Accountants and Actuaries Liaison Committee

27 September 2013

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007
AUSTRALIA

Dear Sir

Response to AASB exposure draft ED 244 *Insurance Contracts* ("the ED")

The Accountants' and Actuaries' Liaison Committee ("AALC") is pleased to provide its response to the ED. This response represents the views of the members of the AALC (and not necessarily their employing organisations or professional association).

The AALC is supported by The Institute of Chartered Accountants in Australia and the Institute of Actuaries of Australia. The AALC is primarily concerned with matters affecting both professions, including the development and implementation of accounting standards for the insurance industry. The AALC takes a practical approach to problems, as its members are all practitioners in insurance and related fields.

We are supportive of the move towards international consistency in the accounting for insurance contracts. The AALC continues to support the IASB's proposal to:

- use a current value approach; and
- measure outstanding claims on a basis that reflects the time value of money.

We also acknowledge the significant improvement in the proposals set out in the ED relative to the 2010 exposure draft, particularly with respect to:

- the unlocking of margins for changes in estimates relating to future coverage;
- contract boundaries;
- the treatment of diversification benefits;
- characterisation of the Premium Allocation Approach as an approximation for the Building Block Approach rather than an alternative model; and
- the approach to transition.

We have concerns, however with respect to some aspects of the ED, specifically:

- the mandatory use of other comprehensive income to recognise some, but not all, of the impacts of interest rates on insurance contracts and their supporting assets is likely to result in new accounting mismatches in reported profit; and

- the application of "mirroring" particularly with respect to participating life insurance and investment contracts appears to be unnecessarily complex and may not result in the reporting of useful information.

Further discussion on these matters, together with other detailed comments are provided below in our responses to the specific IASB and AASB questions set out below.

This letter sets out the collective view of the AALC members at the date of drafting. The proposals set out in the ED are complex and further issues may emerge as the proposals are further analysed. We will advise the AASB of any such issues identified.

Answers to Specific Questions - IASB

IASB Question 1 — Adjusting the contractual service margin

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if differences between the current and previous estimates of the present value of future cash flows if:

(a) differences between the current and previous estimates of the present value of future cash flows related to future coverage and other future services are added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative; and

(b) differences between the current and previous estimates of the present value of future cash flows that do not relate to future coverage and other future services are recognised immediately in profit or loss?

Why or why not? If not, what would you recommend and why?

Response

Adjusting the contractual service margin for changes in expected future cash flows

The AALC is supportive of proposal to adjust the contractual service margin for differences between the current and previous estimates of the present value of future cash flows relating to future coverage. Specifically, the proposed approach:

- correctly characterises such changes in estimates as changes in expected future profitability rather than current period gains and losses;
- is more consistent with the approach proposed for other types of revenue in the IASB's exposure draft "Revenue for Contracts With Customers";
- provides a more sensible pattern of profit emergence and
- estimates of future cash flows related to future coverages typically involve a significant element of judgement and therefore we consider it appropriate that such impacts are not capitalised through profit or loss (for profitable contracts).

Changes to the risk margin

The AALC recommends that this approach also be adopted for changes in the risk margin which relate to future coverage. In the view of the AALC, such changes also reflect changes in expected future profitability rather than current year gains and losses. Changes in the expected future cash flows will result in a reassessment of the risk margin and as such the treatment of the risk adjustment needs to match that of the cash flow changes and therefore be reflected as in the contractual service margin.

We understand that there are concerns that it may be difficult to separate risk margins between the component that relate to future coverage and those that do not. In our view, the allocation of the movement in risk margin between these components will be relatively straight forward as an insurer will have already separated changes in expected cash flows that relate to future coverage from other changes in cash flows for the purposes of adjusting the contractual service margin. It would therefore be relatively straight forward to separate the risk margin on the same basis as the expected cash flows.

Where risk adjustment relates to incurred claims then we agree changes should be included in reported profit or loss.

