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8 November 2010

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
MELBOURNE VIC 8007

Dear Sir

Re: Exposure Draft ED 201 Insurance Contracts

QBE Insurance Group Limited (QBE) is an Australian-based public company listed on the Australian Securities Exchange. QBE is Australia's largest international insurance and reinsurance company with operations in 49 countries. We are also one of the top 25 global insurers and reinsurers as measured by net earned premium.

QBE fully supports the IASB in its aim to improve the quality and comparability of financial information in relation to insurance contracts reporting. We welcome the opportunity to comment on the exposure draft issued.

Overall, we support the recommendations set out in this exposure draft, recognising that many of the key principles such as the building block approach and an overall fulfilment objective are broadly aligned with the current requirements of Australian accounting standards. The framework applied in Australia since the implementation of AASB 1023, after much consultation and amendment, has worked well in practice and is understood by both the preparers and users of the financial statements of Australian general insurers. We would not be supportive of a framework that results in a backward step compared with the current high standards of reporting.

In the current draft standard, we are concerned that there are significant deficiencies that need to be addressed in order for the Board to achieve its overall objectives. We draw your attention to the areas set out below where we believe that recommendations in the draft standard require your further review before the standard can be considered to be workable in practice.

The contract boundary principle and the modified measurement model

We are concerned that the contract boundary principle, as currently defined, is too restrictive. It appears that we would be required to provide for future renewal of contracts which may have elements relating to obligations to renew or are subject to regulatory or other external constraint which limits our ability to re-price or re-underwrite individual risks on renewal. As an example, Compulsory Third Party (CTP) motor liability insurance is a state run class of business in Australia with differing states allowing varying degrees of flexibility to respond to actual claims experience. The application of the proposed contract boundary principle to the different regulatory regimes in each Australian state may result in different approaches to determining the relevant cash flows. This would result in very different accounting outcomes, despite the underlying insurance product being similar in each state. The same concern exists in relation to many of the classes of business that we write through our global insurance operations, and specifically certain classes of business written in the US, where a price must be filed with the regulator and we then have limited opportunity to re-price risk on renewal of individual contracts.

If a provision for future renewals of CTP and the US classes referred to above is required, this would be a hugely subjective estimate in practice due to the complete flexibility of the insured to change insurer without penalty.

We welcome the modified measurement approach for pre-claims liabilities of short duration contracts as a concession to minimise the impact of the proposed changes on non-life insurers. In practice, however, the criteria to qualify for this approach ("the coverage period of the insurance contract is approximately one year or less") combined with the impact of the boundary principle on certain classes of business as described above are too restrictive. As a diversified general insurer, we write many classes of business such as consumer credit, builders' warranty, lenders' mortgage insurance and construction risks which exceed the one year coverage period rule. These factors will result in many general insurers having to run two measurement models which defeats the overall objective of achieving comparability of financial information and would, in our view, be confusing for readers of the financial statements.

The fundamental purpose and nature of life insurance and general insurance contracts are very different. Tenure of contract should not be a limiting or determining factor in accounting and reporting. Rather, the substance and purpose of the desired outcome of the business should prevail. We propose that the boundary contract principle and the criteria for application of the modified measurement approach need to be redefined so that more emphasis is placed on the substance of the underlying risk. The boundary principle could be amended to focus specifically on the identification and capture of cash flows relating to long duration contracts. Contracts not meeting the specific definition of long duration contracts would therefore not be required to estimate renewals for those classes subject to regulatory pricing constraints or other anomalies. In turn, companies writing short duration contracts (i.e. those contracts not caught by the definition of long duration contracts) would be permitted (or required) to apply the modified measurement approach.

