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30 November 2010

Sir David Tweedie
Comment Letters
International Accounting Standards Board
1st Floor 30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Sir David,

Exposure Draft ED/2010/8 Insurance Contracts

We are pleased to have the opportunity to provide our comments on the draft IFRS for insurance contracts contained in Exposure Draft ED/2010/8.

National Australia Bank (NAB) is one of the four major banks in Australia. Our operations are predominately based in Australia, New Zealand, the United Kingdom, the United States and Asia. In our most recent annual results we reported net profit after tax of A$4.2 billion and total assets of A$686 billion.

Through our wealth management division, MLC, we provide investment, superannuation and insurance solutions to corporate and institutional customers. MLC is a leading provider of life insurance in Australia and holds the number one position for personal insurance annual inforce premiums with 14.1% market share[1].

We are supportive of the draft IFRS utilising the current fulfilment value approach, focusing on an entity's fulfilment obligations. We welcome the move towards a uniform IFRS that will apply across many jurisdictions.

We have a number of reservations regarding the proposals which we believe will inappropriately impact reported results if the draft IFRS is not amended. In our opinion, the major areas to be addressed are as follows:

1. Transition requirements – The proposed transition requirements are to measure insurance contracts at the present value of fulfilment cash flows, which in effect results in the residual margin being transferred to retained earnings. Setting the residual margin to zero on transition will result in mature and profitable life insurance businesses reporting little profit or loss for several years until the business written after transition becomes a significant proportion of the portfolio. Such a representation of the underlying performance of the business is not in line with market expectations of the life insurance industry particularly as there is future benefit in the portfolio.

We acknowledge the need for international comparability. We instead propose that insurers should either have the option or be required to retrospectively determine the residual margin on transition, utilising the approach in the final IFRS on insurance contracts. As many contracts may date back for decades, we suggest that insurers retrospectively calculate the residual margin for contracts the insurer became a party to in a specified period immediately prior to transition (say the five year period), and make some estimations to calculate the residual margin for earlier contracts.

2. Inability to revalue the residual margin – The draft IFRS determines a residual margin that eliminates any gain on inception of a contract, and does not allow subsequent remeasurement of this residual margin. In the case of long-duration insurance contracts, we believe that presenting the impact of changes in assumptions (in particular non-economic assumptions) in profit or loss will continually distort reported results. This is because the profit or loss may be dominated by the impact of current assumptions differing from initial assumptions. We do not believe this is appropriate given the level of uncertainty as to whether current assumptions will be consistent with actual outcomes in the future, particularly as life insurance contracts may be in place for many decades. We believe that users of an insurer's financial statements will not be able to assess the underlying profitability of the business as the results will continually include on-going changes to assumptions.

We believe the margin on services approach currently adopted in Australia for life insurance contracts provides a more relevant profit or loss. Under the margin on services approach, profit is released over the life of the contract and changes to non-economic assumptions are absorbed by future profit calculations, which are maintained on the balance sheet as part of policy liabilities. We propose that the IFRS on insurance contracts should instead adopt the margin on services approach encapsulated in Australian Accounting Standard AASB 1038. A less preferred approach is to adopt the proposals in the draft IFRS and instead reflect the impact of changes in non-economic assumptions directly in other comprehensive income, rather than profit or loss.

3. Acquisition and overhead costs – The draft IFRS only allows for acquisition costs incremental at the contract level to be included in the fulfilment cash flows, and requires other acquisition costs and overhead costs to be expensed as incurred. Excluding some acquisition costs and general overheads in the fulfilment cash flows is not consistent with the pricing of insurance business. In addition, we believe it is likely to result in outcomes driven more by legal form than by substance. Insurance businesses will have the opportunity to restructure their operations to drive a different accounting result by outsourcing more services which can be charged on a unitised basis rather than performing them in-house, thereby undermining comparability between insurers. We propose that all acquisition and overhead costs should be included in the fulfilment cash flows as it will more appropriately reflect the underlying business performance.