Loss recognition and reversal

The AALC proposes that, for products where the contractual service margin has been exhausted and changes in expected future cash flows have been losses through profit or loss, subsequent changes in expectations which result in a reduction in the value of fulfilment cashflows should be recognised through profit or loss as a reversal of the previously recognised losses. Under this approach, losses and profits are treated symmetrically which is more logical and for this reason it is also more likely to accord with the expectations of account users.

The approach proposed in the Exposure Draft of adjusting the contractual service margin for subsequent improvements in expectations would result in the inclusion an amount in reported profits over a number of periods which is not reflective of current maintainable earnings (relating to the release over time of past capitalised losses).

IASB Question 2 — Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items

If a contract requires an entity to hold underlying items and specifies a link between the payments to the policyholder and the returns on those underlying items, do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if the entity:

- *(a) measures the fulfilment cash flows that are expected to vary directly with returns on underlying items by reference to the carrying amount of the underlying items?*
- *(b) measures the fulfilment cash flows that are not expected to vary directly with returns on underlying items, for example, fixed payments specified by the contract, options embedded in the insurance contract that are not separated and guarantees of minimum payments that are embedded in the contract and that are not separated, in accordance with the other requirements of the [draft] Standard (ie using the expected value of the full range of possible outcomes to measure insurance contracts and taking into account risk and the time value of money)?*
- *(c) recognises changes in the fulfilment cash flows as follows:*
  - *(i) changes in the fulfilment cash flows that are expected to vary directly with returns on the underlying items would be recognised in profit or loss or other comprehensive income on the same basis as the recognition of changes in the value of those underlying items;*

(ii) *changes in the fulfilment cash flows that are expected to vary indirectly with the returns on the underlying items would be recognised in profit or loss; and*

(iii) *changes in the fulfilment cash flows that are not expected to vary with the returns on the underlying items, including those that are expected to vary with other factors (for example, with mortality rates) and those that are fixed (for example, fixed death benefits), would be recognised in profit or loss and in other comprehensive income in accordance with the general requirements of the [draft] Standard?*

Why or why not? If not, what would you recommend and why?

Response

We agree with the principle that, for contracts which require the entity to hold underlying items and specify a link to returns on those underlying investments, the accounting basis should be consistent for the contract and the underlying items so as to avoid accounting mismatches.

Whilst the approach of "mirroring" the accounting for the underlying items provides a conceptual solution to this problem, it is complex to apply in practice and may not achieve a sensible outcome. This is particularly the case in respect of:

- products backed with a mixture of simple debt instruments, complex debt instruments and assets which are not financial instruments;
- participating products; and
- situations where the underlying item is an equity or debt instrument issued by an entity within the same consolidated group.

Part of this complexity arises from the diversity of accounting treatments allowed for supporting assets, particularly due to the proposal to introduce a "fair value through other comprehensive income" category into IFRS 9 *Financial Instruments*.

Under the proposal, a single portfolio of insurance contracts, could end up with the following accounting treatments within its insurance contract liability balance:

- Linked component to the extent backed by complex debt instruments and investment properties at fair value profit or loss;
- Linked component to the extent backed by simple debt instruments at fair value through other comprehensive income using the effective interest rate on the backing assets;
- Linked component to the extent backed by assets held at cost (such as controlled private equity investments) on the accounting bases applying to individual assets;
- Other components, such as surrender options measured at expected values with changes offset against the contractual service margin;
- Unwind of discount on components not linked to underlying assets at the discount rate on inception of the contracts.

In the AALC's view, the complexity of this approach makes it unsatisfactory, despite its conceptual appeal.

Further complications may arise on consolidation. The situation is likely to arise where, while the insurer is required to hold underlying items, these underlying items may be investments in or balances with entities that are consolidated into the same group. In such circumstances, mirroring will be applied by the insurer in its stand-alone accounts, but not on consolidation. We have already identified this as a problem where the underlying item is a deposit with a bank or an investment vehicle that is consolidated into the same consolidated group.

