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The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007
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Dear Sir,

Re: Exposure draft (ED) on insurance contracts standard

QBE fully supports the development of a high quality international accounting standard for reporting general insurance business and we will continue to utilise our global experience and expertise to provide input into the process of developing this standard.

We are in the process of developing our response to the IASB and performing our field-testing for the IASB in relation to the proposed insurance contracts standard and therefore our comments attached are necessarily draft at this stage.

Whilst we consider many aspects of the proposed insurance contracts standard are positive steps towards global consistency and comparability in insurance accounting, some aspects will result in potential inconsistency across companies, more volatile results and the use of historical discount rates at inception which bear little resemblance to the current economic environment in which the business is operating.

Significant improvements have been made in the development of the insurance contracts standard since the introduction of the first ED in 2010 and we fully support these developments. Changes which we fully support and consider essential to the effectiveness of the proposed standard are:

- **Unlocking the contractual service margin** – this change is essential to allow insurers to reflect up to date actual and expected loss profiles and in reducing unnecessary volatility.
- **Contract boundary changes** – the change to acknowledge re-pricing at a portfolio level is critical for a number of general insurance classes to ensure that similar portfolios are measured on a consistent basis. This also reflects the way the business is managed.
- **Diversification** – the IASB proposals now support appropriate measurement of diversification across portfolios which reflects one of the fundamental concepts of insurance business.
- **Eligibility for use of PAA** – the introduction of the reasonable approximation test will significantly improve the ability of general insurers to utilise the PAA.
- **Presentation of the BBA and PAA approaches** – alignment of the reporting of these two approaches in the profit or loss and balance sheet is a significant step forward allowing insurers who have business accounted for under both approaches to continue to report a combined result for their business.

There are, however, a number of areas where we feel the direction the ED has taken has not appropriately addressed the commercial realities of general insurance accounting, in particular the proposal to **present the discount unwind at an inception date rate in profit or loss and the remainder of the discount movement in "Other Comprehensive Income (OCI)"**. We believe this proposal will introduce more volatility into the reported results of many general insurers. The proposal and examples provided do not take into account the correlation between inflation and interest rates and assume a level of asset and liability matching that is unlikely to exist in practice for many general insurers.

This aspect of the proposals will also create a significant increase in the costs of applying the proposed requirements compared with the 2010 ED due to the data requirements to capture and unwind historical discount rates.

Details of our draft comments on the IASB specific questions are included in Appendix 1.

Included in Appendix 2 are our specific responses to the questions raised by the AASB.

We would be happy to discuss and further clarify any of the points raised in this letter. Please contact Anne Driver on anne.driver@qbe.com for coordination of further input. 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 sincerely,

Neil Drabsch
Chief Financial Officer

Appendix 1 IASB questions and responses

Adjusting the contractual service margin (paragraphs 30–31, B68,

BC26–BC41 and IE9–IE11)

Paragraphs 30–31 propose that the contractual service margin should be adjusted for differences between the current and previous estimates of the present value of future cash flows that relate to future coverage and other future services, provided that the contractual service margin would not be negative. That proposal revises the IASB's conclusion in the 2010 Exposure Draft, which stated that all changes in the estimate of the present value of future cash flows should be recognised immediately in profit or loss.

Question 1—Adjusting the contractual service margin

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if differences between the current and previous estimates of the present value of future cash flows if:
(a) differences between the current and previous estimates of the present value of future cash flows related to future coverage and other future services are added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative; and
(b) differences between the current and previous estimates of the present value of future cash flows that do not relate to future coverage and other future services are recognised immediately in profit or loss?

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

Response

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

The CSM represents the expected profitability of a contract/portfolio. As the coverage period elapses, more information comes to light (regarding the actual vs expected claims experience, final adjustments to premium and actual vs expected claims and acquisition expenses) directly impacting the expected profitability of the contract/portfolio. It is logical to adjust this information against the CSM to reflect the current economic reality of the contract/portfolio and then to amortise the remaining CSM over the remaining life of the policy based on the pattern of transfer of services rather than taking all of the re-estimate at one point in time as proposed in the 2010 ED.