4. Various levels of measurement – The draft IFRS adopts different levels of measurement for separate components of the draft IFRS. For example, acquisition costs are assessed as to whether they are incremental at the contract level, and release of the residual margin is determined at the cohort within a portfolio with similar dates of inception and coverage period level. We believe the use of different levels of measurement adds undue complexity, is not aligned to the pricing of an insurance business, and the costs would outweigh any benefits gained from disaggregation below a portfolio level. In our opinion, the unit of measurement should be the portfolio level across all aspects of the IFRS on insurance contracts.

The Appendix to this letter outlines our responses to questions within the Exposure Draft. We have prepared responses to the questions from the viewpoint of a life insurer.

Should you have any queries regarding our comments, please do not hesitate to contact Marc Smit, Head of Group Accounting Policy at marc.smit@nab.com.au.

Yours sincerely

Peter Beharis
General Manager, Group Finance

[1] Source: DEXX&R Life Analysis as at June 2009.

Appendix

Detailed Answers to Questions

QUESTION 1 - RELEVANT INFORMATION FOR USERS

Question 1 - Do you think that the proposed measurement model will produce relevant information that will help users of an insurer's financial statement to make economic decisions?

Subject to concerns with (i) the transition requirements, (ii) the risk and residual margin, and (iii) the treatment of acquisition and overhead costs in the draft IFRS, we believe that the proposed model based on measuring future cash flows related to the portfolio will help users of an insurer's financial statements. Reporting on future cash flows is consistent with the pricing of the long-duration insurance contracts.

In our opinion, the transition requirements and the risk and residual margin in the draft IFRS will result in less relevant information being available for users of an insurer's financial statements. Refer to our comments on question 17(a) in relation to our concerns on the proposed transition requirements.

In respect of the residual margin, we believe that the inability to revalue the residual margin after initial recognition is likely to reduce the relevance of information provided to users of an insurer's financial statements, in particular in relation to long-duration insurance contracts. This is because the profit or loss may be dominated by the impact of current assumptions differing from initial assumptions. We do not believe this is appropriate given the level of uncertainty as to whether current assumptions will be consistent with actual outcomes in the future, particularly as life insurance contracts may be in place for many decades. We believe that users of an insurer's financial statements will not be able to assess the underlying profitability of the business as the results will continually include on-going changes to assumptions.

We believe the margin on services approach currently adopted in Australia for life insurance contracts provides a more relevant profit or loss. Under the margin on services approach, profit is released over the life of the contract and changes to non-economic assumptions are absorbed by future profit calculations, which are maintained on the balance sheet as part of policy liabilities. We propose that the IFRS on insurance contracts should instead adopt the margin on services approach encapsulated in Australian Accounting Standard AASB 1038. A less preferred approach is to adopt the proposals in the draft IFRS and instead reflect the impact of changes in non-economic assumptions directly in other comprehensive income, rather than profit or loss.

We are also concerned that the use of a risk margin and residual margin, rather than a single composite margin, may confuse users of an insurer's financial statements.

We believe that the treatment of acquisition costs and general overheads in the draft IFRS may result in less comparable information being available for users of an insurer's financial statements. The ability to only include incremental acquisition costs in the present value of fulfilment cash flows gives insurers the opportunity to restructure their operations to drive a different accounting result by outsourcing more services which can be charged on a unitised basis rather than performing them in-house, thereby undermining comparability between insurers.

QUESTION 2 - FULFILMENT CASH FLOWS

Question 2(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?

Long-duration insurance contracts are priced taking into account the expected present value of the future cash flows, at a portfolio level. We disagree with the proposal to apply a unit of measurement for incremental cash flows at a contract level, and to exclude some acquisition costs and general overheads from the expected present value of future cash flows as it is inconsistent with pricing.

Insurers seek to write business at a portfolio level and are readily able to adjust their distribution model to reflect business trends.