The AALC further notes that accounting mismatches for life insurers also arise on investment contracts which are outside the scope of insurance contracts as defined in the ED and are therefore treated as financial instruments. As "mirroring" is not included within IFRS 9, the proposal to implement it for Insurance Contracts will result in an inconsistent approach between these two standards and accounting mismatches arising on investment contracts will continue to arise.

The AALC recommends that, as a principle, accounting mismatches are best addressed by achieving consistency between the measurement approaches of standards rather than by exceptions within the standards. In this instance, the reduction in accounting mismatch would be very easily achieved by requiring (or at least allowing) fair value through profit or loss measurement for both the asset and liability.

With respect to participating products, the AALC supports the proposal put forward by the IASB staff to the December 2012 meeting of the IASB that the contractual service margin for participating contracts is adjusted for changes in the value of the premiums by adjusting the margin for changes in the value of the underlying items as measured using IFRS. In our view this approach is more aligned to with the service provided by the insurer to the policyholder through the payment of bonuses over time.

The AALC further recommends that, to ensure consistency between the standards, if mirroring is introduced for insurance contracts, that mirroring also be introduced for financial liabilities within the scope of IFRS 9 which have a similar link to underlying items.

Furthermore, if mirroring is achieved for the insurer on a stand-alone basis, this treatment should continue on consolidation, even where the underlying asset is consolidated. In such cases the measurement of the insurance contract should be adjusted to align with the treatment of the underlying assets on consolidation.

IASB Question 3 — Presentation of insurance contract revenue and expenses

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if, for all insurance contracts, an entity presents, in profit or loss, insurance contract revenue and expenses, rather than information about the changes in the components of the insurance contracts?

Why or why not? If not, what would you recommend and why?

Response

The AALC agrees that the presentation in profit or loss of an entity's insurance contract revenue and expenses more adequately represents the entity's financial performance and the economic reality of the underlying products than a summarised margin approach. The AALC supports the inclusion of a measure of premium revenue and claims expense on the face of the income statement.

However, we note some omissions and inconsistencies in the approach taken by the IASB to appropriately define the revenue and expenses and the related balance sheet amounts insofar as they relate to general insurance business applying the simplified approach set out in paragraphs 38-40.

These inconsistencies are discussed further below.

Inconsistency relating to premium recognition

Under the premium allocation model, the measurement of the liability is made with reference to the premium received but excluding premium written but not yet received. This approach results in a liability for future coverage which is largely driven by the pattern of premium receipts and costs paid. This is a cash rather than accruals concept of accounting and which results in a different outcome for policies which are economically identical and which are sold as identical products but for which the cash payments may differ.

In many classes of general insurance business it is common to have different payment options which drive only the timing of cash receipts and not the economics of the policy sold. The current, and generally accepted, approach is to determine an unearned premium based on the total gross written premium, including business for which the entity has accepted risk but where final terms and conditions are being negotiated or business is simply not yet processed and the business has therefore not yet closed ("unclosed business").

Estimation of unclosed business is a significant and highly relevant aspect of determining all contractual obligations that an insurer is exposed to. We believe there is significant value to users of financial statements in being able to identify a liability for future coverage which includes all expected premium within the contract boundary rather than a more volatile balance sheet amount that fluctuates based on a pattern of premium receipts.

In addition, the recognition of gross written premium is essential for enabling adequate and timely credit control management of premium collection and control over the period premium is held which is a driver of insurance profitability.

The AALC proposes that paragraph 38 be reworded to refer to expected premiums and acquisition costs rather than those received or paid.

Reinsurance presentation and disclosure

Paragraphs 54 and 55 require separate disclosure of insurance and reinsurance assets and liabilities. In addition, paragraph 63 prevents any offsetting of insurance and reinsurance income or expense. This would imply that the risk adjustment needs to be separately calculated for gross claims and reinsurance recoveries. However, the risk adjustment can only logically be calculated on a net of reinsurance basis to reflect the reinsurance as a risk mitigant.

