Department of Treasury and Finance

1 Treasury Place
GPO Box 4379
Melbourne Victoria 3001
Telephone: (03) 9651 5111
Facsimile: (03) 9651 2062
DX 210759

9 NOV 2010

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
COLLINS ST WEST VIC 8007

Dear Mr Stevenson

ED 201 Insurance Contracts

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on the International Accounting Standards Board (IASB) Exposure Draft: *Insurance Contracts*.

HoTARAC commends the IASB's efforts in drafting a single consistent and comprehensive international Standard on insurance contracts. HoTARAC is generally supportive of the proposed requirements; in particular, the move away from an 'exit value' measurement to a 'fulfilment' method is a step in the right direction. However, HoTARAC does have a concern with the degree of subjectivity that is established through the application of the dual-margin approach.

HoTARAC would like the AASB to recommend to the IASB to review the required disclosures as to whether they meet users' needs and are not considered excessive, particularly, in a principle-based standard. HoTARAC is of the view that the level of disclosure should recognise and reflect the differences in the risk factors between core and non-core insurance product providers.

Comments by HoTARAC on questions from the exposure draft are attached.

If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Australian Department of Finance and Deregulation on 02 6215 3551.

Yours sincerely

Grant Hehir
CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE
9 November 2010

Victoria
The Place To Be

Contact: Batisha Perzhaku
Phone: (03) 9651 5524
Our Ref: D10/439803

HoTARAC Response to AASB ED 201 *Insurance Contracts*

AASB Specific Matters for Comment

The AASB would particularly value comments on whether:

(a) 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:

(i) not-for-profit entities; and

(ii) public sector entities.

(i) No comment.

(ii) HoTARAC supports the replacement of the Discussion Paper's proposed 'current exit value model' with the 'current fulfilment model'. The issue of estimating the timing of payments and determining a discount rate for non-life contracts was raised with regards to the discussion paper proposals and continues to be of concern. Additionally, the following issues are expected to have a significant impact on public sector insurers:

- The acquisition costs concept – HoTARAC foresees problems in aligning costs to individual contracts (one of our insurance providers has highlighted this to be a potentially significant issue); HoTARAC would prefer such alignment to be performed at portfolio level.
- The dual-risk margin – HoTARAC supports the less subjective and simpler approach of a single composite margin as proposed by FASB.
- Extensive disclosure required.

These issues may also impact the private sector; however, HoTARAC considers that they are of a greater concern to the public sector.

Additionally, HoTARAC anticipates potential difficulties in applying the draft IFRS to financial guarantee contracts that are granted without any consideration or premium, which is often the case in government. It is not clear how the draft IFRS would apply in such circumstances.

(b) overall, the proposals would result in financial statements that would be useful to users.

HoTARAC considers that the proposed amendments to the financial statements of entities that are not insurance companies (but still have contracts that would be accounted for under

Contact: Batisha Perzhaku
Phone: (03) 9651 5524
Our Ref: D10/439804

HoTARAC Response to IASB ED 2010/8 *Insurance Contracts*

IASB Invitation to comment

Measurement (paragraphs 16–61, B34–B110 and BC45–BC155)

Measurement model (paragraphs 16–53 and BC45–BC144)

Question 1 – Relevant information for users (paragraphs BC13–BC50)

Do you think that the proposed measurement model will produce relevant information that will help users of an insurer's financial statements to make economic decisions? Why or why not? If not, what changes do you recommend and why?

HoTARAC disagrees in part.

HoTARAC views having a single measurement model as proposed is beneficial for all types of insurance contracts and is an improvement from the proposed method in the Discussion Paper. However, HoTARAC considers that the model is very subjective and requires an insurance contract liability/asset to be measured applying the dual-margin approach and using a range of scenarios.

Given there are many assumptions that need to be made, this could lead to manipulation, and hence, is likely to impair comparability. Therefore, HoTARAC does not consider the model to produce relevant information, particularly, regarding the risk adjustment and the residual margin, which are both in our view arbitrarily calculated and thus notional amounts.

Question 2 – Fulfilment cash flows (paragraphs 17(a), 22–25, B37–B66 and BC51)

(a) Do you agree that the measurement of an insurance contract should include the expected present value of the future cash outflows less future cash inflows that will arise as the insurer fulfils the insurance contract? Why or why not? If not, what do you recommend and why?