In our opinion, all costs, including all acquisition costs and general overheads, should be included in the expected cash flows. To exclude these cash outflows will generally result in a lower present value of the fulfilment cash flows, which may be offset by an increase in the residual margin. The resulting profit or loss is arguably less relevant for users of the financial statements if the emergence of expenses differs from the release of the residual margin.

Question 2(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?

Yes, we feel that the draft application guidance on estimates of future cash flows is at the right level of detail.

We have the following comments on the guidance:

- Paragraph B62(f) states not to include general overheads in estimating the cash flows that will arise as the insurer fulfils an existing insurance contract. We believe this may result in less comparable information being available for users of an insurer's financial statements as it gives insurer's the opportunity to restructure their operations to drive a different accounting results. For example, if an insurer outsources claims management activities, the charge from the service provider would be at a level so as to recover the service provider's general overheads, and the total amount payable to the service provider may be included in cash outflows incremental to a portfolio of insurance contracts.
- We believe there is inconsistency in the guidance in paragraph B61 that acquisition costs in paragraph B61(f) are to be incremental to the level of an individual insurance contract, whereas all other items in the same paragraph of the guidance are to be incremental at the level of a portfolio of insurance contracts.

QUESTION 3 – DISCOUNT RATE

Question 3(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 the liability?

Yes.

Question 3(b) - Do you agree with the proposal to consider the effect of liquidity and with the guidance on liquidity?

We agree that in principle that the liquidity characteristics of the liabilities could be taken into account when determining the discount rate.

As noted in the Basis for Conclusions in the Exposure Draft, there is no consensus on how best to measure the liquidity characteristics of an item. Even with consensus and further guidance, measurement of liquidity effects may be difficult, if not impossible, as it would be trying to measure the additional return when the market for an instrument is illiquid, and therefore not observable.

Given these difficulties, we do not believe that the effect of liquidity should be a mandatory requirement, but rather be at the discretion of the insurer.

Question 3(c) - Some have expressed concerns that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts. Are these concerns valid? 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?

Other than our comments in response to question 3(b), we do not share these concerns that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts.

QUESTION 4 – RISK ADJUSTMENT VERSIS COMPOSITE MARGIN

Question 4 - Do you support using a risk adjustment and a residual margin, or do you prefer a single composite margin?

We prefer a single composite margin. We are concerned that the use of a risk adjustment and residual margin, rather than a single composite margin, may confuse users of an insurer's financial statements.

We propose that the IFRS on insurance contracts should require revaluation of the residual or composite margin for the reasons we have outlined in our response to question 1.

QUESTION 5 – RISK ADJUSTMENT

Question 5(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?

We are concerned with the concept of a risk adjustment, and challenge whether such a risk adjustment is required. The risk adjustment appears to be adding a buffer to liabilities for the variability in fulfilment cash flows, whereas the fulfilment cash flows are already required to be determined based on the probability weighted outcome of a full range of possible outcomes. We do not believe that such a buffer is appropriate for accounting purposes, but is taken into account by regulators for solvency and capital adequacy purposes.

If the risk adjustment were to stand as is, we find the clause "...the maximum amount the insurer would rationally pay..." unclear and not in line with the way insurers think about the variability in fulfilment cash flows.

In our opinion, it is more appropriate to accept that there exists a range of outcomes that could meet an insurer's appetite to convert future probabilistically determined liabilities into fixed payments rather than assume a single number.

We believe it is more appropriate to define the risk adjustment as the amount of capital that would be required to compensate for the costs of covering the uncertainty associated with the risks arising from the insurance portfolio.

Question 5 (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?

No. We are concerned that the draft IFRS does not allow for development in the future of other approaches that could be more appropriate.

We believe that the IFRS on insurance contracts should be written on a principles basis. Hence we believe that there should not be a limited, prescribed methodology, but that the IFRS should require use of the most appropriate technique. The three specified techniques can be provided as guidance, but allow other techniques to be utilised where their relevance can be justified.

