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30 April 2012

Dear Michelle:

Re: Insurance Accounting Staff Paper – Mind the UK GAAP

QBE European Operations (QBE EO) welcomes the opportunity to comment on the proposals contained in the above document, which we have reviewed in the context of the broader Accounting Standards Board's (ASB) consultation on the Future of UK GAAP.

QBE Insurance Group 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 52 countries. We are also one of the top 20 global insurers and reinsurers as measured by net earned premium. QBE EO is the parent company of the European Operations Division of QBE, and currently produces UK GAAP consolidated accounts for its European subsidiaries, and individual company accounts currently under local GAAP, mainly UK GAAP. We also produce syndicate accounts under UK GAAP for our Lloyd's syndicates.

Our responses to the questions in the paper are set out in the appendix to this letter.

In addition, we enclose a copy of a letter we sent recently to the IFRS about an important issue relating to the current treatment of currencies within IFRS, and a mismatch between the treatment of insurance items in the accounts. This is potentially an issue with UK GAAP accounts, as the relevant standard, IAS 21 is converged as FRS 23.

Overall, we believe the ASB should support the IASB's accounting for insurance contracts as this will bring the UK closer to global comparability, which is essential in a globally competitive market such as insurance.



Should you wish to contact us about any comments, please feel free to contact Richard Rees (020 7105 5255, richard.rees@uk.qbe.com) in our London office.

Yours sincerely

A handwritten signature in blue ink, appearing to read "D. J. Winkett".

David Winkett
Chief Financial and Operating Officer

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Appendix –Response to ASB’s questions:

Long-term solution

7.4 Do you agree that the long-term solution for accounting for insurance by reporting entities in the UK (listed and unlisted) is to incorporate IFRS 4 Phase II into UK GAAP, when issued by the IASB and adopted for use in the EU?

Yes. We see no reason for UK GAAP to have a unique accounting standard for Insurance.

Short-term solution

7.5 When providing comments on the short-term solutions please comment on:
(a) whether you agree that all aspects of the problem have been identified? If not, what is missing and how do you see it impacting the accounting for insurance contracts?

The discussion paper does not cover the issue of the interaction of the Companies Act (derived from the Insurance Accounts Directive) and current IFRS 4. For example, as quoted in the discussion paper, current IFRS 4 grandfathers existing accounting, whilst allowing changes that render the financial statements more relevant and no less reliable or more reliable and no less relevant. We would want to incorporate discounting of all insurance balances, as the principles behind IFRS 4 and Solvency II are now known and incorporate discounting, however, the Companies Act prohibits discounting of general insurance unless the period between claim and settlement is greater than four years.

The adoption of the current IFRS 4 and then the final IFRS 4 Phase II standard should not be restricted to those treatments permitted by the current Companies Act and as such the Insurance Accounts Directive and the Companies Act need to be changed.

(b) what is your preferred solution (whether one of those set out in section 6 above or not) for insurance accounting in the UK during the gap period?

Our preferred solution is to adopt the current IFRS 4, and replace with IFRS 4 Phase II when that standard is finalised, giving UK and Irish companies the full range of options permitted by IFRS 4. It will be important to maintain parity with the standards required by listed groups applying full IFRS, which may well preclude early adoption of the



Phase II standard, as many users of the relevant UK standards will be subsidiaries of IFRS groups.

Specific disclosures required by the standard should be reviewed using similar principles to that used for other standards as part of the reduced disclosure framework (draft FRS 101). Many of the disclosures are not currently required in the UK on a subsidiary level, just at a group level.

(c) what is the your rationale for proposing that solution, including the balance of cost and benefits?

To increase comparability amongst users of insurer accounts worldwide and to reduce the costs on preparers of maintaining more than one set of accounting standards.

(d) what is the likely impact of any changes in accounting for insurance contracts under UK GAAP on the entity you have in mind. It would be helpful if your response clarifies the current position of the reporting entity you have in mind (listed, unlisted, reporting in accordance with IFRS/grandfathering/own accounting policies/UK GAAP/other).