Unit of account and recognition of diversification benefit

The draft standard currently references different units of accounts for different proposals. For example, incremental acquisition costs are identified at the contract level; the risk adjustment is determined at the portfolio level assuming "similar risks and managed as a pool"; and the residual margin and onerous contracts test reference a portfolio of contracts with similar date of inception. The contract boundary principle focuses on the ability of the insurer to reassess risk at the contract level. These differing units of account serve to introduce unnecessary complexity into the draft standard and do not reflect the way that business is managed in practice which is typically on a broader portfolio or business segment basis. They will create additional complexity and costs for preparers of financial information. Two specific issues are raised by this:

- The application of the risk adjustment at the narrowly defined portfolio level serves to disallow the recognition of diversification in the risk adjustment calculation. This causes us specific concerns because:

    - This is not the way that insurers run their business in practice and ignores the fact that diversification is currently recognised in both the sale and purchase of insurance companies and in the purchase of reinsurance protections;

    - We disagree with the Board's view that diversification cannot be measured; and

    - A recalibration of the probability of adequacy (POA) calculation excluding the impact of diversification is wrong in principle and practice. The underlying principles for effective risk management in a general insurer rely on diversification by product and risk. Excluding an allowance for diversification will require significant re-education of those investors, analysts, regulators and other users of the accounts of Australian insurers who understand that there is a diversification component. This generates the risk that the market will attribute more weight to a more realistic "diversified POA" instead of the required "undiversified POA" in the financial statements.

- We strongly disagree with the requirement to apply the onerous contracts test at the proposed level of a portfolio of contracts with a similar date of inception. This fails to recognise how insurers price risk in practice.

We propose that the standard should recognise that entities have already defined portfolios and business processes to underwrite and price underwriting risks at a level that is appropriate given the size, complexity and mix of business. The portfolio definition should be defined at a level which has regard to the way that management prices and controls its business in practice. This broader portfolio definition should be applied consistently throughout the standard.

Accounting for assets backing insurance liabilities

The exposure draft currently only permits a redesignation of financial assets to fair value through profit or loss on adoption of the Insurance Contracts standard. There is no option for entities that are currently required to value financial assets at fair value through profit or loss to elect to use amortised cost if this is more relevant to the underlying business model. We believe that entities should be permitted to make any appropriate redesignation subject to providing all relevant disclosures.

We would be happy to discuss and further clarify any of the points raised in this letter. We look forward to working with you to achieve a high quality accounting standard that serves the needs of preparers and users of the financial statements alike.

Yours faithfully,

Neil Drabsch
Chief financial officer

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Response to IASB Invitation to comment on ED/2010/8

Question 1 – Relevant information for users
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?

Overall we believe that the proposed measurement model has the capacity to improve the quality of financial information available to users by providing a consistent and robust framework for use by insurers globally. However, we are of the view that the model could be further improved and simplified by addressing the following points:

- The boundary principle as currently defined is too restrictive and, as presently drafted, appears to require provision for renewal of those future contracts which we are obliged to accept on renewal and which are subject to regulatory or external constraint which limits our ability to re-price or re-underwrite individual contracts.
- The criteria for application of the modified measurement approach are too restrictive. This combined with the current contract boundary proposal will result in many non-life insurers having to run two measurement models in practice. This will only serve to confuse rather than assist users of the financial statements.
- The unit of account varies throughout the standard and the definition of unit of account has no regard to how entities underwrite and price their risks in practice. A more consistent approach throughout would improve the quality of information produced by preparers of financial statements.
- The recognition of diversification only at the narrowly defined portfolio level has no regard to how entities underwrite and price their risks in practice. Such an approach ignores the real economics underlying the management and underwriting of risk.
- The requirement to apply an onerous contracts test at the narrowly defined portfolio level is unnecessarily penal and ignores the way that insurers price and manage risks in practice.
- Incremental acquisition costs have been defined too narrowly in the draft ED creating the very significant risk that insurers may be driven to establish structures to achieve a desired accounting outcome. The narrowly defined approach also ignores that insurers typically price contracts to recover other direct as well as some indirect costs.
- The reinsurance provisions of the draft standard are unclear and require further work to ensure that they can be applied in practice.
- The disclosure requirements seem to be particularly onerous, creating significant cost for preparers of financial information without necessarily improving the overall quality of the financial statements.
- Insurers should be allowed the flexibility on transition to the new standard to designate financial assets in a way that is appropriate to their business model. There should not be limitations on this designation.
- Insurers that are able to identify and substantiate the residual margin at the date of transition to the new standard should be allowed to recognise this margin at transition.