Question 5(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?

Yes. The estimation of confidence levels entails uncertainty. Disclosure needs to acknowledge this element of uncertainty to allow better comparability by users of insurer's financial statements. We also believe that comparability will always be difficult as there will be subjectivity around what the insurer's own risk appetite is, and therefore how the corresponding risk adjustments would be measured.

Question 5(d) - Do you agree than an insurer should measure the risk adjustment at a portfolio level of aggregation?

Yes. We consider that the insurance industry manages its business at a portfolio level and that the portfolio level should be adopted as the unit of measurement throughout the IFRS on insurance contracts, including for the risk adjustment.

Question 5(e) - Is the application guidance on risk adjustments at the right level if detail?

Yes.

QUESTION 6 – RESIDUAL/COMPOSITE MARGIN

Question 6(a) - Do you agree that an insurer should not recognise any gain at initial recognition of an insurance contract?

Yes. We believe that not recognising a gain at initial recognition of an insurance contract is in line with revenue recognition principles, given that the service implicit in the insurance contract is yet to be provided to the policyholder.

We are equally of the opinion that recognition of a loss from acquisition expenses around the time of initial recognition of an insurance contract is inappropriate. The residual margin in the draft IFRS is an accounting mechanism to ensure a gain is not recognised on initial recognition of an insurance contract, but as proposed it also includes the costs of establishing the contract.

Provided the total costs incurred in establishing the contract (including those that may have been incurred before the insurance contract exists) are included in the fulfilment cash flows, we believe that is inappropriate to report a gain at inception.

Question 6(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?

Yes.

Question 6(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?

No. We believe that the proposal to effectively account for each new year's business as a separate cohort for the life of the new business portfolio is unwieldy and would be costly and complex to implement with significant changes required to financial and administration systems. We believe such costs would outweigh any benefits gained from such disaggregation.

The draft IFRS adopts different levels of measurement, such as:

- portfolio for determination of the future cash flows and the risk adjustment (paragraphs 23 and 36 respectively)
- cohort within a portfolio for contracts with a similar date of inception and coverage period for determination of the residual (or composite) margin (paragraph 20), and
- contract for determination whether acquisition costs are incremental (paragraph B61(f)).

In our opinion, a single unit of measurement should be selected and applied to all principles in the IFRS on insurance contracts, and we suggest that the unit of measurement should be consistent with the management of an insurance business. In our opinion, a portfolio level is the appropriate unit of measurement.

Question 6(d) - Do you agree with the proposed method(s) of releasing the residual margin?

We believe that remeasurement of the residual margin should be allowed, particularly in the case of long-duration insurance contracts. Our reasons for this opinion are outlined in our response to question 1.

Should the draft IFRS stand as is, we believe that it is more appropriate for the IFRS on insurance contracts to require a release of income in profit or loss based on the passage of time, but based on another basis if a more relevant driver for release of the residual margin is identifiable.

The basis of release would require disclosure as part of the disclosures about the amounts recognised in the financial statements under paragraph 79(a) of the draft IFRS. We expect that in many cases, the basis of the expected timing of claims and benefits would be used in practice, however believe that a broader approach for release of the residual margin is a better principle for the IFRS on insurance contracts.

Question 6(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?

No. Our opinion on release of the composite margin is the same as that outlined in our response to question 6(d) on release of the residual margin.

Question 6(f) - Do you agree that the interest should be accreted on the residual margin? Would you reach the same conclusion for the composite margin?

We believe that remeasurement of the residual margin should be allowed, particularly in the case of long-duration insurance contracts. Our reasons for this opinion are outlined in our response to question 1.

Should the draft IFRS stand as is, we agree that an insurer should accrete interest on the carrying amount of the residual margin, and to the extent that the residual margin is locked, this accretion of interest will need to be at the discount rate determined at initial recognition. Our view on accretion of interest on the composite margin is the same for the residual and composite margin.