Treatment of changes in risk adjustment and discount related to the liability for future coverage:
We note, however, that changes in the risk adjustment and discount related to future coverage do not impact the CSM <Refer BC 32 (e) "the effects of changes in discount rates and in the risk adjustment do not affect the amount of unearned profit because those changes unwind over time. Accordingly, the contractual service margin would not be adjusted to reflect the effects of changes in the discount rate or in the risk adjustment.">. We do not agree with this assertion.

Where a risk adjustment relates to incurred claims then we agree changes should be included in reported profit or loss. Where the risk adjustment relates to future coverage and requires adjustment in response to a change in expected cash flows then the treatment of the change in cash flows and risk adjustment should align and both be adjusted against the CSM.

The risk adjustment related to future coverage reflects the inherent uncertainty in the cash flow estimates related to future coverage and is inexorably linked to, and based on, the methodology *and assumptions used in the determination of the future cash flows. Any changes in future cash flows result in a reassessment of the risk adjustment in order to revalidate the risk adjustment and as such the treatment of the risk adjustment needs to match that of the cash flow changes and therefore be reflected in the CSM.*

We agree that the discount rate unwinds over time. However, discount changes are not just a function of time but also the changing estimate of cash flows and we believe the dependent nature of the cash flows related to future coverage and the resulting discount require the accounting treatment of both to be aligned. Therefore any discount relating to liability for future coverage should also be adjusted against the CSM.

In summary, the risk adjustment and discount related to future coverage are driven by the estimate of future cash flows and should be accounted for in a consistent manner by adjustment against the CSM. Including the movements in risk adjustment and discount related to future coverage in the profit and loss is an overly complex approach that will result in more volatility. The profit and loss is focused on earned revenue and associated expenses – inclusion of volatility related to business which has not yet earned will introduce unnecessary accounting mismatch into the profit and loss.

In reporting to our regulator, APRA, we are required to determine the valuation of premium liabilities which has similar features to the liability for future coverage. We can confirm from experience that the determination of both the risk adjustment and discount respond to the future cash flow assumptions made.

***Recommendation:** Adjusting both the risk adjustment and discount relating to **future coverage** against the CSM will assist in reducing unnecessary volatility, provide a better accounting match and make financial statements less complex.*

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

Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items (paragraphs 33–34, 66, B83–B87, BC42–BC71 and IE23–IE25)

Paragraphs 33–34 and 66 propose a measurement and presentation exception that would apply when the contract requires the entity to hold underlying items and the contract specifies a link between the payments to the policyholder and the returns on those underlying items. The 2010 Exposure Draft did not propose different accounting for such cash flows.

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

If a contract requires an entity to hold underlying items and specifies a link between the payments to the policyholder and the returns on those underlying items, do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if the entity:
(a) measures the fulfilment cash flows that are expected to vary directly with returns on underlying items by reference to the carrying amount of the underlying items?
(b) measures the fulfilment cash flows that are not expected to vary directly with returns on underlying items, for example, fixed payments specified by the contract, options embedded in the insurance contract that are not separated and guarantees of minimum payments that are embedded in the contract and that are not separated, in accordance with the other requirements of the [draft] Standard (i.e. using the expected value of the full range of possible outcomes to measure insurance contracts and taking into account risk and the time value of money)?
(c) recognises changes in the fulfilment cash flows as follows:
(i) changes in the fulfilment cash flows that are expected to vary directly with returns on the underlying items would be recognised in profit or loss or other comprehensive income on the same basis as the recognition
of changes in the value of those underlying items;
(ii) changes in the fulfilment cash flows that are expected to vary indirectly with the returns on the underlying items would be recognised in profit or loss; and
(iii) changes in the fulfilment cash flows that are not expected to vary with the returns on the underlying items, including those that are expected to vary with other factors (for example, with mortality rates) and those that
are fixed (for example, fixed death benefits), would be recognised in profit or loss and in other comprehensive income in accordance with the general requirements of the [draft] Standard?

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

Response
No comment.

