB. This draft is not an authoritative pronouncement of the AASB. Decisions become final only after completion of the formal processes required to issue an Exposure Draft. No responsibility is taken for the results of actions or omission to act taken on the basis of any information in this draft or for any errors or omissions.



Australian Government

**Australian Accounting
Standards Board**

Commenting on this Exposure Draft

Comments on this Exposure Draft are requested by 31 January 2009.
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All non-confidential submissions to the AASB will be made available to the public on the AASB website: www.aasb.gov.au.

Obtaining a Copy of this Exposure Draft

This Exposure Draft is available on the AASB website: www.aasb.gov.au.
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AASB 10XX AMENDMENT TO AASB 139 – RECLASSIFICATION OF
FINANCIAL ASSETS BACKING INSURANCE LIABILITIES OR LIFE
INVESTMENT CONTRACT LIABILITIES**

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[DRAFT] BASIS FOR CONCLUSIONS ON AASB 10XX

[Draft] Australian Accounting Standard AASB 10XX *Amendment to AASB 139 – Reclassification of Financial Assets backing Insurance Liabilities or Life Investment Contract Liabilities* is set out in paragraphs 1-7 and Appendix A. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. AASB 10XX is to be read in the context of other Australian Accounting Standards, including AASB 1048 *Interpretation and Application of Standards*, which identifies the Australian Accounting Interpretations. In the absence of explicit guidance, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies.

PREFACE

Background

Australian Accounting Standards

The Australian Accounting Standards Board (AASB) makes Australian Accounting Standards, including Interpretations, to be applied by:

- (a) entities required by the *Corporations Act 2001* to prepare financial reports;
- (b) governments in preparing financial statements for the whole of government and the General Government Sector (GGS); and
- (c) entities in the private or public for-profit or not-for-profit sectors that are reporting entities or that prepare general purpose financial statements.

Australian Accounting Standards incorporate International Financial Reporting Standards (IFRSs), including Interpretations, issued by the International Accounting Standards Board (IASB), with the addition of paragraphs on the applicability of the Standard in the Australian environment.

Australian Accounting Standards also include requirements that are specific to Australian entities. These requirements may be located in Australian Accounting Standards that incorporate IFRSs or in other Australian Accounting Standards. In most instances, these requirements are either restricted to the not-for-profit or public sectors or include additional disclosures that address domestic, regulatory or other issues. In developing requirements for public sector entities, the AASB considers the requirements of International Public Sector Accounting Standards (IPSASs), as issued by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants.

Private sector for-profit entities complying with Australian Accounting Standards will simultaneously comply with IFRSs. Many other entities complying with Australian Accounting Standards will also simultaneously comply with IFRSs.

Exposure Drafts

The publication of an Exposure Draft is part of the due process that the AASB follows before making a new or amending an existing Australian Accounting Standard. Exposure Drafts are designed to seek public comment

on the AASB's proposals for new Australian Accounting Standards or amendments to existing Australian Accounting Standards.

Reasons for Issuing this Exposure Draft

This Exposure Draft is being issued in response to the publication of Amending Standard AASB 2008-10 *Amendments to Australian Accounting Standards – Reclassification of Financial Assets*. AASB 2008-10 permits entities, including insurers, to reclassify financial assets out of the fair value through profit or loss classification, under AASB 139 *Financial Instruments: Recognition and Measurement*, in particular circumstances. Some of those financial assets could potentially be assets backing insurance liabilities or life investment contract liabilities. The AASB considers that all assets backing insurance liabilities or life investment contract liabilities should be measured at fair value through profit or loss where this is permitted under the applicable accounting standards.

Main Features of this Exposure Draft

This Exposure Draft proposes to include an 'Aus' application paragraph in AASB 139 to prevent insurers from adopting the option in paragraph 50(c) to reclassify certain financial assets backing insurance liabilities or life investment contract liabilities out of the fair value through profit or loss category.

Application Date

It is proposed that this Standard be applicable to annual reporting periods ending on or after a date soon after the Amending Standard is made.

Request for Comments

Comments are invited on the proposal in this Exposure Draft by 31 January 2009. The AASB would prefer that respondents express a clear overall opinion on whether the proposal is supported and that this opinion be supplemented by detailed comments, whether supportive or critical. The AASB regards supportive and critical comments as essential to a balanced review of the issue.

Specific Matters for Comment

The AASB would particularly value comments on whether:

- (a) insurers should be prevented from adopting the option, in AASB 2008-10, to reclassify financial assets out of the fair value through profit or loss category in respect of financial assets backing insurance liabilities or life investment contract liabilities; and
- (b) the proposals are in the best interest of the Australian economy.