We would interpret the requirement in paragraph 72(e) of the draft IFRS to include interest on insurance contract liabilities in an insurer's statement of comprehensive income, to mean that two interest expense lines may be presented. As a bank we believe it is important for users of our financial statements to have information about net interest income from our banking activities, in addition to interest expense being a line item within the breakdown of "net income or expense from insurance contracts". As many banks perform insurance activities, the Board may consider whether it wishes to specifically address this issue.

QUESTION 7 – ACQUISITION COSTS

Question 7 - Do you agree that the 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 costs should be recognised as expenses when incurred?

No. We have two concerns with the treatment of acquisition costs in the draft IFRS. Firstly, we believe all acquisition costs should be included in the initial measurement as this is how insurance contracts are priced. Secondly, we believe that the appropriate unit of measurement for acquisition costs is the portfolio level as this is the level at which business is written and managed.

We believe that the treatment of acquisition costs in the draft IFRS may result in less comparable information being available for users of an insurer's financial statements. The ability to only include incremental acquisition costs in the present value of fulfilment cash flows gives insurers the opportunity to restructure their operations to drive a different accounting results by outsourcing more services which can be charged as a unitised basis rather than performing them in-house. Such outsourcing will avoid an adverse accounting outcome but may introduce greater risk into an insurer's business.

We believe that the appropriate unit of measurement is the portfolio level as this is the level at which business is written and managed. In particular, underwriting costs do not exist at a contract level as the function of underwriting is to accept and decline contracts based on levels of acceptable risk across a portfolio. If acquisition costs are to be restricted to incremental costs, then in our opinion, determination of what acquisition costs are incremental needs to made at the portfolio level, not the contract level.

QUESTION 8 – PREMIUM ALLOCATION APPROACH

Question 8(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?

We believe the Board should permit but not require a separate measurement approach for short-duration insurance contracts.

If short-duration insurance contracts have the option of using the modified measurement approach, then insurers with both short and long duration contracts could choose to measure both as long-duration contracts to avoid two sets of accounting methodologies, but general insurers for example, would have the option to use the modified approach for most of their renewable business.

Question 8(b) - Do you agree with the proposed criteria for requiring that approach and with how to apply that approach?

In our opinion, what constitutes a short-duration insurance contract requires additional clarity or definition. To apply short-duration insurance accounting, paragraph 54 of the draft IFRS requires that insurance contracts, among other things, have a coverage period of approximately one year or less. We believe this may result in similar insurance contracts having different accounting treatments.

An alternative definition may be to consider whether the insurance contract is a simple product, for example, if it is managed on a simple renewable basis and the customer is freely able to transfer to a new insurer without underwriting hurdles. We believe that it is appropriate to provide an option to account for insurance contracts that are readily entered into and exited by the consumer as short-duration insurance contracts. Where the insurance contract is more complex these would be excluded from the definition.

We believe that appropriate disclosure should be required to specify that simple products are deemed so because that is how the insurer manages those products.

QUESTION 9 - CONTRACT BOUNDARY PRINCIPLE

Question 9 - Do you agree with the proposed boundary principle and do you think insurers would apply it consistently in practice?

We agree with the proposed contract boundary principle. We have concerns that the contract boundary principle in the draft IFRS would not be applied consistently in practice.

The boundary principle applies on a contract level, and a potential outcome for life insurers is that yearly renewable term business may be considered an annual contract since the portfolio is subject to repricing each year.

We consider that yearly renewable term contracts should result in long-duration insurance accounting as the insurer is obligated to continue the contract as a multi-year policy unless premiums are unpaid. Indeed the remuneration arrangements typically involve amounts exceeding the first year's premium on the expectation that the portfolio will be largely multi-year.

Further, if the customer wished to switch insurers, he/she would typically be required to meet the new insurer's underwriting requirements.