Risk adjustments typically reflect the variability of the underlying insurance contract/portfolio or reinsurance contract/portfolio held. Mathematically, variability measures cannot be simply added together (e.g. the sum of the 90th percentile of two random variables X and Y is not equal to the 90th percentile of the random variable X+Y). Hence summing the risk adjustments for insurance contracts and reinsurance contracts held yields a total risk adjustment that may be inappropriate given the variability of the total risk presented (i.e. the insurance contract along with reinsurance contracts acting as a risk mitigant) and the insurer's overall risk tolerance (of which it is the residual risk that is important, that is the total risk presented after allowing for risk mitigants like reinsurance).

The AALC recommends that the IASB clarify that the risk adjustment covers the insurance contracts risk after allowing for offsetting impact of the reinsurance contracts.

IASB Question 4 — Interest expense in profit or loss

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if an entity is required to segregate the effects of the underwriting performance from the effects of the changes in the discount rates by:

- *(a) recognising, in profit or loss, the interest expense determined using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows; and*
- *(b) recognising, in other comprehensive income, the difference between:*
  - *(i) the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date; and*
  - *(ii) the carrying amount of the insurance contract measured using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows?*

Why or why not? If not, what would you recommend and why?

AALC Response

The AALC does not support the proposal to allocate changes in insurance liabilities between profit or loss and other comprehensive income.

We understand that the aim of the IASB's proposal to present changes in the carrying amount of insurance contracts through other comprehensive income (OCI) was to disaggregate and separately present components of the entity's performance that have arisen as a result of changes to market variables during the period.

While we are supportive of this aim, the IASB's proposal will only present useful information on economic mismatches in limited circumstances, namely:

- All assets supporting the liabilities are recognised at fair value through OCI, and
- Assets supporting the liabilities are not purchased or sold after initial recognition of the liability, and
- There is no link between the liabilities and underlying rates of inflation.

In other circumstances, the IASB's proposal will not provide meaningful information to the users of the financial statements. Specifically:

- Accounting mismatches will arise for any liabilities that are supported by assets which are recognised at fair value through profit or loss. Such assets include derivatives, investment property and complex debt instruments.

These are commonly used by Australian insurers to support long term liabilities and to match asset portfolio durations to insurance liability where real assets of sufficient duration are not available.

- Accounting mismatches will arise where assets supporting the liabilities may be sold or mature during the period and the proceeds reinvested. The proceeds from the sale of an asset used to support the liabilities will be recognised in profit or loss with no corresponding change in liabilities, creating an accounting mismatch even though there has been no overall change in the entity's economic position. The effective interest rate on the asset will be the effective interest rate on the new instrument which will have been set at a different point in time (and potentially different interest rate environment) to the liability that it backs. In addition, for multi-premium policies, assets supporting the liabilities are progressively purchased, as those premiums are received. This would also result in movements in the profit or loss statement with no corresponding change in the liabilities and a further accounting mismatch.
- Accounting mismatches will arise where the liabilities are affected by the underlying rate of inflation. Underlying rates of inflation are closely linked to nominal interest rates. However, under the IASB's proposals, the impact of changes to the liabilities resulting from changes in nominal rates will be presented in OCI whereas changes to the liabilities resulting from changes in underlying inflation will be presented in the profit or loss statement. This presentation will be misleading to users as the profit or loss statement will imply that the liabilities are more sensitive to inflation than they in fact are because any offsetting impacts due to the impact of inflation on nominal interest rates will be presented in OCI.
- The use of policy inception date interest rates to discount expected cash flows that emerge from the discovery of unexpected latent claims from coverage provided in prior periods would be difficult to apply and does not provide information that is relevant to users.