HoTARAC regards the proposed measurement model to be an improvement from the 'current exit value' model that was proposed in the Discussion Paper. However, as discussed further in response to questions 3(b), 4, 5(a), (d), 6(c), (f) and 7 below, HoTARAC has concerns with the methodology of the incremental acquisition costs, the discount rate, and the dual-risk margin.

Additionally, HoTARAC disagrees with the view that the Present Value of the Fulfilment Cash Flows is made up of the 'full range of possible outcomes' (paragraph B38); HoTARAC did not support a similar approach taken in ED 2010/1 *Measurement of Liabilities in IAS 37.*

Contact: Batisha Perzhaku
Phone: (03) 9651 5524
Our Ref: D10/439804

While most other standards prescribe a 'reasonable' range of possible options (including the proposed accounting standard on Leases – refer ED 2010/9 *Leases*), expecting entities to calculate the full range of options is excessive. HoTARAC considers a 'standard deviation' approach to be more suitable.

(b) Is the draft application guidance in Appendix B on estimates of future cash flows at the right level of detail? Do you have any comments on the guidance?

HoTARAC is of the opinion that the draft application guidance on the estimates of future cash flows (paragraphs B37-B66) is at the appropriate level of detail.

Additionally, HoTARAC would like to note that it regards the measurement examples in Appendix B to be reasonably basic but useful. However, the first measurement example should involve a connection between building block (a) 'expected value of the future cash outflows less the future cash inflows' and building block (b) 'discount rate' as outlined in paragraph 22 of the draft IFRS.

Question 3 – Discount rate (paragraphs 30–34 and BC88–BC104)

(a) Do you agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability? Why or why not?

HoTARAC agrees.

HoTARAC is of the opinion that, given there is no asset directly included in such contracts, the discount rate should reflect the liability and not the assets backing that liability.

(b) Do you agree with the proposal to consider the effect of liquidity, and with the guidance on liquidity (see paragraphs 30(a), 31 and 34)? Why or why not?

HoTARAC has concerns in relation to distinguishing illiquidity and credit risk. HoTARAC considers this to be a subjective approach given that the IASB has not provided adequate guidance. This is emphasised by the recent credit crisis, which has highlighted the difficulty in distinguishing between illiquidity and credit risk within market prices. Given the issue, it would be appropriate for IASB to provide guidance on this matter.

Contact: Batisha Perzhaku
Phone: (03) 9651 5524
Our Ref: D10/439804

(c) *Some have expressed concerns that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts. Are those concerns valid? Why or why not? If they are valid, what approach do you suggest and why? For example, should the Board reconsider its conclusion that the present value of the fulfilment cash flows should not reflect the risk of non-performance by the insurer?*

HoTARAC supports the proposed discount rate (refer to our response to question 3 (a) above).

Question 4 – Risk adjustment versus composite margin (paragraphs BC105–BC115)

Do you support using a risk adjustment and a residual margin (as the IASB proposes), or do you prefer a single composite margin (as the FASB favours)? Please explain the reason(s) for your view.

HoTARAC supports the Board's conclusion that the Present Value of the fulfilment cash flows should not reflect the risk of non-performance by the insurer and thus should not be reconsidered.

The majority of HoTARAC supports the single composite margin.

Mainly on the basis of subjectivity, the composite margin as proposed by the FASB is less subjective and less open to management manipulation than the dual-margin approach proposed by the IASB; in this regards, HoTARAC agrees with Alternative View AV2.

As discussed in response to question 5 below, the risk adjustment component of the dual-margin approach assumes that there is a market for such risk and through the use of one of the three permitted techniques places an artificial price (liability) on relieving that risk. This concept assumes an 'exit value' and is inconsistent with the ED's proposed model.

It is also difficult to apply if the entity is the insurer of last resort as it is often the case for government insurers. Further, considerable judgement will have to be used by the insurer to determine the most appropriate technique, out of the three methods allowed, for the risk adjustment calculation. Additionally, the IASB's proposed risk adjustment can create a notional loss position.

A HoTARAC minority supports a modified version of the single composite margin involving an annual reassessment of the composite margin.