This type of business would not meet the 'simple product' definition proposed in our response to question 8(a), therefore requiring long-duration insurance accounting.

QUESTION 10 – PARTICIPATING FEATURES

Question 10(a) - Do you agree that the measurement of insurance contracts should include participating benefits on an expected present value basis?

Yes.

Question 10(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 financial instruments standards?

In our opinion, financial instruments with discretionary participation features should be within the scope of the IFRS on insurance contracts.

Question 10(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?

Yes.

Question 10(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?

Yes.

QUESTION 11 – DEFINITION AND SCOPE

Question 11(a) - Do you agree with the definition of an insurance contract and related guidance, including the two changes summarised in paragraph BC191?

Yes.

Question 11(b) - Do you agree with the scope exclusions in paragraph 4?

Yes.

Question 11(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?

No. In our opinion, the measurement in the IFRS on insurance contracts is more complex than other models for the measurement of financial guarantee contract liabilities, however in many cases would have a similar impact on the statement of financial position and profit or loss.

The current measurement for financial guarantee contracts under IAS 39 generally does not result in a gain on inception of the contract. In an arm's length transaction, the fee charged for providing the guarantee is commensurate with risk being accepted. Further, in many cases this outcome is intuitive without the need for modelling of the fair value. The financial guarantee liability is subsequently increased, if necessary, to the amount determined in accordance with IAS 37.

If financial guarantee contract liabilities were within scope of the IFRS on insurance contracts, there would also be no gain on initial recognition, however the measurement would be closer to a fair value model, in that changes in assumptions (such as the timing and amount of default of the specified debtor) would be reflected in profit or loss. This measurement model requires modelling, including at inception for determination of the residual margin.

We do not believe that the benefit of reflecting the current fulfilment value of a financial guarantee liability justifies the complexity of the methodology in the draft IFRS, in particular in determining the residual margin and risk adjustment. In addition, including financial guarantee liabilities within the scope of the IFRS on insurance contracts will require significant effort for entities that have no other contracts within the scope of this IFRS to understand the majority of the concepts in the IFRS on insurance contracts.

QUESTION 12 - UNBUNDLING

Question 12 - 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?

Yes. The intention appears to prevent non-insurance elements being added to an insurance product to avoid accounting for the non-insurance component as a financial instrument, and we consider this prevention appropriate.

QUESTION 13 - PRESENTATION

Question 13(a) - Will the proposed summarised margin presentation be useful to users of financial statements?

Yes.

Paragraph 72 of the draft IFRS lists items that an insurer should as a minimum include in its statement of comprehensive income, including the underwriting margin. Whilst we agree that the items listed in paragraph 72 will be useful to users of financial statements, we believe it is more appropriate to require "net income or expense from insurance contracts" to be presented on the face of the statement of comprehensive income, and require the items listed in paragraph 72 to be either presented in the statement of comprehensive income or disclosed in the notes to the financial statements. We are a bank, and in our case we do not believe it is appropriate for the face of the statement of comprehensive income to be dominated by insurance contract amounts, when our insurance activities are only one segment of our business. We believe that other Australian and some international banks are in a similar situation to us, and believe the preparers of financial statements should be able to apply judgement to determine whether such information is presented on the face of the statement of comprehensive income or disclosed in the notes to the financial statements.

Question 13(b) - Do you agree that an insurer should present all income and expense arising from insurance contracts in profit or loss?

We propose that the IFRS on insurance contracts should require revaluation of the residual or composite margin for the reasons we have outlined in our response to question 1.

A less preferred approach is to adopt the proposals in the draft IFRS and instead reflect the impact of changes in non-economic assumptions directly in other comprehensive income, rather the profit or loss. This would be in line with the accounting for some aspects of the change in carrying amount of defined benefit plans.

QUESTION 14 - DISCLOSURES

Question 14(a) - Do you agree with the proposed disclosure principle?

Yes.

Question 14(b) Do you think the proposed disclosure requirements will meet the proposed objective?