Question 2 – Fulfilment cash flows
(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?

Response: In principle, we 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. For those entities adopting the modified approach applicable to short-duration contracts, we agree that the same broad principles should apply recognising that the pre-claims liabilities will be recognised over the appropriate coverage period.

We have some concerns on the proposed treatment of incremental acquisition costs. These are addressed more specifically in the response to question 7 below.

(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?

Response: We support the IASB's overall approach of supplying principles-based guidance and we agree that the application guidance in appendix B37 – B66 appears to be broadly at the right level of detail. However, we are concerned that the guidance has an expectation that the majority of cash flows must be estimated at the individual contract level (which, for most insurers will be impractical and hugely onerous for the limited gains achieved) rather than the portfolio level. We propose that the guidance should explicitly state that estimates of cash flows should be undertaken at the portfolio or business segment level as defined by management with the option to analyse at the contract level if practicable.

Question 3 – Discount rate
(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?

Response: We agree with the principle that the appropriate discount rate is the one that reflects the characteristics of the insurance liability, such as maturity and currency.

We agree that for non-participating contracts, using a discount rate which reflects the characteristics of the assets backing insurance liabilities would not provide useful information given that it would not necessarily reflect the specific characteristics of the 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?

Response: We agree in principle that it is appropriate to include an allowance in the discount rate for the impact of liquidity.

(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?

Response: No response.

Question 4 – Risk adjustment versus composite margin
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.

Response: We support the IASB's proposal to separately identify a risk adjustment and a residual margin. In our view, the risk adjustment and the residual margin are very different in nature, with the risk adjustment being a specific measure of risk in the relevant liability whilst the residual margin essentially reflects the profit component of the contract. Given these fundamental differences, these

amounts should be recognised in the result over different periods of time. We are therefore of the view that it is inappropriate to combine them.

In Australia, we already have significant experience of determining the risk margin component of our insurance liabilities and we have found that this information has been valuable to analysts, regulators and other users of the financial statements. We would not support any proposal that effectively results in the loss of this key information.

That said, the limitations of the risk margin approach should also be noted. The actuarial science behind the determination of the risk margin is subject to some debate amongst the actuarial community and the subjectivity of the calculations, particularly with three calculation options available, will not give rise to the complete comparability of financial information between entities that the ED is looking to achieve. Acknowledging these limitations, we remain of the view that a separately identified risk adjustment will nevertheless provide invaluable information about the development of individual entities year on year.

Question 5 – Risk adjustment
(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?

Response: The terminology used in the ED being "*the maximum amount the insurer would rationally pay to be relieved of the risk*" is confusing. The description implies an exit value basis of measurement. It would not be appropriate to combine a fulfilment objective and an exit value objective in the standard as this could lead to confusing outcomes. In addition, the use of the word "maximum" indicates the selection of an option which is at the top end of a range of options available. This implies inappropriate conservatism in the calculation.

That said, the guidance in BC110 seems to clarify that this is not the intent. In view of the guidance provided in the basis for conclusions, we concur with the intent of the ED but would suggest that the wording of the ED be amended to make this clearer.

(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?

Response: We are of the view that mandating a technique or techniques to apply is not appropriate to an accounting standard, which should instead focus on establishing appropriate principles. By specifically nominating the three techniques that can be used, the Board is limiting the opportunity to recognise the benefits of future developments in actuarial science.

We would prefer to see the ED apply a rebuttable assumption that these techniques are adopted. This would allow entities the option to apply other techniques where they can clearly be seen to provide improved analysis.

(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?

Response: We acknowledge that the disclosure of the confidence level will assist users of the financial statements when comparing similar companies or groups.

We believe that disclosure of a confidence level should be a requirement for all entities.

(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?

Response: We agree that the risk adjustment should initially be measured at the portfolio level. However, we are also of the view that the overall risk adjustment should reflect the characteristics of a

specific insurer. In practice, this means that the real economic benefits of diversification that exist between portfolios and even between entities in a geographically and product diverse insurance group should be recognised.