Presentation of insurance contract revenue and expenses (paragraphs 56–59, B88–B91, BC73–BC116 and IE12–IE18)

Paragraphs BC73–BC76 describe the IASB's view that any gross measures of performance presented in profit or loss should be consistent with commonly understood measurements of revenue and expense. Accordingly, paragraphs 56–59 propose that an entity shall present insurance contract revenue that depicts the transfer of promised services arising from the insurance contract in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services. Similarly, paragraph 58 proposes that an entity should exclude from insurance contract revenue and incurred claims presented in the statement of profit or loss and other comprehensive income any investment components, defined as amounts that an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur.
This proposal revises the proposal in the 2010 Exposure Draft that entities would use a summarised-margin presentation, unless the entity was required to apply the premium-allocation approach. The summarised-margin approach proposed in the 2010 Exposure Draft would have presented, in profit or loss, information about changes in the components that make up the insurance contract liability. In effect, the summarised-margin approach would have treated all premiums as deposits and all claims and benefit payments as returns of deposits, by not presenting revenue and expenses in profit or loss.

Question 3—Presentation of insurance contract revenue and expenses Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if, for all insurance contracts, an entity presents, in profit or loss, insurance contract revenue and expenses, rather than information about the changes in the components of the insurance contracts? Why or why not? If not, what would you recommend and why?

Response
We agree that presentation in profit or loss of an entity's insurance contract revenue and expenses more faithfully represents the entity's financial performance and the economic reality of the underlying products. However, we note some omissions and inconsistencies in the approach taken by the IASB to appropriately define the revenue and expenses and the related balance sheet amounts insofar as they relate to general insurance business applying the simplified approach set out in paragraphs 38-40. These inconsistencies are summarised below:

3.1 Inconsistency relating to premium recognition
*As part of the process of working through the PAA accounting requirements we note that paragraph 38 states that an entity may measure the liability for the remaining coverage using the "premium, if any, **received** at initial recognition".*

The emphasis on premium received results in a liability for future coverage largely driven by the pattern of premium receipts. The outcome is a balance sheet driven by a cash rather than accruals concept of accounting and which results in a different outcome for policies which are economically identical and which are sold as identical products but for which the cash payments may differ. In many classes of general insurance business it is common to have different payment options driving only the timing of cash receipts and not the economics of the policy sold.

We note also that the terminology used in part (a) of paragraph 38 above is different in Appendix B91 that better reflects the actual mechanics and economics of the general insurance contract as follows:

*"B91 ……When an entity applies the premium-allocation approach, insurance contract revenue for the period is determined as the amount of **the expected premium receipts** allocated in the period. The entity shall allocate the expected premium receipts as insurance contract revenue to each accounting period in the systematic way that best reflects the transfer of services that are provided under the contract."*

Recommendation: *We propose that paragraph 38 be reworded to refer to expected premiums. This approach will also better align the BBA and PAA approaches in respect of the balance sheet presentation and disclosure.*

3.2 Reinsurance presentation and disclosure

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

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

Recommendation: *The IASB clarify that the risk adjustment covers the insurance contracts risk after allowing for offsetting impact of the reinsurance contracts.*

Interest expense in profit or loss (paragraphs 60–68 and BC117–BC159)

Paragraphs 60, 64 and 66 propose that an entity should recognise:
(a) in profit or loss interest expense determined on an amortised cost basis; and
(b) in other comprehensive income the difference between the carrying amount of the insurance contract measured using the discount rates that were used to determine that interest expense, and the carrying amount of the insurance contract measured using the current discount rates.
These proposals are intended to segregate the effects of the underwriting performance from the effects of the changes in the discount rates that unwind over time. These proposals revise the conclusion in the 2010 Exposure Draft that the effects of changes in discount rates should always be presented in profit or loss.

Question 4—Interest expense in profit or loss

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if an entity is required to segregate the effects of the underwriting performance from the effects of the changes in the discount rates by:
(a) recognising, in profit or loss, the interest expense determined using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows; and
(b) recognising, in other comprehensive income, the difference between:
(i) the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date; and
(ii) the carrying amount of the insurance contract measured using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows?

