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Principal Adviser
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via email to: insurancetax@treasury.gov.au

Dear Sir / Madam

Re: *Taxation of insurance companies:* Consultation paper on the tax impacts of AASB 17, recognition of outstanding claims and tax provisions for health insurers

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 over 30 countries and territories. We are also one of the top 20 global insurers and reinsurers as measured by net earned premium.

QBE welcomes the opportunity to comment on the Consultation paper. Since QBE writes only general insurance, our responses to the questions in Sections 1 and 3 of the Consultation paper are from a general insurance perspective. We have not responded to the questions in Section 2.

In responding to the questions in the Consultation paper, we draw your attention to the following:

- We have performed sufficient work on the application of AASB 17 to be able to determine the major areas of impact to QBE, but have not yet quantified those impacts. Ongoing discussion on a number of key issues with the IASB, the industry and auditors is expected to result in further changes to IFRS 17 before it must be applied.
- We agree that the most significant impacts in terms of taxable income for general insurers will be transitional, as noted at page 5 of the Consultation paper.
- QBE supports the core principle of aligning tax and financial reporting to the extent feasible in order to minimise costs to the business and our consumers.

We would be happy to discuss and further clarify the points raised in this letter. Please contact our Group Head of Tax, Paul Masnick at [redacted] for coordination of further input.

Yours sincerely,

Inder Singh
Chief Financial Officer

Appendix – responses to Consultation paper questions

Stage of implementation

1.1 Have you commenced an assessment of the financial implications of AASB 17?

In 2017, QBE completed a global assessment of the impact IFRS 17 on QBE businesses. This assessment identified key areas of interpretation or resolution required before AASB 17 could be implemented. Our second project phase focused on these key areas of interpretation and also on how the standard could be practically applied.

1.2 Have you completed your assessment of the financial implications of AASB 17? If not, when do you anticipate your assessment of the financial implications of AASB 17 will be complete?

Our impact assessment and interpretation work to date has identified, at a high level, the focus areas of financial impact both on transition and in the post AASB 17 accounting state; however, we have not yet quantified the likely impact.

The following areas need to be resolved to allow assessment of the financial implications:

- A number of issues of technical interpretation, particularly those applying to general insurance and QBE. We are hopeful that many of these issues will be resolved by the IASB at its Board meetings in early 2019 and at the scheduled April 2019 IASB Transition Resource Group meeting.
- Clarity over the generally accepted practice of determining the level of aggregation applied to identify 'portfolios' and 'groups of contracts' within portfolios.
- Clarity over the determination of the risk adjustment for measurement of insurance contracts issued and reinsurance contracts held, particularly in relation to the measurement of onerous contracts issued.
- A final determination on the extent to which QBE's products are eligible to apply the premium allocation approach (PAA) which impacts both the accounting for ongoing business and acquired portfolios.

1.3 When do you anticipate adopting the standard for the first time?

QBE currently plans to adopt AASB 17 from the mandatory application date of 1 January 2022.

Financial impacts for accounting and tax purposes

1.4 What are the expected financial impacts of AASB17 in the first year of adoption (including any transitional adjustment required on implementation of AASB17) and in subsequent years? Please identify both profit and loss and balance sheet impacts and quantify the impact where possible.

In terms of the key areas noted in respect of Q1.1 and Q1.2, QBE is making solid progress on technical interpretation and PAA eligibility and therefore has a broad sense of the financial implications of AASB 17. However, it is too early to make estimates as:

(a) there are ongoing deliberations regarding interpretation and potential changes to the standard; and
(b) the market's interpretation around areas such as aggregation is still forming.

Our work so far has identified that there are likely to be day-one transitional impacts created by the following factors:

- The AASB 17 requirement to adopt the 'group of contracts' (rather than portfolio) as the level at which contracts will be measured, will likely result in earlier recognition of onerous contracts relative to AASB 1023. At least some of the impacts that would have been recognised during the coverage period will now be recognised when the contracts incept.
- Inclusion of an illiquidity component in discount rates is likely to result in slightly higher rates for discounting cash outflows associated with outstanding claims and, consequently, a lower (present value) liability for claims and associated expenses on transition relative to AASB 1023. The impact will unwind as the impact of discounting unwinds.