Contact: Batisha Perzhaku
Phone: (03) 9651 5524
Our Ref: D10/439804

If the Board was to proceed with the dual-margin approach, HoTARAC provides the following comments:

Question 5 – Risk adjustment (paragraphs 35-37, B67-B103 and BC105–BC123)

(a) *Do you agree that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected? Why or why not? If not, what alternatives do you suggest and why?*

HoTARAC disagrees (refer response to question 4).

The proposal assumes that the insurer can be relieved of the risk and that there is a market for such contracts, which, HoTARAC considers, would not always be the case. Additionally, legislative requirements may restrict insurers from transferring such risk.

(b) *Paragraph B73 limits the choice of techniques for estimating risk adjustments to the confidence level, conditional tail expectation (CTE) and cost of capital techniques. Do you agree that these three techniques should be allowed, and no others? Why or why not? If not, what do you suggest and why?*

No comment.

(c) *Do you agree that if either the CTE or the cost of capital method is used, the insurer should disclose the confidence level to which the risk adjustment corresponds (see paragraph 90(b)(i))? Why or why not?*

If the IASB dual-margin approach is adopted, HoTARAC agrees with the disclosure, provided such disclosure is simple, straight-forward and understandable.

Given that the confidence level is used in the formulation for both of these methods (per application guidance paragraphs B81 and B86), HoTARAC does not consider there would be an issue with such disclosure if the technique used is disclosed as well. HoTARAC also views that such disclosure would assist in comparability, subject to the same method being adopted consistently year-on-year.

Contact: Batisha Perzhaku
Phone: (03) 9651 5524
Our Ref: D10/439804

(d) *Do you agree that an insurer should measure the risk adjustment at a portfolio level of aggregation (i.e. a group of contracts that are subject to similar risks and managed together as a pool)? Why or why not? If not, what alternative do you recommend and why?*

HoTARAC would like the Board to note that this response also responds to question 6(c).

HoTARAC disagrees with portfolio level aggregation for the risk measurement under the dual-margin approach.

HoTARAC has concerns with regards to the determination of risk margins without including diversification benefits between portfolios of insurance contracts, given that diversification assists mitigating risks and therefore is useful information to be provided to users to improve their decision-making. For that reason, HoTARAC prefers an approach consistent with current Australian requirements which take into account the diversification benefits between portfolios of insurance contracts (refer AASB 1023 *General Insurance Contracts* paragraph 5.1.7).

(e) *Is the application guidance in Appendix B on risk adjustments at the right level of detail? Do you have any comments on the guidance?*

HoTARAC considers the application guidance to be at the right level of detail to identify the most suitable technique to the preparers. However, this does not overcome the issue of subjectivity of the notional nature of the risk adjustment and the considerable judgement that is required in choosing which technique to apply.

Question 6 – Residual/composite margin (paragraphs 17(b), 19–21, 50–53 and BC124–BC133)

HoTARAC notes that both residual and composite margins are notional figures and are profit oriented concepts as they attempt to deal with profit loading, which is less relevant for Not-For-Profit entities.

(a) *Do you agree that an insurer should not recognise any gain at initial recognition of an insurance contract (such a gain arises when the expected present value of the future cash outflows plus the risk adjustment is less than the expected present value of the future cash inflows)? Why or why not?*

HoTARAC agrees that day one gains should not be recognised. HoTARAC is of the view that profit at inception should only be recognised if a reliable and robust risk margin has been incorporated into the valuation; however, as stated in response to question 4, HoTARAC regards the dual-margin to be subjective.

Contact: Batisha Perzhaku
Phone: (03) 9651 5524
Our Ref: D10/439804

(b) *Do you agree that the residual margin should not be less than zero, so that a loss at initial recognition of an insurance contract would be recognised immediately in profit or loss (such a loss arises when the expected present value of the future cash outflows plus the risk adjustment is more than the expected present value of future cash inflows)? Why or why not?*

HoTARAC has similar concerns to question 6(a) in regards to a reliable and robust risk margin.

(c) *Do you agree that an insurer should estimate the residual or composite margin at a level that aggregates insurance contracts into a portfolio of insurance contracts and, within a portfolio, by similar date of inception of the contract and by similar coverage period? Why or why not? If not, what do you recommend and why?*

Refer to HoTARAC's response to question 5(d). Additionally, HoTARAC believes that the level of aggregation for the residual margin adds another layer of complexity in requiring contracts with similar inception dates and similar coverage periods within a portfolio to be aggregated.