Yes.

Question 14(c) - Are there any disclosures that have not been proposed that would be useful (or some proposed that are not)?

We believe that in some cases the disclosure requirements are quite generic, and similar to those in IFRS 7 rather than being tailored to information that would be useful to users of an insurer's financial statements. The proposed disclosures may make it more difficult for a user of the financial statements to identify more useful disclosures, for example if insurance risk disclosures are lost amongst various non-insurance risk disclosures. In addition, if an insurer were to provide a note to their financial statements containing each of the disclosure requirements in the draft IFRS, that it may be confusing for a user to distinguish between some similar disclosures.

We believe the disclosure requirements can be streamlined. For example, in our opinion, the exposure to market risk from insurance contracts is most likely to arise from interest rates used to discount cash flows and inflation assumptions. The Board should consider whether it is likely to result in a better quality of disclosures if it replaces paragraphs 93, 96 and 97 with specific disclosure requirements, or provides examples of items that may be disclosed under the generic disclosure requirements.

One of the disclosures required by paragraph 90 on the methods and inputs used to develop the measurements appears similar to the disclosure requirements in relation to the nature and extent of risks arising from insurance contracts as follows:

- Paragraph 90(d) requires disclosure of a measurement uncertainty analysis of the inputs that have a material effect on the measurement. That is, if changing one or more inputs used in the measurement to a different amount that could have reasonably been used in the circumstances would have resulted in a materially higher or lower measurement, the draft IFRS requires the insurer to disclose the effect of using those different amounts and how it calculated that effect.
- Paragraph 92(e)(i) requires disclosure of the sensitivity to insurance risk in relation to its effect on profit or loss and equity. The draft IFRS requires this sensitivity analysis to disclose any material effect on profit or loss and equity that would have results from (a) changes in the relevant risk variable that were reasonably possible at the end of the reporting period; (b) the methods and inputs used in preparing the sensitivity analysis; and (c) any changes from the previous period in the methods and inputs used.

It may be simpler and clearer for users if the IFRS on insurance contracts required a sensitivity analysis of the impact on profit or loss from changes in relevant risk variables (such as mortality, morbidity and maintenance assumptions), and rely on the disclosure requirements of IAS 1 on sources of estimation uncertainty in relation to a preparer highlighting major sources of estimation uncertainty.

QUESTION 15 – UNIT-LINKED CONTRACTS

Question 15 - Do you agree with the proposals on unit-linked contracts?

Yes.

QUESTION 16 - REINSURANCE

Question 16(a) - Do you support an expected loss model for reinsurance assets?

Our comments on the expected loss model are contained in our comment letter to the International Accounting Standards Board on Exposure Draft ED/2009/12 Financial Instruments: Amortised Cost and Impairment. Our comments in the context of reinsurance assets are the same as in the previously submitted comment letter.

Question 16(b) - Do you have any other comments on reinsurance proposals?

Consistent with our opinion on measurement of insurance contract liabilities, we believe that remeasurement of the residual margin should be allowed for reinsurance contract assets. Our reasons for this opinion are outlined in our response to question 1.

Should the draft IFRS stand as is, we believe that the IFRS on insurance contracts should include some guidance (i) that it would generally be expected that consistent assumptions will be applied in measuring reinsurance contract assets and related insurance contract liabilities, and (ii) that any gain recognised on initial recognition of a reinsurance contract under paragraph 45(b) is capped at the amount of a loss recognised on initial recognition of the underlying insurance contract under paragraph 18.

QUESTION 17 – TRANSITION AND EFFECTIVE DATE

Question 17(a) - Do you agree with the proposed transition requirements?

No, we strongly oppose the proposed transition requirements for the following reasons.

Firstly, setting the residual margin to zero on transition will not provide relevant information to users of insurers' financial statements as the underlying profitability of a mature life insurance business will not be reported, having been transferred to retained earnings on transition.