Given that a specific objective of the proposed standard is to *"provide information to users of financial statements for economic decision-making"*, it would seem completely inappropriate to ignore the commercial reality of diversification. The basis for conclusions suggests that the determination of diversification benefits beyond the portfolio level is difficult because of *"lack of full fungibility between portfolios"*. We believe that this is a very narrow view and we draw the Board's attention to the following points:

- In practice, risks do offset each other even if there is no "fungibility" in the strictest sense of the word. In simplistic terms, to not recognise diversification beyond the portfolio level means that you can have the nonsensical outcome of a mono-line insurer holding a lower risk adjustment than an appropriately diversified multi-line insurer of the same size.
- We have extensive experience in Australia, reporting under both AASB 1023 and APRA's regulatory requirements, of measuring and actively monitoring the impacts of diversification on the Group's overall insurance liabilities. We therefore believe that we have the capability to calculate the impact of diversification and our view is that this is not unduly burdensome on an ongoing basis.
- We fundamentally disagree with the suggestion in the Basis for Conclusions that limiting the determination of the risk adjustment to the portfolio level is "the most practical solution and the most likely to produce relevant information for users at reasonable cost". Again, with extensive experience in this area, we feel that we can produce better quality and more relevant information for users of the financial statements which incorporates the impact of diversification. Unfounded concerns about the practicalities of producing this information should not be used as a reason to reduce the quality of information to be produced.

We propose that entities should be permitted to take credit for diversification beyond the narrowly defined portfolio level subject to specifically explaining the process for doing this and quantifying the amounts involved in the financial statements.

On a broader level, we are concerned that the definition of "portfolio" seems to be applied inconsistently and too narrowly throughout the draft standard. The definition of portfolio does not reference the way that entities manage and price risk in practice.

(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?

Response: We reiterate our concerns about the ED's proposal to only permit recognition of diversification benefit at the portfolio level (see response to 5(d) above) and the limitations around the application of actuarial techniques for measuring the risk adjustment (see response to 5(b) above). With these exceptions, we agree that the guidance is broadly at the appropriate level of detail.

Question 6 – Residual/composite margin

(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?

Response: We agree that it is not appropriate to recognise a gain at initial inception of a contract. As no performance obligations have yet been satisfied on day one and because the possibility of significant and real day one gains is unlikely in a normal commercial situation, we agree that it makes sense to calibrate the residual margin to negate such day one gains.

(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?

Response: We agree that any loss on initial recognition should be expensed immediately. It is not appropriate to capitalise a day one loss and release this over an arbitrary period of time.

(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?

Response: Recognising that the determination of the residual or composite margin at the contract level is impracticable, the Board is proposing an approach that virtually equates to the contract level in practice and which is therefore similarly unworkable. For a group like QBE, this would effectively involve further analysing the thousands of individual portfolios we already manage to an even greater level of detail.

We believe that the ED should focus on establishing principles, which in this case means that the margin (residual or composite) should be set at the portfolio level which practically reflects how a company or group manages and prices its insurance risks. The "portfolio" definition should be a management determination and should not be mandated by the ED. This definition should be used consistently throughout the ED. Given that a rational entity would only write loss making business in order to achieve a better overall outcome, this economic reality should be reflected in the way that the results are reported.

(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)?

Response: We agree that a release pattern for the residual margin which is based on the insurer's performance under the contract, using either the passage of time or some sort of risk weighted pattern of release, is appropriate. Release patterns should not be prescribed. They should be at the discretion of the insurer based on portfolio-specific criteria relevant to the risk profile.

We are also of the view that insurers that are able to identify and substantiate the residual margin at the date of transition to the new standard should be allowed to recognise this margin at transition.

(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?

Response: We do not agree with the concept of the composite margin and we do not concur with the proposed composite margin approach. The formula suggested for the amortisation of the composite margin, which brings in both premium and claims / other benefits components, is arbitrary and will not assist a reader in better understanding the financial statements of an insurer.