ACCOUNTING STANDARD AASB 10XX
AMENDMENT TO AASB 139 –
RECLASSIFICATION OF FINANCIAL ASSETS
BACKING INSURANCE LIABILITIES OR LIFE
INVESTMENT CONTRACT LIABILITIES

Objective

- 1 The objective of this Standard is to prescribe that the option to reclassify certain financial assets out of the fair value through profit or loss category in AASB 139 *Financial Instruments: Recognition and Measurement* is not available to entities applying AASB 1023 *General Insurance Contracts* or AASB 1038 *Life Insurance Contracts* in respect of financial assets backing insurance liabilities or life investment contract liabilities.

Application

- 2 **This Standard applies to:**
 - (a) **each entity that is required to prepare financial reports in accordance with Part 2M.3 of the *Corporations Act 2001* and that is a reporting entity;**
 - (b) **general purpose financial statements of each other reporting entity; and**
 - (c) **financial statements that are, or are held out to be, general purpose financial statements.**
- 3 **This Standard applies to annual reporting periods ending on or after [date to be determined].**
- 4 **The requirements specified in this Standard apply to the financial statements where information resulting from their application is material in accordance with AASB 1031 *Materiality*.**

Scope

- 5 **This Standard applies to:**
 - (a) **financial assets backing *insurance liabilities* accounted for under AASB 1023 or AASB 1038; and**

- (b) **financial assets backing *life investment contract liabilities* accounted for under AASB 1038.**

Proposed amendment to AASB 139

- 6 It is proposed that the following 'Aus' application paragraph be inserted into AASB 139:

Aus1.1.1 An entity shall not apply paragraph 50(c) to financial assets backing *insurance liabilities* or *life investment contract liabilities* accounted for under AASB 1023 *General Insurance Contracts* or AASB 1038 *Life Investment Contracts*.

APPENDIX A

DEFINED TERMS

This appendix is an integral part of AASB 10XX.

Insurance liability	An insurer's net contractual obligation under an insurance contract
Life investment contract liability	A life insurer's net contractual obligations under a life investment contract which arise under the financial instrument component of a life investment contract

BASIS FOR CONCLUSIONS

The Basis for Conclusions accompanies, but is not part of, AASB 10XX.

Background

- BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board considerations in reaching the conclusions in the exposure draft *Amendment to AASB 139 – Reclassification of Financial Assets backing Insurance Liabilities or Life Investment Contract Liabilities*. Individual Board members gave greater weight to some factors than to others.

Significant Issues

- BC2 AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts* ('the insurance standards') require assets backing insurance liabilities or life investment contract liabilities to be measured at fair value through profit or loss, where this is allowable under applicable accounting standards, to minimise, wherever possible, the accounting mismatch that would arise if assets were measured at cost, given the present value measurement approach applied to insurance liabilities and life investment contract liabilities. This is referred to in this Basis for Conclusions as the 'fair value principle'.
- BC3 In relation to financial assets, the insurance standards require financial assets backing insurance liabilities or life investment contract liabilities, which are permitted to be designated as at fair value through profit or loss, to be designated as at fair value through profit or loss, on first application of the insurance standards or on initial recognition. Financial assets that meet the held for trading definition are not permitted to be designated as at fair value through profit or loss as they are required to be classified as held for trading. These assets, however, prior to AASB 2008-10 *Amendments to Australian Accounting Standards – Reclassification of Financial Assets*, were measured at fair value through profit or loss under AASB 139 *Financial Instruments: Recognition and Measurement*, and could not be transferred out of the fair value through profit or loss category.
- BC4 AASB 2008-10 amended AASB 139 to allow entities to reclassify financial assets out of the held for trading classification in particular circumstances. Accordingly, insurers can now choose to reclassify financial assets backing insurance liabilities or life investment contract liabilities, that are classified as held for trading, out of the

fair value through profit or loss category, in particular circumstances. This is inconsistent with the fair value principle.

- BC5 The AASB expects few insurers to have significant levels of financial assets backing insurance liabilities or life investment contract liabilities that are classified as held for trading, given that these assets are generally principally acquired to be available to settle insurance liabilities or life investment contract liabilities.
- BC6 However, the AASB considers the fair value principle to be an integral component of the measurement models required by the insurance standards, and fundamental to the spirit of the standards. The AASB continues to support the fair value principle, in the absence of an IFRS that addresses the recognition and measurement of insurance contracts. Arguably, the insurance standards would have been drafted differently if the reclassification option introduced through AASB 2008-10 had been in place at the time, in such a way that the option to reclassify out of the fair value through profit or loss category, would have been unavailable to insurers in respect of financial assets backing insurance liabilities or life investment contract liabilities.
- BC7 The Board concluded that it is appropriate, therefore, to propose an amendment to AASB 139 that prevents insurers from applying the reclassification amendments in AASB 2008-10.