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

Response
We agree with discounting of claims liabilities and the liability for future coverage to recognise the time value of money. However, we do not agree with the changes that have been made since the first ED to split discount into two components reported in the PROFIT OR LOSS (unwind of discount at inception rate discount rates) and OCI (differences arising from current movements in rates).

4.1 All discount movements should be reflected in the profit or loss

QBE is of the view that all movements in discount rate should be included in the profit and loss for the following reasons:

1. ***Reflecting the current business environment*** - *We deliver results to shareholders and policyholders based on and in the current economic environment – the profit or loss reported should reflect the current economic environment in which we do insurance business. The recognition of discount movement should be based on current rates i.e. opening versus closing reflecting the current economic environment the business is operating in.*

2. ***Clarity of reporting*** - *The composition of the movement in discount rates included in the profit or loss is very clear and unambiguous to investors and other users of our financial statements. Allocating discount movement between OCI and profit and loss adds complexity and at best can only be determined on an arbitrary basis.*
3. ***Natural offset against inflation movements*** - *General insurance claims are significantly impacted by changes in inflation. The recognition of discount movements in profit or loss provides a natural offset between explicit and implicit inflation movements in the claims incurred. This*

relationship is much less apparent for life insurance business where only a few isolated classes tend to respond to inflation.

There are two types of inflation:

Consumer price index – reflecting general price inflation trends impacting the direct claims cost associated with the insured loss. This element of inflation tends to trend with interest rates.

Superimposed inflation – generally relates to increased court awards and therefore reflects political and legislative risks that general insurers face.

AASB 1023: General Insurance Contracts was issued in 1991and contains specific mention of inflation as follows: " The longer the expected period from the end of the reporting period to settlement, the more likely it is that the ultimate cost of settlement will be affected by inflationary factors likely to occur during the period to settlement. These factors include changes in specific price levels, for example, trends in average periods of incapacity and in the amounts of court awards for successful claims. For claims expected to be settled within one year of the end of the reporting period, the impact of inflationary factors might not be material."

As a result it is common for Australian actuaries to specifically model inflationary factors, whereas our experience globally indicates this is not such a common practice elsewhere. This, and the fact Australian insurers discount claims, has allowed us to see demonstrable trends between inflation and discount rates.

4. ***Consistency** - Consistency in accounting approach is key to simplifying the financial statements of general insurers. Given that all changes in the liability for claims incurred and changes in the risk margin related to claims incurred are included in the profit and loss it is sensible to adopt the same approach for the discount movements which are derived directly from the claims liability.*

5. ***Comparability** - Requiring all insurers to account for the discount movement associated with earned business in the profit and loss will improve comparability. Any method which attempts to split discount movement requires significant assumptions to be made and will result in reduced comparability. We support inclusion in the profit and loss of the full discount movement accompanied by appropriate analysis of the drivers of discount movement.*

6. *D**emonstration of key general insurance metrics including duration mismatch** – Life insurance business has many products requiring an alignment of the duration of assets and liabilities. General insurance does not have such a compelling need to match duration. From our discussions with the IASB, we note the concern of some IASB Board members that an amortised basis of discounting is essential to allow users to understand duration mismatch. We do not believe this approach is necessary for general insurance. Depending on the risk tolerance of the general insurance entity, maintaining a level of duration mismatch may be a preferred approach to reduce risk. Such a mismatch is usually down to management decisions, taken now, and thus is part of the current business performance and current year's profit and loss account.*

4.2 Why the IASB proposal to report some discount movement through OCI is flawed

QBE is of the view that the IASB proposals to split the discount movement between an amortised component reported in profit and loss and a fair value movement reported in OCI are flawed for the following reasons:

1. ***Complexity** – The explanation of the unwind of discount in the current profit and loss at a historic rate that may bear no relation to prevailing discount rates or any other metrics within the profit and loss introduces additional complexity when explaining to users of financial statements.*

2. ***Mismatch of asset and liability** – The IASB proposal and supporting examples assume that assets perfectly match liabilities when in practice, the unwind of the discount at an inception based rate will continue regardless of the changes in asset profile. Mismatch may arise from many sources such as:*