If the Board were to adopt a composite margin approach, our view is that the composite margin should be remeasured at each reporting date so that an insurer can recognise the changes in the risk profile of insurance contracts, thereby ensuring an accurate balance sheet position at each reporting date.

We would like to see pro forma primary statements and notes to the financial statements included in the ED to understand how this proposed information will be presented in practice.

(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?

Response: We agree that interest should be accreted to the residual or composite margins as we believe that this is a more meaningful presentation for users of the financial statements.

Question 7 – Acquisition costs
(a) 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 costs should be recognised as expenses when incurred? Why or why not? If not, what do you recommend and why?

Response: We agree that it is appropriate for incremental acquisition costs to be included in the initial measurement of the insurance contract as contract cash outflows; however, we believe that the ED and related guidance has defined "incremental" acquisition costs too narrowly. This narrow definition means that there will be different accounting outcomes with varying cost structures when the overall costs involved may be very similar. This will create a situation where the current proposal may drive companies to set up structures to achieve a desired outcome. We are also of the view that insurance contracts are typically priced to recover other direct costs as well as some indirect costs. The proposal could therefore potentially give rise to a day one loss when this does not reflect the commercial reality of the transaction.

The current guidance proposes that acquisition costs should be determined at the contract level. We believe that this also contributes to an unnecessarily restrictive approach which does not reflect the way that an insurer's costs are managed in practice. Acquisition costs should be determined at the portfolio level, using one definition of portfolio that is consistent throughout the ED. This will provide an outcome that is a more realistic reflection of the economics of the underwriting decision taken by management.

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?

Response: See combined response below.

(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?

Response: Our understanding is that the modified measurement model was intended to minimise the significant impact of the new measurement approach in terms of the changes in systems and processes that would impact non-life insurers, and we welcome this concession. If this is the intention, however, the definition in the ED needs to be expanded to allow this to happen in practice. The requirement to include only contracts where the coverage period is approximately one year or less is too restrictive and, for many general insurers, will result in two measurement approaches being applied. Two measurement approaches will give rise to unnecessary complexity and cost. This concern is further compounded by the contract boundary principle which currently serves to extend the coverage period for certain regulated classes of non-life business, resulting in the inability to apply the modified measurement approach.

We believe that the contract boundary principle needs to be reconsidered in relation to regulated classes of non-life business. See response to note 9.

Assuming that the criteria are amended to broaden the application, we would prefer that there is an obligation to use the modified measurement approach when the relevant criteria are achieved. This would serve to ensure comparability of financial information between companies with broadly similar portfolios e.g. non-life insurers. From a general insurance perspective, the modified measurement approach (which is essentially an alternative presentation of the unearned premium approach) is currently well understood by users and preparers of financial information.

We recognise that companies writing both life and general insurance may not necessarily want to maintain multiple reporting systems. The Board should consider how it balances the need for consistency with the requirement to make systems changes that have little or no benefit to preparers or users of the financial statements.

The ED proposes an onerous contracts test at the level of a portfolio of contracts with a similar date of inception. We strongly disagree with this. As noted in response to previous questions, the definition of portfolio should be consistent throughout the ED and should reflect how the insurer manages its business and prices its insurance risk in practice.

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?

Response: We are concerned that the current draft principles define the termination boundary too restrictively and would require provisioning for future renewal of certain fixed term contracts (for example compulsory third party motor liability contracts (CTP) in Australia and many classes of business that we write in the US) that are subject to particular regulatory or other external constraints that oblige to renew the contract but limit our ability to price or underwrite individual risks on renewal.

The application of the ED definition to different CTP regulatory regimes in each of the Australian states may result in different accounting outcomes by state despite the underlying insurance product being the same in each state. For example, in New South Wales (NSW), there are multiple CTP insurers and, although each insurer is obliged to offer renewal on each insured vehicle as the registration falls due to renewal, these insurers have the ability to re-price the risk each year and can take into account individual risk attributes to do this (for example age, change in driving record etc). In Queensland, insurers can add or remove customer incentives based on changes to the risk profile, but the actual premium itself remains subject to community rating. In other Australian states, the CTP market is represented by state government owned monopoly insurers and their freedom to re-price individual risks each year is much more heavily constrained. Application of the ED requirements would appear to result in NSW having clear termination boundaries at each renewal period but unclear termination boundaries would exist for Queensland contracts, and for the other states the termination boundary criteria would not appear to be satisfied.