- The change of treatment of acquired businesses and portfolios under AASB 17, relative to AASB 1023.
- The measurement of the risk adjustment for entities within a consolidated Group.

QBE does not currently anticipate significant ongoing volatility as a result of adopting AASB 17. That is, for the most part the transitional changes are expected to be 'once-only' impacts; however, ongoing work at QBE on contracts with long coverage periods is still in progress and could potentially change this view.

1.5 Are the financial impacts outlined in Question 1.4 principally related to the change to the treatment of Deferred Acquisition Costs as described in this consultation paper? If not, what are the main drivers of the financial impacts? [see attached slides for indication]

At this stage, the narrower definition of costs included as acquisition costs under AASB 17 (as compared with AASB 1023) is unlikely to give rise to a material impact for QBE in the year of transition or subsequently. QBE does not currently plan to apply the AASB 17 option to immediately expense all acquisition costs for contracts with coverage periods of a year or less.

We note that some costs may be reclassified, for example, being classified as overheads under AASB 17, rather than as acquisition costs under AASB 1023.

1.6 Should the tax arrangements for risk underwriting business be the same for general, life and health insurers (noting that there would need to continue to be separate arrangements for the other components of life insurance business)? Why or why not?

As a matter of principle, tax reporting and financial reporting should be aligned to minimise reporting costs for preparers and to provide a level of comfort for the ATO that the financial reporting is subject to external audit.

We note that QBE is a general insurer, and we therefore cannot comment on the appropriateness of this approach for life insurance and/or health insurance business.

1.7(a) What is the estimated impact of risk adjustment in the financial statements?

For QBE as a general insurer already recognising risk margins under AASB 1023, the AASB 17 risk adjustment requirements are not expected to result in material changes at the consolidated entity level.

There has been some discussion at the IASB Transition Resource Group, and now within the IASB itself, about how risk adjustments are determined at the Group versus subsidiary level and the extent to which the Group view on risk is 'pushed down'. This may result in changes to the risk adjustment in subsidiary entities of the QBE Group, including the Australian reporting entities. In addition, there have been recent discussions with the IASB on the extent to which reinsurance held is recognised in measuring the risk adjustment which could have implications for general insurers in particular.

1.7(b) How should the risk adjustment for life insurers be treated for tax purposes? Would there be benefits in aligning the treatment across the life, general and health insurance sub-sectors? See 1.6 above

As a matter of principle, we believe that tax reporting and financial reporting should be aligned; however, we note that QBE is a general insurer, and we therefore cannot comment on the appropriateness of this approach for life insurance and/or health insurance business.

1.8 Have you identified other areas where implementing AASB 17 results in a change in tax treatment? If so, please describe this change, how it arises and estimate the value of the impact in the financial statements.

If the tax treatment is aligned with AASB 17, areas where current tax requirements for general insurers might need to be changed are as follows:

- AASB 17 requires identification of claims settlement costs but does not distinguish between direct and indirect claims settlement costs in the way AASB 1023 does. To align with AASB 17, tax laws would need to change to bring the tax treatment of indirect claims settlement costs in line with direct claims settlement costs.

- AASB 17 requires earlier identification of onerous or loss-making contracts and consideration should be given to how this will be treated for tax purposes.
- When the 'general model' [AASB 17.32 to 52], rather than the PAA, needs to be applied, a decision would need to be made about how contractual service margins and their allocation over coverage periods ought to be treated for tax purposes.
- AASB 17.88 to 90 permit entities to choose between presenting insurance finance income or expenses for the period:
  - in profit or loss (the existing AASB 1023 policy); or
  - disaggregated between profit or loss an amount and other comprehensive income (with previous years' amounts from other comprehensive income being systematically allocated to profit or loss over the duration of the group of contracts).

A decision will need to be made as whether this choice would have any impact on the way in which finance income or expenses are treated for tax purposes. At this stage, consistent with the existing AASB 1023 policy, QBE plans to present all finance income and expense in profit or loss.

Linking tax to accounting standards

1.9(a) Is it appropriate for the tax outcomes for insurance contracts to be linked (or aligned) to accounting outcomes under AASB 17?

Yes. As noted in our response on Question 1.6, we consider there are significant efficiencies associated with aligning tax reporting with financial reporting both for preparers and the ATO in terms of minimising reporting costs and benefiting from the comfort provided by the external audit of financial reports.