- *Assets initially classified as amortised cost or FVOCI may be rolled over, sold or reclassified if the business investment strategy changes.*
- *General insurers may have a different investment philosophy depending on their risk tolerance. This may result in a significant component of assets in the FVP&L classification.*
- *Insurers also invest in many asset classifications, which are required to be valued at FVP&L, such as equities and derivatives, often using derivatives in conjunction with interest bearing securities to manage areas such as duration risk.*

3. ***Existence of latent claims** - Latent claims are a significant feature of the general insurance industry. Latent claims are claims not anticipated when the policy was underwritten and the premium determined and where the potential for claims to emerge at a much later date was not appreciated. Premiums and profits related to latent claims have generally been recognised in prior reporting periods (often many years previous). Claims emerge due to evidence of an issue and the ability (e.g. due to developments in technology or medicine) to link the loss to the cause. Examples of latent claims related to many years ago, which the insurance industry continues to deal with, include pollution, asbestosis, silicosis, industrial deafness. As the premium has been fully earned many years ago there are no assets supporting claims that could, or would, link to an inception date earning rate and therefore such an inception date rate has no relevance to discounting of liabilities.*

   The application of a discount rate based on the inception date of the policy is meaningless in the context of latent claims as by their nature no assets have been held to support latent claims.

4. ***Ignores inflation** - The proposals put forward by the IASB ignore the natural offset between inflation and discount rates relevant to most general insurance classes of business. Refer point 3 above.*

   In particular, for many long tail claims there may be specific links between discount rates and the inflation rates used to drive claims values. Long tail claims are claims for which there is an extended period between recognition of the claim and final determination of the payment amount and settlement. Long tail claims may include latent claims but are not limited to these claims. Where there is a significant period between recognition and settlement the impact of discount is particularly significant and there may be a defined link between the discount rate and the inflation rates used to determine the net loss – for example in Argentinian workers compensation business and Australian dust diseases.

5. ***No clear methodology** – There is no clear definition of the cohort required to measure inception discount rates. The requirement in paragraph 60 (h) to include in profit and loss the "interest expense on insurance contract liabilities determined using the discount rates specified in paragraph 25 that applied at "**the date the contract was initially recognised**" requires application to a cohort of contracts or portfolios. As interest and therefore discount rates move daily this could imply that the inception discount rate should vary daily. Alternatively a clear and unambiguous cohort already available in the world of general insurance is the underwriting year – being the calendar year the policy incepts.*

6. ***Cost** – There is significant cost associated with the requirement to analyse discount movement into two components. Adopting the concept of a cohort as an underwriting year requires entities to develop significant systems and collect previously unused data in order to track discount unwind. If this cohort is intended to be more granular then the level of data collected and the system complexity escalates accordingly. This results in significant escalation of costs.*

7. ***OCI Undefined** – The basis for OCI and the appropriate use of OCI continues to be undefined and thus OCI risks becoming a "dumping ground" for all unwanted volatility. Our view is that it is better to address volatility through appropriate disclosure.*

8. ***Multiple data for business combinations** – Acquired entities will be required to maintain two different discounts rates - one for the entity and one on consolidation. This would result in a different discount unwind in subsidiary vs consolidated results.*

4.3 Approach to a workable option

QBE recognises that some insurers consider that reporting all discount movements in the profit or loss does not appropriately reflect their business model and we therefore consider that the inclusion of an option to adopt the split approach for discount (profit or loss and OCI) may alleviate their concerns and we would support such an option ("the discount option").

The inclusion of an option for discounting needs to be worded with care to ensure that it does not inappropriately interact with the Fair Value Option (FVO) proposed in IFRS 9 which can be applied to reduce accounting mismatch. To ensure a sensible application of both options we propose:

- *The option to split the discount into two components is made at transition into the insurance standard or on first adoption.*
- *The option to elect to transfer the difference between historic unwind of discount and current discount rates is adopted at portfolio level and is irrevocable. The election would be made at portfolio level in order to allow composite insurers to elect the most appropriate business model for the business in that portfolio.*
- *In the event of a business combination a one off election is permitted at acquisition date.*
- *Elect the discount option first. We consider the FVO in IFRS 9 to be perfectly compatible with a discount option provided there is some simple guidance on application. IFRS 9 adopts a business model led approach in determining the classification of assets to accounting categories. The FVO for assets in the FVOCI category is applied to specific assets and can only be elected in the case of accounting mismatch. Therefore it is clearly necessary to elect the discount option first (either on transition, first adoption of a business combination) allowing entities to then determine whether the FVO in IFRS 9 should be applied.*

The fair value option in IFRS 9 proposals allows for a FVO to be applied to assets otherwise recognised as FVOCI in the case of accounting mismatch. This election is made on inception and irrevocable. However, assets are generally much more transferable than insurance liabilities allowing entities to buy and sell to drive investment outcomes. The FVOCI category has sufficient latitude to allow selling within investment objectives.

Effective date and transition (paragraphs C1–C13, BC160–BC191 and IE26–IE29)

Paragraphs C1–C13 propose that an entity should apply the [draft] Standard retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when it is practicable. When it would not be practicable, paragraphs C5–C6 propose a modified retrospective application, which simplifies the transition requirements while maximising the use of objective information. These proposals revise those in the 2010 Exposure Draft, which proposed that the entity should recognise no contractual service margin for contracts in force at the beginning of the earliest period presented. These proposals increase the comparability of contracts in existence at the date of transition with those that are written after the date of transition. However, estimates of the contractual service margin may not be verifiable.

Question 5—Effective date and transition
Do you agree that the proposed approach to transition appropriately balances comparability with verifiability?

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

Response
We consider the proposed transition requirements are a significant improvement on the first ED. Our major concern relates to the timing of the introduction of the insurance standard and the timing of mandatory application of IFRS 9. We believe the application dates of both standards need to be aligned due to the significant dependencies introduced through the added classification of "Fair Value through OCI". Whilst transitional arrangements can align the standards at a later date the extent of the changes arising from application of both the insurance standard and IFRS 9 is significant and further transition requirements related to IFRS 9 just increase the amount of work and associated costs of implementing a standard only to have to revise accounting approaches at a subsequent date.

The main issues arising on application of IFRS 9 will be application of the FVOCI vs FVP&L split which will cause significant accounting and systems changes. The existence of a workable fair value option would largely remove these issues. In addition, the existence of a fair value option for equities which does not recycle to the profit or loss and a FVOCI classification which does recycle is introducing inconsistency of accounting approach and more complexity in explaining results to users.

The likely effects of a Standard for insurance contracts

The proposals in this Exposure Draft result from the IASB's consideration of the comments received on its 2010 Exposure Draft. In the IASB's view, the revised proposals would result in a more faithful representation and more relevant and timely information about insurance contracts in the financial statements of entities that issue insurance contracts compared to the proposals in the 2010 Exposure Draft and with IFRS 4. In developing these proposals, the IASB has sought to balance those benefits with the costs of greater operational complexity for preparers, and any increased costs for users of financial statements in understanding the more complex information produced.
Those costs arise both on initial application and on an ongoing basis, and are described in the following sections of the Basis for Conclusions:
(a) adjusting the contractual service margin (see paragraph BC35);
(b) contracts that require the entity to hold underlying items and specify a link to returns on those underlying items (see paragraphs BC56–BC62);
(c) presentation of insurance contract revenue and expenses (see paragraphs BC99–BC100);
(d) interest expense in profit or loss (see paragraphs BC127–BC132);
(e) effective date and transition (see paragraphs BC164–BC173); and
(f) the likely effects of a Standard for insurance contracts (see Appendix B: Effect Analysis).

The IASB is particularly interested in receiving feedback on how its response to the comments on the 2010 Exposure Draft balance the costs of applying these proposals with the benefits of the resulting information provided.

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

Considering the proposed Standard as a whole, do you think that the costs of complying with the proposed requirements are justified by the benefits that the information will provide? How are those costs and benefits affected by the proposals in Questions 1–5? How do the costs and benefits compare with any alternative approach that you propose and with the proposals in the 2010 Exposure Draft?