(d) *Do you agree with the proposed method(s) of releasing the residual margin? Why or why not? If not, what do you suggest and why (see paragraphs 50 and BC125–BC129)?*

To some extent, HoTARAC agrees.

Generally this issue, which deals with profit loading, would have no impact on not-for-profit entities. However, HoTARAC would like to note that the application of this concept may have some implication on the method for revenue recognition for insurance providers within the public sector.

HoTARAC supports straight-line amortisation, as this method may often reflect the fact that insurers provide their service over a certain period. However, HoTARAC could support using the pattern of expected timing of incurred claims and benefits when this approach better reflects the insurer's risk exposure pattern. HoTARAC considers guidance is required on this matter.

HoTARAC is concerned with the Board's discussion on the releasing of the residual margin in BC125 – BC129. Specifically, BC125(e) implies that non-performance risk is a factor of the residual margin, which is inconsistent with the ED's proposal in paragraph 38. If this was

Contact: Batisha Perzhaku
Phone: (03) 9651 5524
Our Ref: D10/439804

the case, HoTARAC would be concerned that the release of the residual margin was based on the entity's performance (BC127) as this could lead to management manipulation.

(e) *Do you agree with the proposed method(s) of releasing the composite margin, if the Board were to adopt the approach that includes such a margin (see the Appendix to the Basis for Conclusions)? Why or why not?*

HoTARAC broadly agrees, on the basis of the reduction in the insurer's risk exposure.

HoTARAC notes the difference between the IASB and FASB in terms of the amortisation period, i.e. IASB prescribes coverage period while FASB prescribes coverage period and claims handling period. HoTARAC considers that this could have an impact on revenue recognition. If the Board was to proceed with the composite margin approach, the Board should clarify the relevant period; that is, whether it includes both the coverage period and the claims handling period.

In addition, HoTARAC considers the formula approach adds an unnecessary layer of complexity to releasing the margin and would prefer the straight-line amortisation method (refer response to question 6 (d)).

(f) *Do you agree that interest should be accreted on the residual margin (see paragraphs 51 and BC131–BC133)? Why or why not? Would you reach the same conclusion for the composite margin? Why or why not?*

HoTARAC disagrees with the accretion of interest on the residual margin. In that respect, HoTARAC supports the views of FASB and considers the issue to be too complex.

However, HoTARAC does not agree with FASB in regards to the residual margin being 'deferred credit' (BC 133 and Appendix to Basis for Conclusions).

Finally, HoTARAC believes such information would not provide any real benefit to users of financial statements given the notional nature of the residual margin.

Question 7 – Acquisition costs (paragraphs 24, 39 and BC135–BC140)

Do you agree that incremental acquisition costs for contracts issued should be included in the initial measurement of the insurance contract as contract cash outflows and that all other acquisition cost should be recognised as expenses when incurred? Why or why not? If not, what do you recommend and why?

HoTARAC broadly agrees.

Contact: Batisha Perzhaku
Phone: (03) 9651 5524
Our Ref: D10/439804

However, HoTARAC considers that as a practical matter, it could be difficult for some insurers to link costs to specific contracts. Where the relationship cannot be reasonably estimated, costs that should be capitalised will be expensed, which would not faithfully represent the transactions.

An alternative method could be to identify administration and overhead costs, which would be expensed consistent with the ED proposals, and the remaining costs would be capitalised.

Also, HoTARAC questions the appropriateness of immediately expensing costs when there is no clear linkage to the individual contract but which would not have been incurred if the portfolio of such contracts did not exist. HoTARAC regards this to be inconsistent with the proposed 'portfolio level' approach, given that most of the other components of the proposed measurement model are performed at portfolio level.

HoTARAC is of the opinion that the proposed approach differs considerably from the existing Australian practice of capitalising acquisition costs and expensing them over the contract period. Additionally, if the proposed approach is adopted, entities will need to adopt new systems to capture the data to distinguish costs between individual contracts, which will increase the cost of implementing the ED. HoTARAC would prefer the approach adopted in Australia at portfolio level.

Short-duration contracts (paragraphs 54–60 and BC145–BC148)

Question 8 – Premium allocation approach

(a) *Should the Board (i) require, (ii) permit but not require, or (iii) not introduce a modified measurement approach for the pre-claims liabilities of some short-duration insurance contracts? Why or why not?*

HoTARAC prefers (ii).