In addition, we believe the IASB's current proposals will add significant complexity for preparers of the financial statements, and the cost of this complexity exceeds any benefits. In particular we highlight the following key concerns:

- The IASB proposes to require the use of 'locked-in' interest rates to accrete interest on insurance liabilities for presentation in the profit or loss statement, where the yield curve is locked in at initial recognition. This will likely require entities to record successive yield curves and associate them with the related insurance contracts. This will require significant modification to existing systems and processes in order to identify and maintain the required records. We believe that the information on discount rates that existed at the date of writing a contract is irrelevant to the users of the financial statements. In our view, interest should be accreted on insurance liabilities at current interest rates, consistent with the IASB's current value model.
- On transition, the requirement to ascertain and apply discount rates applicable at initial recognition for each insurance contract is likely to be impracticable, particularly for older contracts. We also note that, for conglomerate groups that have acquired insurers, the date of initial recognition will be the date of policy inception for the insurance entity and date of acquisition for the financial statements of the consolidated group. This will result in different performance outcomes (between entity and consolidated group) over the remaining life of the policies.

Consistent with a current measurement approach, the AALC believes that changes in the carrying amounts of insurance contracts, and the fair value of assets supporting them, should be recognised through profit or loss.

We further note that the IASB has not developed its contractual framework with respect to the use of OCI. The AALC is of the view that it is not prudent to allocate further amounts to other comprehensive income until such time that the IASB develops a framework for its use.

The AALC notes that, notwithstanding the issues discussed above, there is strong support from some European insurers for the use of OCI (although this support is far from universal). We encourage the IASB to be global in its thinking and work towards a model that will provide a sensible accounting outcome across different jurisdictions and business models. To that end, if the use of OCI is to be maintained, then the AALC proposes that:

- changes to the carrying amount of insurance liabilities be recognised through profit or loss as the primary approach, with an option for each portfolio to recognise these changes through OCI where:
  - all assets supporting the liabilities are recognised at fair value through OCI;
  - the insurer has a business model where assets supporting the liabilities are not normally purchased or sold after initial recognition of the liability; and
  - there is no link between the liabilities and underlying rates of inflation; and
- amounts recognised in OCI be based on the difference between current interest rates and interest rates applicable the start of the reporting period rather than the interest rate at inception of the contract.

If this alternative is adopted, the accounting treatment for the supporting financial assets under IFRS 9 would be determined by the approach adopted for the insurance contracts and not at the discretion of the insurer. Under the requirements of IFRS 9:

- if changes in insurance contracts are recognised through profit or loss, the supporting assets would be required to be measured at fair value through profit or loss so as to avoid an accounting mismatch; and
- if the impact of changes in discount rates are taken to OCI, measuring the assets of fair value through profit or loss would not remove an accounting mismatch and therefore would be not available if the assets met the criteria for measurement at fair value through OCI.

IASB Question 5 — Effective date and transition

Do you agree that the proposed approach to transition appropriately balances comparability with verifiability?

Why or why not? If not, what do you suggest and why?

Response

The AALC is supportive of the fully retrospective approach which is expected to allow meaningful consisted information to be reported post transition and addresses the concerns raised with respect to the proposal in the previous exposure draft to set the residual margins to zero at transition.

The AALC also supports the explicit allowance for the use of a practical expedient where the full retrospective application is impracticable.

The AALC expects that a period of 3 years from the standard's publication is a reasonable length of time to prepare for transition. We recommend, however that the IASB align the dates of application of IFRS 9 and IFRS 4, or, if this is not possible, allow insurers to delay the application of IFRS 9 until they can apply the insurance contracts standard.

The AALC also recommends that the IASB clarify that an entity is not required to reopen accounting for business combinations involving insurance contracts where the application of IFRS 1 *First Time Adoption of International Financial Reporting Standards* or the transition requirements of IFRS 3 *Business Combinations* do not require the business combination to be accounted for in accordance with the current version of IFRS 3.

IASB Question 6 — The likely effects of a Standard for insurance contracts

Considering the proposed Standard as a whole, do you think that the costs of complying with the proposed requirements are justified by the benefits that the information will provide? How are those costs and benefits affected by the proposals in Questions 1–5?

