



Australian Government
**Australian Accounting
Standards Board**

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Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
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Dear Hans

Insurance Contracts

The Australian Accounting Standards Board (AASB) has long had a keen interest in the IASB's Insurance Contracts project and issued comprehensive Standards on insurance contracts in the 1990s, which since 2005 were modified to complement IFRS 4.

As noted in our comment letter on ED/2010/8 *Insurance Contracts*, the AASB supports the main thrust of the project. The AASB also notes that some of the decisions made during the IASB's re-deliberations on ED/2010/8 proposals would further improve the accounting for insurance contracts.

The purpose of this letter is to support the IASB's efforts on this important project and note matters that the AASB believes would further improve the likely outcomes of the project.

IFRS 4 is essentially an 'interim' Standard and its fundamental revision is a critical step in making IFRSs a truly comprehensive set of high-quality global Standards.

The AASB considers the IASB has made good progress on this project and believes the process for revising IFRS 4 should not be delayed unnecessarily by waiting for the FASB to complete its due processes in the context of US GAAP.

Contract boundary

The AASB supports the IASB's re-deliberations on identifying the ability to re-price risk at the portfolio level in determining the contract boundary. However, we note there are constituents who consider this could cause some term life contracts that are managed on a portfolio basis to inappropriately be treated as short-term.

The AASB considers the most useful information for users would be generated if the IASB were to identify the ability to re-price at the individual or portfolio level as a determinant of the contract boundary, depending on the manner in which the relevant business is managed. The AASB envisages this being a matter determined by an entity on the basis of the nature of the business model applying to each class of contracts. The AASB does not envisage this being an option.



The AASB notes the relationship between contract boundary and locking-in residual margins at inception, which may result in a proliferation of portfolios that would detract from an insurer's ability to provide useful information about the business – see comments below on not locking-in residual margins.

Risk margins

The AASB considers re-measuring risk margins at each reporting date to be essential because markets re-price risk as new information becomes available and reflecting this in insurance contract liabilities provides useful information for users. Accordingly, the AASB supports the IASB's confirmation of its proposals in recent deliberations on this topic.

The AASB also supports the IASB's re-deliberation of the risk margin objective to 'the compensation the insurer requires to bear the risk that the ultimate cash flows could exceed those expected' rather than referring to 'maximum amount', which may have implied only the highest value in a range.

Residual margins

The AASB supports residual margins being re-measured at each reporting date (rather than being locked-in at inception) and considers users would benefit from being provided with information that reflects the knowledge available at each reporting date about the actual business that remains in-force. Furthermore, there are likely to be many circumstances in which locking in residual margins and subsequently recognising them in income based on a formula as proposed in ED/2010/8 would not coincide with periods in which relevant services are performed.

Re-measuring residual margins would enable insurers to better associate the performance of services with the recognition of revenue, which would result in more useful information for users.

Accordingly, the AASB supports the IASB re-deliberating its proposals in this regard. The AASB also appreciates that this matter would need to be included in the IASB's proposed re-exposure process.

One measurement model

The AASB notes the IASB presently considers its proposals as including two separate measurement models, and proposed that entities must use the 'modified approach' for pre-claims liabilities relating to 'short-duration' business. The AASB considers this approach is not principles based, and appears to be giving rise to other complications in the IASB's deliberations on presentation, such as having to separately show results from each model where both models are applied by an entity (which would generally need to be the case).

The AASB favours having one measurement model and allowing entities to use the modified approach if it would provide materially the same outcomes as the 'building blocks approach'. The AASB appreciates that some consider this means insurers would need to apply both models to identify whether using the modified approach results in materially the same outcomes. However, the AASB considers it would be feasible to outline the circumstances in which the modified approach would be expected to result in materially the



same outcomes, and that practice would develop to a point where the need to re-work the outcomes for both models would be rare.

The AASB notes this approach already operates in respect of life insurance contracts in Australia, whereby a net present value of future cash flows approach is required, but an accumulation method can be used where the result would not be materially different. The AASB considers this to be no different from requiring some assets and liabilities to be measured at fair value under IFRSs and then having entities determine the method used to achieve fair value under IFRS 13 *Fair Value Measurement* in a manner consistent with the relevant circumstances.

Presentation of margin information

The AASB supports the IASB re-deliberating the proposals for presenting relatively detailed information about margins, in particular, where that information must be located.

Many of the entities that sell insurance contracts in Australia have other activities, including banking and wealth management, and the AASB considers that users would find it potentially confusing to have detailed information about insurance margins presented on the face of the financial statements together with information about other businesses prepared on a different and less detailed basis. The AASB favours permitting margin information to be presented in notes to the financial statements.

If you wish to have further information on the matters covered in this letter, please contact me or Angus Thomson, Research Director [athomson@asb.gov.au].

Yours sincerely

Kevin M. Stevenson
Chairman and CEO