Given how the draft IFRS is currently worded, to determine if a contract is onerous, the general measurement approach will need to be applied regardless of the contract duration.

Therefore, HoTARAC considers the proposed paragraphs to be flawed, in particular, paragraph 60; and consequently the proposals could create a burden on preparers.

HoTARAC is of the view that there is a need for a modified approach; however, it is inappropriate to then require the unmodified approach to determine if a contract is onerous.

Contact: Batisha Perzhaku
Phone: (03) 9651 5524
Our Ref: D10/439804

(b) Do you agree with the proposed criteria for requiring that approach and with how to apply that approach? Why or why not? If not, what do you suggest and why?

HoTARAC generally agrees.

However, HoTARAC is concerned about the lack of clarity of the proposed criteria in relation to 'coverage period'.

In particular, HoTARAC is uncertain about what would be considered to be the coverage period for reinsurers. Appendix A of the draft IFRS defines coverage period to be 'the period during which the insurer provides coverage for insured events'. This definition is considered to be ambiguous for reinsurance contracts, i.e. is the coverage period of the underlying contract considered to be the coverage period for the reinsurance contract? If that is the case, a reinsurer that commits to reinsure policies written by an insurer in the next twelve months may not meet the short-duration contract criteria.

Cash flows that arise from future premiums (paragraphs 26–29 and BC53–BC66)

Question 9 – Contract boundary principle

Do you agree with the proposed boundary principle and do you think insurers would be able to apply it consistently in practice? Why or why not? If not, what would you recommend and why?

HoTARAC agrees.

Furthermore, the valuation methodology of most Australian government insurers already captures the requirements contained within the boundary principle.

Contact: Batisha Perzhaku
Phone: (03) 9651 5524
Our Ref: D10/439804

Participating features (paragraphs 23, 62–66, BC67–BC75 and BC198–BC203)

Question 10 – Participating features

(a) *Do you agree that the measurement of insurance contracts should include participating benefits on an expected present value basis? Why or why not? If not, what do you recommend and why?*

No comment.

(b) *Should financial instruments with discretionary participation features be within the scope of the IFRS on insurance contracts, or within the scope of the IASB's financial instruments standards? Why?*

HoTARAC agrees that these elements should be within the scope of the financial instruments standards.

HoTARAC supports the views of FASB and considers financial instruments with discretionary participation features are primarily investments rather than insurance contracts.

(c) *Do you agree with the proposed definition of a discretionary participation feature, including the proposed new condition that the investment contracts must participate with insurance contracts in the same pool of assets, company, fund or other entity? Why or why not? If not, what do you recommend and why?*

No comment.

(d) *Paragraphs 64 and 65 modify some measurement proposals to make them suitable for financial instruments with discretionary participation features. Do you agree with those modifications? Why or why not? If not, what would you propose and why? Are any other modifications needed for these contracts?*

As mentioned in our response to question 10(b), HoTARAC is of the view that financial instruments with discretionary participation features should be within the scope of the financial instruments standards.

For that reason, HoTARAC does not support the modification in the proposed insurance contracts standard.

Contact: Batisha Perzhaku
Phone: (03) 9651 5524
Our Ref: D10/439804

Definition and scope (paragraphs 2–7, B2–B33 and BC188–BC209)

Question 11 – Definition and scope

(a) Do you agree with the definition of an insurance contract and related guidance, including the two changes summarised in paragraph BC191? If not, why not?

HoTARAC agrees.

HoTARAC notes that the definition and the related guidance are mostly consistent with IFRS 4 and that the guidance has been strengthened in regards to 'significant insurance risk'. HoTARAC supports the strengthening of the 'significant insurance risk' principle.

HoTARAC would like the IASB to be aware that paragraph B21 is inconsistent with IAS 18 *Revenue* paragraph 20; whereas, the original wording of IFRS 4 paragraph B21 is consistent with IAS 18. HoTARAC considers the original wording from IFRS 4 should be retained in paragraph B21 until the corresponding wording in the current IAS 18 paragraph 20 is replaced.

(b) Do you agree with the scope exclusions in paragraph 4? Why or why not? If not, what do you propose and why?

HoTARAC broadly agrees.