Please describe the likely effect of the proposed Standard as a whole on:
(a) the transparency in the financial statements of the effects of insurance contracts and the comparability between financial statements of different entities that issue insurance contracts; and
(b) the compliance costs for preparers and the costs for users of financial statements to understand the information produced, both on initial application and on an ongoing basis.

Response
Our view is that the current proposals further increase the complexity of reporting for general insurers and significantly increase the costs. The benefits of comparability and consistency are minimal given the general insurance industry has already in place some clearly defined metrics and measurement methods which required only minimal amendment by the IASB to arrive at a workable global solution. The desire of the IASB to blend both life insurance and general insurance together into a single solution has been the trigger for a deterioration in the overall outcome for general insurers.

A much more elegant solution would have been to deliver a general insurance standard based on generally accepted global principles with the addition of the key components of the IASB model i.e. expected cash flows, risk adjustment, discounting and contractual service margin representing unearned profit.

Clearly the greatest difficulty is arising in the life insurance space and the need to develop a standard that best reflects the economics and profitability of the products being sold in a way that is transparent to users. The push to resolve life issues between the first and second ED has resulted in a backward step for general insurers.

Our view is that the requirement to split discount between profit or loss and OCI stands out as a requirement which has no benefit in general insurance but requires significant tracking, data collection *and assumptions and significant cost. The ED does permit discount to be ignored for claims expected to settle within a year but the majority of general insurance claims take in excess of one year (the weighted average term to settlement of our portfolio is approximately 2.9 years) and to adopt the one year or less approach at contract level would mean splitting portfolios to reflect the different payout patterns of greater or less than a year – all additional tracking and data collection for no benefit.*

Clarity of drafting

The IASB welcomes views on whether the proposals are drafted clearly and whether they reflect the decisions made by the IASB. If a proposed requirement is not clear, the IASB invites suggestions on how to clarify the drafting of the proposed requirement.

Question 7—Clarity of drafting

Do you agree that the proposals are drafted clearly and reflect the decisions made by the IASB? If not, please describe any proposal that is not clear. How would you clarify it?

Response
Our preliminary view is that the wording is complex and difficult to interpret. We see this as the inevitable result of trying to account for two quite different industries in one accounting standard. Generally accepted principles of general insurance have been omitted in the effort to deliver two quite different industries into one accounting standard. Whilst we acknowledge the overlap between some life products and general insurance a significant component of the life industry has more in common with the asset management industry than it does with general insurance.

As a global general insurer our business will primarily be reported under the simplified approach with some lines of business requiring the main measurement model. As such we have worked through the ED and illustrative examples for both the main and simplified models and note the following areas where we consider the drafting is unclear:

1. *Determination of liability for future coverage under simplified approach (refer response to question 3 above)*
2. *Implication that the risk adjustment can be calculated for gross claims and reinsurance recoveries separately (refer response to question 3 above)*
3. *Use of terms "portfolio" and "contract" in an inconsistent manner.*

We also note that the IASB has included many examples of the main measurement model but omitted to include any relating to the simplified model making it impossible to verify our conclusions and interpretations of how the simplified model is applied.

Recommendation
We recommend that worked examples for the PAA approach be included in the final standard and that the term portfolio is used consistently throughout the standard.

Appendix 2 AASB questions and responses

AASB question 1

Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:
(a) not-for-profit entities; and
(b) public sector entities, including any GAAP/GFS implications;

Response
We have not identified any regulatory issues or other issues arising in the Australian environment at this stage of our analysis that may affect the implementation of the proposals.

AASB question 2
Whether, overall, the proposals would result in financial statements that would be useful to users

Response
Our major concern is the requirement to report a component of the discount movement in OCI. Our detailed comments on this area are included in our response to question 4 of Appendix 1.

AASB question 3
Whether the proposals are in the best interests of the Australian economy

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

AASB question 4
Unless already provided in response to specific matters for comment 1 – 3 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative.

Response
There are still aspects of the ED we consider require further development, change or clarification. However, we believe the insurance contracts project needs to be driven through to completion in the existing process to begin the process of a developing a more consistent international approach to accounting for general insurance.