The same concern exists in relation to many of the classes of business that we write through our global insurance operations, and specifically certain classes of business written in the US, where a price must be filed with the regulator and we then have limited opportunity to re-price risk on renewal of individual contracts.

Further, if a provision for future renewals is required for CTP and similar products, it would be hugely subjective due to the uncertainty in quantifying the potential outcome of future multiple renewals and the likely impact caused by a competitive market dynamic where the insured can change insurer without penalty at renewal due date.

For the Board's information, the CTP market in Queensland comprises around A$1.0 billion of annual gross written premium and the equivalent market in NSW is around A$1.2 billion.

Globally, there are many contractual variations based on particular statutory requirements that, by default, may deem a contract as having a long duration when industry practice and management of such risks indicates otherwise. We are of the view that the contract boundary principle should be revised to focus on the underlying characteristics of the risk and the contract in question. Specifically, we think that there is merit in the ED more clearly defining those long duration contracts where significant future cash flows need to be included in the calculation of the day one liability.

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?

Response: Not applicable

(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?

Response: Not applicable

(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?

Response: Not applicable

(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?

Response: Not applicable

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?

Response: We agree with the definition of an insurance contract and the related guidance.

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

Response: We agree that it makes sense to exclude the examples in paragraph 4 from the definition of an insurance contract.

(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?

Response: Not applicable

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?

Response: We consider the guidance in relation to unbundling to be appropriate. Whilst there is certainly a degree of subjectivity in identifying a component of the contract that may or may not be "closely related to the insurance coverage", we believe that on balance this is preferable to mandating unbundling in all circumstances when this can give rise to significant effort and complexity for a modest benefit.

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?

Response: The proposed presentation in the ED seems to be more focused on the objective of consistency of reporting between long-duration and short-duration contracts at the expense of the other stated objective of providing information that is relevant to users. For short-duration business, the current global practice of reporting underwriting results has built up over many years and is widely understood. Volume information such as gross written premium, earned premium, claims incurred, commissions and expenses are very important information for analysts and other users in monitoring entity growth and performance. As a result, they should be included in the income statement on a mandatory basis.

(b) Do 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?

Response: We agree that all aspects of an insurer's core underwriting performance should be reflected in the profit and loss account.

Question 14 – Disclosures
(a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?

Response: We agree with the overall objective of helping users of the financial statements to understand the amount, timing and uncertainty of cash flows arising from insurance contracts. To achieve this objective, we believe that the level of disclosure must be pitched at the appropriate level, relevant to how the business is actually managed. Too much information can be as confusing and uninformative as too little. We therefore welcome the overarching comments about the appropriate level of detail in paragraphs 80 and 81 of the ED.

We think that mandating a level of analysis which is at least as detailed as the IFRS 8 operating segments (paragraph 83) is inappropriate. Applying this requirement to the required disclosures in paragraphs 86 to 97 will generate significant volumes of data with potentially a large degree of repetition. This will make the disclosures hugely onerous for minimum value added. Whilst we agree with the specific disclosures identified, we believe that management should explain what level of analysis is appropriate and why, and should then prepare the disclosures on that basis. We believe that there will be sufficient market pressure from interested parties (rating agencies, analysts and regulators) to pressure companies to an appropriate level of disclosure without mandating the provision of information that adds no value and possibly detracts from the overall communication.

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

Response: We think that potentially the proposed disclosures may not meet the objective for the reasons set out above i.e. they will require insurers to provide a significantly increased level of disclosure for minimal value added.

(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.

Response: We can think of no additional disclosures that would add any significant value.

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?

Response: Not applicable.

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?