How do the costs and benefits compare with any alternative approach that you propose and with the proposals in the 2010 Exposure Draft?

Please describe the likely effect of the proposed Standard as a whole on:

- *(a) the transparency in the financial statements of the effects of insurance contracts and the comparability between financial statements of different entities that issue insurance contracts; and*
- *(b) the compliance costs for preparers and the costs for users of financial statements to understand the information produced, both on initial application and on an ongoing basis.*

Response

Costs

The requirement to calculate interest amounts based on discount rates at inception of contracts is expected to require significant investment in systems and processes. This requirement will result in the proposals set out in the ED being more costly to implement than those set out in the previous exposure draft.

In the view of the AALC, the interest rate at inception of a contract is irrelevant for the purpose of economic decisions that may be made using the financial statements of an insurer and accordingly there is minimal benefit to justify the cost of tracking this information. The AALC has proposed an alternative approach in our response to question 4 above.

The AALC also anticipates that there will be a significant one-off cost in performing the retrospective adjustments on transition to the new standard. This cost is driven in part by the complexity of the proposals set out in the ED and will be reduced if our our proposals set out in response to the other questions above are adopted.

Differing note requirements for BBA and PAA

It is expected that for many insurers who adopt the premium allocation approach (PAA), there will be some products that do not meet the criteria for applying PAA and therefore be accounted for under the building block approach (BBA).

Given that the PAA purports to be an approximation of the BBA we do not see the relevance of the additional disclosure notes for BBA included in paragraph 81. Requiring additional disclosures for portfolios accounted for under the BBA is likely to give undue prominence to these portfolios compared to those accounted for under PAA.

The AALC proposed that disclosures be aligned across PAA and BBA methodologies.

IASB Question 7 — Clarity of drafting

Do you agree that the proposals are drafted clearly and reflect the decisions made by the IASB?

If not, please describe any proposal that is not clear. How would you clarify it?

Response

Unit of Account

The ED alternates between the contract and the portfolio being the proposed unit of account. For instance:

- at paragraph 18 the ED outlines the initial accounting for an insurance *contract* as the sum of its fulfilment cash flows plus a contractual service margin yet at paragraph 22 the fulfilment cash flows are defined as those which relate directly to the fulfilment of the *portfolio* of contracts; and
- at paragraph 28, the ED requires consideration of whether the contract is onerous at a *portfolio* level before considering the fulfilment cash flows at a contract level in order to determine the contractual service margin for the *contract*.

The AALC recommends that the wording in the ED be modified to achieve consistency of unit of accounting. We propose consistent use of portfolio as the unit of account for the risk margin and contractual service margin.

Risk Adjustment

The ED appears inconsistent between the intention of the risk margin in the black letter of the draft standard and the Application Guidance.

At paragraph 22(a), the ED defines the intention of the risk margin as adjusting for "the effects of uncertainty about the amount and timing of those cash flows". In other words, the risk adjustment is designed to address estimation risk in the future cash flows.

The definition and guidance material for the risk adjustment, however, are drafted to allow consideration of broader issues than just estimation uncertainty when measuring the risk adjustment. Indeed, by measuring the risk adjustment as the level of compensation the entity requires to make it indifferent between fulfilling the insurance contract liability and a fixed liability, the ED introduces a quasi fair value measure for insurance liabilities.

In order to determine the level of compensation it requires for bearing risk, an entity would necessarily also need to consider matters such as:

- its risk appetite
- the relevant capital intensity of each portfolio,
- the timeframe over which that capital will be required to held for each portfolio and alternative uses to which that capital could be deployed within the entity.

While the proposed risk adjustment does convey information about the entity's perception of estimation uncertainty, it also reflects these non-estimation risk aspects of the underlying products which are unique to each product and entity. We believe these additional aspects of risk will distort the risk adjustment and jeopardise comparability of results across entities and jurisdictions, and possibly across portfolios or reporting periods within the single entity.

