



## Memorandum

<b>To:</b>	AASB members	<b>Date:</b>	20 August 2013
<b>From:</b>	Sue Lightfoot	<b>Agenda Item:</b>	14.4 (M133)
<b>Subject:</b>	<b>Issues paper on ED 241 <i>Amendments to AASB 1038 arising from AASB 10 in relation to consolidation and interests of policyholders</i></b>		

### Action

The purpose of this paper is for the Board to consider submissions on [ED 241](#) *Amendments to AASB 1038 arising from AASB 10 in relation to consolidation and interests of policyholders* and provide staff with directions on amending AASB 1038.

### Background

- 1.1 In August 2011, the AASB made AASB 10 *Consolidated Financial Statements* (which incorporates IFRS 10 *Consolidated Financial Statements*). Although the consolidation requirements in AASB 10 and its predecessor AASB 127 *Consolidated and Separate Financial Statements* (which superseded AASB 1024 *Consolidated Accounts*, upon which the consolidation requirements in AASB 1038 *Life Insurance Contracts* were originally based) are both based on the concept of ‘control’, AASB 10 contains a revised definition of control and specific requirements in relation to control of specified assets in deemed separate entities.
- 1.2 Currently section 4 of AASB 1038 deals with consolidation in a life insurance business context and, under the heading ‘The Life Insurer Entity’, paragraph 4.1 states:

**A life insurer shall recognise in its financial statements the assets, liabilities, income, expenses and equity of the entity, whether they are designated as relating to policyholders or to shareholders.**
- 1.3 ED 241 contains proposals to remove the specific requirements in relation to consolidation from AASB 1038 (in particular, paragraphs 1.1.1, 4.1, 4.1.1, and 4.2 – 4.2.2), which would leave AASB 10 as the sole source for consolidation requirements applicable to life insurer entities.
- 1.4 A specific question was asked in ED 241 as to whether paragraph 4.1.2 of AASB 1038 should be retained. Paragraph 4.1.2 gives guidance on classification of ‘policyholder retained profits’ as equity or liability. Paragraph 4.1.2 states:

**Equity in a share-holder owned life insurer will generally comprise only shareholder equity. Although participants in the industry commonly refer to “policyholder retained profits”, in relation to Australian business such amounts are unvested policyholder benefits liabilities.**

**Under Australian legislation, “policyholder retained profits” relating to Australian *life insurance business* are paid to policyholders, although the timing of the payment is at the discretion of the life insurer. A life insurer will only have policyholder equity if that life insurer has foreign life insurance operations in a jurisdiction that permits retained profits to remain unallocated between policyholders and shareholders, and the policyholders’ component has yet to be determined.**

- 1.5 In its October 2011 meeting the AASB decided there is no need to create Tier 2 general purpose financial reporting requirements in respect of accounting for insurance contracts, based on the Board’s view that entities with material insurance contracts that prepare general purpose financial statements would all have public accountability and therefore need to apply Tier 1 requirements. The proposals in ED 241 therefore have no Tier 2 implications.
- 1.6 AASB 10 is mandatorily effective for for-profit entities annual periods beginning on or after 1 January 2013. This proposal in ED 241 is that the amendments to AASB 1038 would be application to annual reporting periods beginning on or after 1 January 2014 with early adoption permitted for annual reporting periods beginning on or after 1 January 2005.

## **Analysis of submissions on ED 241**

- 2.1 The AASB received five submissions in response to ED 241. The submissions may be found on the AASB website and as Agenda Paper 14.5. Submissions were received from PwC, National Australia Bank, Ernst and Young, CPA and ICAA and AMP.
- 2.2 All five submissions indicated support for the proposals in ED 241 to remove the consolidation requirements from AASB 1038 *Life Insurance Contracts*, including the explicit requirement for a life insurer to consolidate policyholders’ interests, and thereby leave AASB 10 *Consolidated Financial Statements* as the sole source of consolidation requirements applicable to life insurer entities.
- 2.3 Only one submitter (PwC) supported removing paragraph 4.1.2 of AASB 1038. This was on the grounds that although the paragraph gives specific guidance in relation to the classification as liability or equity of retained profits in a friendly society, the appropriate classification can be derived from AASB 132 *Financial Instruments: Presentation* without need for further guidance. The other submitters were comfortable retaining paragraph 4.1.2 on the grounds that it adds useful guidance that does not conflict with requirements in other Australian Accounting Standards.
- 2.4 PwC’s had not in practice identified a current life insurance structure that would be deconsolidated in accordance with AASB 10 and did not believe the amendment would result in change from current practice. ‘Barriers’ to deconsolidation identified by PwC include the following:
  - (a) provision of guarantees;
  - (b) mechanics of consolidated tax groups in the event of default;
  - (c) reimbursements of Statutory funds for operational incidents; and
  - (d) mechanics of redemptions of unit linked investment contracts.

- 2.5 However, consistent with the view of the AASB, PwC is of the view that it is conceivable that a structure might exist that would meet the 'deemed separate entity' test and therefore should not be consolidated under AASB 10, therefore it would be inappropriate for Australian-specific requirements to require consolidation.
- 2.6 Ernst and Young is of the view that the proposed amendment may affect life insurers that have deemed separate entities within their business. Specifically, life insurers that offer pure investment linked products or have assets that are ring-fenced from the life insurer. However, in Ernst and Young's view there will be very few instances where life insurers will have deemed separate entities because most life insurers who offer investment linked or ring-fenced products include portfolios that are protected by some form of guarantee so in practice it is unlikely that many life insurers will have to consider the issue of deemed separate entities.
- 2.7 CPA and ICAA do not envisage a change in current practice as a result of the change to the standard; however that may depend on materiality and the legal determination of the nature of the policyholder funds for particular types of insurance. Furthermore, in their view, if a 'deemed separate entity' (in accordance with AASB 10) was found to exist, current practice would change as these would then not be consolidated.
- 2.8 None of the submissions identified any regulatory or other issues arising in the Australian environment that may affect the implementation of the proposals, including in relation to not-for-profit entities and public sector entities, including GAAP/GFS implications.
- 2.9 The National Australia Bank noted in its submission that it would be beneficial if the proposal was finalised in time to allow early adoption of the amendments in the same financial periods as the application of AASB 10, being annual reporting periods beginning on or after 1 January 2013. In the staff's view this would be achieved by issuing an amending standard with an effective date as proposed in ED 241.

## Staff Recommendation

- 3.1 Staff recommend that the Board amend AASB 1038 as proposed in ED 241.
- 3.2 Staff also recommend that paragraph 4.1.2 of AASB 1038 is retained as it provides useful additional guidance that is not in conflict with AASB 132 or other Australian Accounting Standards.
- 3.3 Staff recommend that the effective date of the amendments is as proposed in ED 241

### Question 1 to the Board

Does the Board agree with the staff's recommendation to amend AASB 1038 for the changes outlined above?