Response: We support the expected loss model for reinsurance assets, being consistent with the expected value approach for underlying cash flows.

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

Response: We broadly support the overall principle of applying the same measurement criteria to reinsurance and direct contracts.

We agree with the principle of recognising a day one gain in relation to an outward reinsurance contract as this matches the accounting treatment (i.e. the day one loss) in the books of the reinsurer and because, given specific circumstances, it is not inconceivable that there may be a profit on an appropriately structured reinsurance contract. This may be particularly the case in the instance of an outwards quota share transaction following an inwards portfolio assumption.

If a non-life insurer applies the modified measurement approach to its gross insurance liabilities, we would expect that similar modifications would apply to the recognition of outward reinsurance assets and liabilities. However, there seems to be no explicit mention of this in the ED although it may be inferred from BC231. In particular, applying the current proposed definitions, it appears to us that an insurer with inwards contracts meeting the short-duration definition may have a problem if outwards reinsurance protection is purchased on a risks attaching basis and may not therefore satisfy the same definition. This would potentially result in the inwards and outwards books of business being measured on different bases, which clearly is not sensible. An explicit reference permitting all outwards reinsurance contracts protecting inwards contracts that meet the short duration definition to be included in the overall short duration measurement approach would resolve a lot of potential confusion.

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?

Response: We suggest that entities that are capable of identifying the appropriate residual margin at the transition date should be allowed to recognise this at transition. It would be unnecessarily penal to not allow this information to be presented if the amounts can be substantiated.

(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)?

Response: The FASB's approach as outlined in the Basis for Conclusions seems to be slightly confused. It seems contradictory to propose a specific risk adjustment only on transition when the fundamental argument for the composite margin is the inherent difficulty in calculating the risk adjustment.

(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?

Response: We agree that it is necessary for the date of the IFRS on insurance contracts to be aligned with that of IFRS 9. We would go one step further and suggest that the proposed insurance accounting standard should not limit the redesignation options available to an entity at the date of transition to the insurance standard. As long as the entity is fully in compliance with both the requirements of IFRS 9 and the insurance accounting standard, an entity should be permitted to make any redesignation subject to making the appropriate disclosures explaining the change.

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

Response: The proposals of the ED are far reaching and represent a significant change in reporting insurance business results for many jurisdictions. A minimum transition period of two years should be sufficient to allow insurance companies and groups to make the relevant system and process changes to achieve the requirements of the ED.

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

Response: The Australian Accounting Standards Board (AASB) has, in the past, made specific changes to the issues IFRS standard, mandating different reporting requirements for Australian entities. We strongly counsel against this approach given the aim of the ED to increase the consistency and usability of financial information in relation to insurers.

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.

Response: We concur with the Board's objective of providing robust financial information to assist users of that information in making economic decisions and agree that it is not unreasonable for insurers to incur some costs associated with changing systems and processes in order to achieve this overall objective. However, we are concerned that some of the proposed changes will give rise to costs in implementation without necessarily increasing the value added by the information produced. These are addressed in the responses to previous questions, but the main areas to note are:

- The potential for insurers to have to run two sets of books because of the restrictive nature of the contract boundary principle and the narrow definition currently applied to contracts meeting the criteria to apply the modified measurement model. This will clearly increase costs and will create confusion for users of financial information produced.

- The current proposed application of the boundary principle may result in the unintended outcome of an entity being required to forecast provisions for future contract renewals when this would be a hugely subjective exercise. Again, this will increase costs and confusion and will not ultimately improve the value of reported financial information.

- Many of the requirements within the ED are set at either the contract level, at the portfolio level or at a more detailed portfolio level which is defined as a portfolio of insurance contracts grouped *"by similar date of inception of the contract and by similar coverage period"*. Our view is that such micro analysis may not reflect the way that the risk is written, priced and managed in practice and this will therefore give rise to further costs of compliance. The ED must have regard to the way that the business is managed in practice so that financial information can be meaningful for users.

- The current transition proposal to take residual margin on existing contracts to opening retained earnings will unfairly penalise those insurers that are able to substantiate these amounts.