The AALC believes that the disclosure of a single probability of adequacy at an entity level by itself does not remedy this issue, as the risk adjustment would be required to be set at differing confidence levels across each portfolio having regard to these extraneous matters.

The AALC recommends a simplified approach which restricts the considerations relevant to the measurement of the risk adjustment to only the estimation uncertainty in the future cash flows. In Australian non-life insurance the probability of adequacy concept has proved an effective mechanism for financial reporting as it takes into account only the estimation uncertainty in the future cash flows.

Contract Boundary

The AALC acknowledges the improvements made in drafting the contract boundary, compared to the 2010 exposure draft. The 2010 exposure draft would have seen private health insurance contracts classified as long term contracts, given restrictions on risk selection and pricing at an individual policyholder level.

The recognition of repricing at a portfolio level goes a long way to addressing this classification issue, and should allow an appropriate recognition of private health insurance and like contracts as short duration risks. However, we believe the wording of the ED could be enhanced to recognise the ongoing regulatory requirement for government approval of price changes in private health insurance, compulsory third party (CTP) car insurance and similar classes. This pricing approval has regard both to financial sustainability of underwriters and consumer affordability.

The AALC recommends a modified wording at paragraph 23(b)(i) as follows:

> *The entity has the right or the practical ability to reassess the risk of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio. <u>A requirement to obtain regulatory approval for price and benefit changes does</u>*

not, of itself, disprove the contract boundary. Other considerations may include the ability to reprice to achieve rates of return consistent with other issuers of like portfolios.

Answers to Specific Questions - AASB

AASB question 1

Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

(a) not-for-profit entities; and

(b) public sector entities, including any GAAP/GFS implications;

Response

The AALC have not identified any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, other than the matter discussed with respect to contract boundaries discussed in response to the IASB's question 7 set out above.

AASB question 2

Whether, overall, the proposals would result in financial statements that would be useful to users

Response

The AALC has concerns with respect to some aspects of the ED, specifically:

- the mandatory use of other comprehensive income to recognise some, but not all, of the impacts of interest rates on insurance contracts and their supporting assets is likely to result in new accounting mismatches in reported profit; and
- the application of "mirroring" particularly with respect to participating life insurance and investment contracts appears to be unnecessarily complex and may not result in the reporting of useful information.

Further discussion on these matters, together with other detailed comments are provided below in our responses to IASB questions 2 and 4 set out above.

AASB question 3

Whether the proposals are in the best interests of the Australian economy

Response

The AALC has concerns with respect to some aspects of the ED, as noted in our responses to the earlier questions. In the event that these are not resolved, however, it is still likely to be in the interest of the Australian economy to adopt the final IASB standard.

AASB question 4

Unless already provided in response to specific matters for comment 1 – 3 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative.

Response

In the view of the AALC, although there are significant improvements that may be made to the proposals set out in the ED, it is imperative that this project be brought to a close, a final standard issued and insurers move from local standards to an a consistent international approach.

Conclusion

This response reflects the nature and practical focus of the AALC. In this context we note that the comments and opinions set out in this response reflect the consensus views of the members of the AALC, and may not necessarily reflect the view of The Institute of Chartered Accountants in Australia, the Institute of Actuaries of Australia, nor the members' respective employers.

The current members of the AALC are:

Andrew Kitchen - Insurance Australia Group
Andrew Reeves - KPMG
Anne Driver - QBE
Brendan Counsell - EY
Declan Moore - QBE
Graham Duff - AMP
Kerry Hicks - Institute of Chartered Accountants in Australia
Mark Thompson – Hannover Life Re of Australasia
Michael Dermody - KPMG
Paul Harris - EY
Scott Hadfield - PricewaterhouseCoopers
Stuart Alexander - Deloitte
Tim Furlan - Russell Investment Group

Yours faithfully

Graham Duff
Chairman