1.9(b) What are the implications of linking the tax outcomes to AASB 17?

Simplicity and minimising costs to business and, in turn, minimising the costs passed on to consumers. Furthermore, there is the added control aspect provided by the external audit of financial reports.

*1.9(c) What are the implications of **not** linking the tax outcomes to AASB 17?*

Duplication of record keeping obligations for insurers resulting in expenditure on unproductive administrative activities and, in turn, higher costs to consumers. There would be considerable benefits in having on set of documentation that satisfies accounting and tax requirements.

1.10 If the tax outcomes are to be aligned with AASB 17, are transitional rules required and why? For example, are rules required to prevent any double deductions or non-deductions or to otherwise smooth the impact of the change?

Yes. QBE considers it would be appropriate to have clear tax transition rules, including possibly rules around taking the impacts of transition from AASB 1023 to AASB 17 over a number of tax years in a clearly defined manner. We do not have a view as to what an appropriate period would be.

Recognition of outstanding claims

3.1 Should the tax laws specify clear criteria for determining the OCL? Why or why not?

As noted in our response to Questions 1.6 and 1.9 above, QBE firmly supports the principle of aligning tax reporting and financial reporting, producing consistent outcomes and reducing compliance costs through additional record preparation and keeping.

Aligning tax law and the accounting model

Given the scrutiny of financial reporting under AASB 1023, and soon under AASB 17, the Standards provide a highly transparent accounting model which should be leveraged to facilitate administration of taxation, such as in relation to lodgements, calculation of PAYG instalments and transfer of information to the ATO. The same level of transparency may not occur if tax law were to deviate from accounting. We believe the AASB 17 accounting results will be a relevant depiction of insurers' economic outcomes for tax purposes.

The Review of Business Taxation (i.e. Ralph Review) sought to more closely align taxation law with accounting principles wherever possible. There have been a number of examples of this, such as Tax Consolidation, Thin Capitalisation and Taxation of Financial Arrangement regimes. These reforms have created net benefits by reducing compliance costs and improving certainty, without prejudicing tax policy objectives.

Division 321-20 requires the tax OCL to be worked out as "amounts that, at the end of the income year, the company determines, based on proper and reasonable estimates to be appropriate to set aside and invest in order to meet: (a) liabilities for outstanding ...; and (b) direct settlement costs ...". It is widely accepted that this is consistent with the requirements of AASB 1023 and should be consistent with the requirements in AASB 17 regarding OCL, subject to the treatment of claims settlement costs.

AASB 17 requires identification of claims settlement costs but does not distinguish between direct and indirect claims settlement costs in the way AASB 1023 does. Instead, both are included in the OCL under AASB 17 to reflect that they are costs of settling outstanding claims. Tax law [Section 321-20] currently excludes indirect claims settlement costs and requires a separate adjustment when calculating taxable income. QBE supports amending tax law to bring consistency of treatment between direct and indirect claims settlement costs and to align with the AASB 17 accounting model. This would avoid any need to make a split between direct and indirect claims settlement costs purely for tax purposes.

The OCL and timing

In the event that the level of the OCL were under- or over-estimated, the impact would be limited due to the nature of most general insurance business. As a general insurer, the majority of QBE's business is short tail. The average term to settlement for QBE's Australian claims reserves is approximately 2.5 years. That is, claims on average are likely to be finalised and settled within 2.5 years from the date of occurrence. The OCL reported in the financial statements represents the best estimate at the balance date and any under- or over-estimate would, on average, be removed within 2.5 years. It follows that, any advance payment of income tax or deferral of income tax payable due to OCL estimates being lower or higher than actual amounts would also be resolved within that short timeframe.

In conclusion, we believe that that the tax laws do not need to be amended to specify clear criteria for determining the OCL. However, tax law may need to be amended to address:

- alignment with AASB 17 for the matters identified in our response to Question 1.8; and
- aligning the treatment of indirect settlement claims settlement costs to that of direct claims settlement costs.

3.2 Are there other adjustments that should be considered if clear criteria are specified?

QBE does not believe clear criteria need to be specified by the ATO for other adjustments. If accounting is aligned to tax as recommended, no adjustments would be required.