HoTARAC notes that paragraph 4(e) of the draft IFRS excludes from the scope *'fixed-fee service contracts that have as their primary purpose the provision of services, but expose the service provider to risk ...'* and then includes into the scope of the draft IFRS '*insurance contracts in which the insurer provides goods or services to the policyholder to compensate the policyholder for insured events*'.

HoTARAC considers that this scope exclusion is ambiguous because most insurance contracts, generally speaking, are in the nature of fixed-fee (premium) service contracts.

(c) Do you agree that the contracts currently defined in IFRSs as financial guarantee contracts should be brought within the scope of the IFRS on insurance contracts? Why or why not?

HoTARAC does not have an issue with financial guarantee contracts being scoped in, subject to the comments below. However, HoTARAC is concerned that there are no transitional requirements for such contracts.

HoTARAC would like to note that financial guarantee contracts may represent single obligations (i.e. with unique characteristics), so probability weighted assessments of all the

Contact: Batisha Perzhaku
Phone: (03) 9651 5524

possible outcomes would be even more difficult. This is similar to the concerns HoTARAC raised in regards to the ED 2010/1 *Measurement of Liabilities in IAS 37*.

Additionally, HoTARAC foresees potential difficulties in applying the draft IFRS to guarantees that are granted without any consideration or premium. It is not clear how the draft IFRS would apply in such circumstances.

Unbundling (paragraphs 8–12 and BC210–BC225)

Question 12 – Unbundling

Do you think it is appropriate to unbundle some components of an insurance contract? Do you agree with the proposed criteria for when this is required? Why or why not? If not, what alternative do you recommend and why?

HoTARAC considers it appropriate to unbundle some components of an insurance contract.

However, HoTARAC regards the proposed criteria to be vague and therefore supports Alternative View AV9.

HoTARAC is of the opinion that 'closely related' needs to be better defined and the IASB should explain how it would distinguish 'closely related' from 'interdependence'. HoTARAC considers that more guidance is required.

Presentation (paragraphs 69–78 and BC150–BC183)

Question 13 – Presentation

(a) *Will the proposed summarised margin presentation be useful to users of financial statements? Why or why not? If not, what would you recommend and why?*

HoTARAC agrees because it provides better information on the insurer's revenue and the insurance contract liabilities movements.

(b) *Do you agree that an insurer should present all income and expense arising from insurance contracts in profit or loss? Why or why not? If not, what do you recommend and why?*

HoTARAC is uncertain about the usefulness of the requirement to provide detailed reporting as presented in the draft IFRS. This may lead to crowded financial statements.

Contact: Batisha Perzhaku
Phone: (03) 9651 5524

Additionally, HoTARAC views the proposed presentation for the Statement of Comprehensive Income to be unsuitable for entities that are predominantly not insurance companies but still need to account for contracts under the draft IFRS. Therefore, HoTARAC agrees with Alternative View AV1 in relation to the proposed presentation approach, in its current form, being unsuitable for companies where insurance is not the main activity.

In addition, if the Board was to proceed, although noting that the concept of Other Comprehensive Income (OCI) items is yet to be identified, HoTARAC would recommend as a general application that remeasurements be reported as OCI items.

Disclosures (paragraphs 79–97, BC242 and BC243)

Question 14 – Disclosures

(a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?

HoTARAC generally agrees.

However, HoTARAC is of the view that the IASB should consider the differing degree of risk between entities where insurance is core and non-core, and thus the level and type of disclosure required should reflect this.

Therefore, HoTARAC would like the Board to consider, as part of this project, a review of the disclosure requirements to determine if the disclosures meet users' needs and are not excessive.

(b) Do you think the proposed disclosure requirements will meet the proposed objective? Why or why not?

HoTARAC considers the disclosures may be onerous, especially for entities where insurance is not core business.

HoTARAC is also of the view that the disclosure requirements are excessive for a principles-based standard.

Additionally, HoTARAC notes that such disclosures would require some changes to computer applications for certain insurers.

Contact: Batisha Perzhaku
Phone: (03) 9651 5524
Our Ref: D10/439804

(c) *Are there any disclosures that have not been proposed that would be useful (or some proposed that are not)? If so, please describe those disclosures and explain why they would or would not be useful.*

No comment. Australian government actuaries are yet to finalise their review of the impact of the ED's proposals.