Secondly, if the transition requirements stand as is, in order to explain to users of the financial statements the accounting anomaly of how existing profitable contracts are reporting losses, we believe that mature life insurers will need to supplement IFRS financial statements with more meaningful reporting. Such supplementary financial information would need to continue for an extended period until contracts in force on transition are run-off.

Thirdly, in the absence of change to Australian tax laws, there would be a significant cash flow impact from the proposed transition requirements from a tax payment which is effectively brought forward by the transfer of future planned profits to retained earnings. We note that from previous experience on transitioning from previous Australian GAAP to IFRS, relief was not provided from tax consequences of transferring amounts to retained earnings on adoption of new or revised accounting standards. In addition, a significant tax payment would result in an additional capital requirement under Australia's prudential regulation regime.

We acknowledge the need for international comparability. We instead propose that insurers should either have the option or be required to retrospectively determine the residual margin on transition, utilising the approach in the final IFRS on insurance contracts. As many contracts may date back for decades, we suggest that insurers retrospectively calculate the residual margin for contracts the insurer became a party to in a specified period immediately prior to transition (say the five year period), and make some estimations to calculate the residual margin for earlier contracts. This type of approach was successfully used by life insurers in Australia on the implementation of margin on services approach in 1995. Whilst there may be some practical difficulties, we consider that a 'best endeavours' approach to retrospectively calculating the required margin would be far preferable to a zero margin approach.

Whilst retrospective application does incur cost, we consider there is significant benefit to users of the financial statements to do so, and that the cost of a full retrospective adoption can be mitigated with our proposal to allow an estimate basis for business written prior to a certain date before the transition date.

Should the proposed transition arrangements stand as is, we believe that information about new business should be shown separately to assist users in understanding the transitional impacts and to allow for comparability of new business with other insurers.

Question 17(b) If the Board were to adopt the composite margin approach favoured by FASB, would you agree with the FASB's tentative decision on transition?

No. The FASB's tentative decision only includes measurement of the risk adjustment on transition and not the full composite margin. We strongly oppose this for the same reasons outlined in our response to question 17(a).

Question 17(c) - Is it necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9?

No. The current accounting standard for life insurance contracts in Australia requires measurement of financial assets that (i) back life insurance or life investment liabilities, and (ii) are permitted to be designated as at fair value through profit or loss under IAS 39, to be designated as such on initial recognition.

We expect that in transitioning from IAS 39 to IFRS 9, that the accounting for assets that back life insurance or life investment liabilities will remain unchanged in the majority of cases. We therefore do not believe that it is necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9.

Question 17(d) - Please provide an estimate of how long insurers would require to adopt the proposed requirements.

If the proposed requirements were to be enacted as an IFRS without any changes, significant financial and administration system changes would be required. Risk adjustment estimates may require stochastic modelling and cash flow estimation may require multiple stream models. Significant work would also be required to understand how cohort measurement is currently managed (for example by US insurers) and to assess alternative options, plan implementation and execute it. We believe this process could take four years. In addition to systems changes, effort and time will be required for education and messaging to internal and external stakeholders for the expected change in profit or loss patterns.

Aside from initial implementation costs, the costs of maintaining the draft IFRS has the added impact of increasing maintenance costs for policies, which will need to be included in assumption setting.

QUESTION 18 – OTHER COMMENTS

Question 18 - Do you have any other comments on the proposals in the exposure draft?

No.

QUESTION 19 – BENEFITS AND COSTS

Question 19 - Do you agree with the Board's assessment of the benefits and costs of the proposed accounting for insurance contracts? If feasible, please estimate the benefits and costs associated with the proposals.

Although the cost of implementing an IFRS on insurance contracts is high, we believe that an internationally consistent approach is required. Although we are not directly impacted, we believe this may in the long term save costs for insurers with operations in multiple countries, or considering foreign acquisitions.

It is not feasible for us to estimate the benefits and costs associated with the proposals at this time.