Unit-linked contracts (paragraphs 8(a)(i), 71 and 78, Appendix C, and paragraphs BC153–BC155 and BC184–BC187)

Question 15 – Unit-linked contracts

Do you agree with the proposals on unit-linked contracts? Why or why not? If not what do you recommend and why?

No comment.

Reinsurance (paragraphs 43–46 and BC230–BC241)

Question 16 – Reinsurance

(a) *Do you support an expected loss model for reinsurance assets? Why or why not? If not, what do you recommend and why?*

No comment.

(b) *Do you have any other comments on the reinsurance proposals?*

No comment.

Transition and effective date (paragraphs 98–102 and BC244–BC257)

Question 17 – Transition and effective date

(a) *Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?*

HoTARAC considers that the transitional requirement for disclosure about claims development (although 5 years instead of 10) would still be tedious. Otherwise, HoTARAC generally supports the proposed transition requirements.

Contact: Batisha Perzhaku
Phone: (03) 9651 5524
Our Ref: D10/439804

(b) *If the Board were to adopt the composite margin approach favoured by the FASB, would you agree with the FASB's tentative decision on transition (see the appendix to the Basis for Conclusions)?*

HoTARAC supports the composite margin approach. However, HoTARAC disagrees with FASB proposed transitional requirements that provide for the composite margin to be equal to the IASB dual-margin risk adjustment, on the same basis as outlined in our response to question 4.

(c) *Is it necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9? Why or why not?*

HoTARAC is of the opinion that such a response should be left for the joint IASB/FASB Request for Views *Effective Dates and Transition Methods* so that it would also encompass the other proposed accounting standards to be issued (i.e. Revenue from contracts with customers and Leases).

(d) *Please provide an estimate of how long insurers would require to adopt the proposed requirements.*

HoTARAC considers that it would take some systems changes to implement the ED proposals.

In particular, there are potential practical issues if the Board was to proceed with the dual-margin approach and the acquisition costs identified by individual contract.

HoTARAC is also of the view that staff would need to be trained and users would need to be educated in regards to the changes proposed. These issues would need to be considered before providing an estimate of how long insurers would require before adopting the proposed requirements.

Other comments

Question 18 – Other comments

Do you have any other comments on the proposals in the exposure draft?

While HoTARAC commends the IASB's efforts in drafting a single consistent recognition and measurement standard for insurance contracts internationally, HoTARAC would like the IASB to be mindful of differing legislative requirements in relation to insurance contracts in various jurisdictions which may make the proposed changes difficult to apply.

Contact: Batisha Perzhaku
Phone: (03) 9651 5524

HoTARAC is of the view that the term 'portfolio of insurance contracts' is not well-defined and may be open to varying interpretations. In particular, despite the term being defined in Appendix A *Defined terms*, HoTARAC considers the term to be inconsistently defined elsewhere in the draft IFRS in relation to risk diversification. The definition in Appendix A does not consider start-date or end-date; however, guidance in relation to risk diversification assumes the portfolio to have contracts with similar start and end dates (refer BC130).

Benefits and costs (paragraphs BC258–BC263)

Question 19 – Benefits and costs

Do you agree with the Board's assessment of the benefits and costs of the proposed accounting for insurance contracts? Why or why not? If feasible, please estimate the benefits and costs associated with the proposals.

HoTARAC is of the opinion that a cost benefit analysis would be required before commenting on the Board's own assessment of the benefits and costs.

Nevertheless, preliminary comments received from Australian government insurers indicate that there will be some costs related to the identification of incremental costs by individual contract and the extensive disclosure required (refer response to questions 7 and 14(b)).

Minor editing issues

HoTARAC would like to raise the following issues with Appendix A *Defined terms*:

- Claims handling period – this definition would only be required if the FASB's proposed method of releasing the composite margin is adopted given that the term is not cited in the draft IFRS; only the Basis for Conclusions (which accompanies, but is not part of, the draft IFRS) uses the term;

- Residual margin – this is missing from Appendix A despite being in italics in paragraph 17(b);

- Direct insurance contract – paragraph 4(g) should have this in italics;

- Insurance risk – paragraph 63 should have this in italics;

- Insured event – paragraph 4(e) (and not paragraph B3(a)) should have this in italics;

- Reinsurance assets – paragraph 70 should have this in italics; and

- Reinsurer – paragraph 44 should have this in italics.

Contact: Batisha Perzhaku
Phone: (03) 9651 5524
Our Ref: D10/439804