We are the wholly owned European arm of an Australian listed insurer, whose group accounts are prepared under the Australian equivalent of International Financial Reporting Standards (AIFRS). AIFRS has more detailed requirements for insurance accounting than the existing IFRS 4, whilst complying with it. Currently our European accounts are prepared under local GAAP, mostly UK GAAP, and we produce a consolidated set of accounts for our European companies under UK GAAP. The accounting principles used have to be adjusted for prior to inclusion in our Australian ultimate group accounts. We are in the process of aligning accounting policies across entities worldwide, which, without changes in UK GAAP, will entail us moving to IFRS for our European entities. Our preference is to continue with UK GAAP, thus we are interested in using a UK GAAP that is aligned with IFRS, but only if the options we need to choose to align with AIFRS are not prevented by the Companies Act.

We also prepare Lloyd's Syndicate Accounts for our syndicates at Lloyd's. These are prepared under the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008. Subject to a few changes, these accounts must comply with Schedule 3 to the 2008 Accounting Regulations to the Companies Act, and give a true and fair view, which means comply with UK GAAP. Without a change in the requirements, companies such as ours would be in the situation of accounting for



some entities under IFRS and some, for example Lloyds entities, restricted to UK GAAP. This will lead to lack of comparability in local markets and with overseas peers.



5 April 2012

Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
UNITED KINGDOM

Dear Sir,

Re: Treatment of insurance contracts as a monetary item

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

QBE fully supports the IASB in their aim to develop a set of global financial standards and we will continue to provide input into the process of developing these standards where we have the experience and expertise.

One of the long-standing issues we, and many other insurance companies, face in dealing with multiple currencies is the interpretation of the application of IAS 21: The Effects of Changes in Foreign Exchange Rates (IAS 21) as it applies to insurance contracts. This issue is set out in more detail below and in the attachment overleaf and was expected to be resolved on application of the proposed insurance standard. Given the significant delay in developing and issuing the insurance standard we believe this matter needs to be addressed separately and urgently as a clarification of IAS 21.

A number of our operations deal with multiple foreign currencies. In particular our London market operations are exposed to a significant number of foreign currencies. IAS 21 paragraph 23(b) specifies that at the end of each reporting period "non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction". As monetary items are defined, in paragraph 8, as "units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency" this is interpreted to exclude all amounts of unearned premium and deferred acquisition costs relating to insurance contracts. As a result, all amounts of unearned premium and deferred acquisition costs are translated at historical rates, both initially and in subsequent reporting periods, resulting in a distortion of the underwriting result and combined operating ratio due to currency mismatch.

In simple terms, premium and related acquisition costs are recognised in the underwriting result at the initial transaction rate, both at the inception date and in subsequent reporting periods, but the claims arising from this risk, both reported and unreported claims, are translated at current spot rates and continue to be retranslated at current rates until they are settled. Unearned premium net of deferred acquisition costs is in essence a liability to fund future claims and therefore the distortion in the combined operating ratio of the multi currency insurer needs to be removed by treating the unearned premium and deferred acquisition costs as monetary amounts. The combined operating ratio is one of the most important performance measures used in the global insurance industry and, in times of currency volatility, this distortion can be significant. Example 1 of the attachment illustrates this issue.

We note that the proposed changes to the insurance standard seek to alleviate this problem by specifying the following requirement in paragraph 61 of the Exposure Draft ED/2010/8: "When applying IAS 21: The Effects of Changes in Foreign Exchange Rates to an insurance contract that results in cash flows in a foreign currency, the insurer shall treat the contract as a monetary item." We

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concur with this approach and we acknowledge that this will resolve a long-standing industry issue. Given the significant time delay in the development of the insurance standard, we consider that this issue should be addressed at an earlier date as a clarification of IAS 21 by recognising that unearned premium and deferred acquisition should be considered monetary items.

Yours sincerely,

Neil Drabsch
Chief Financial Officer

cc Ian Mackintosh – Vice-chairman, IASB
cc Kevin Stevenson – Chairman and CEO, AASB

Attachment 1

To illustrate distortion in underwriting result arising from the treatment of premiums and insurance costs as non-monetary items.

Example 1: Multi-currency insurer with a functional currency of £
GWP written 1/1/Y1 of US\$120m

	P&L for Y1 US\$	Rate	Multi- currency insurer P&L for Y1 £	
Premium	120,000,000	1.50	80,000,000	Non-monetary item - booked at transaction date rate 1.5 and earned during Y1
Claims	(88,000,000)	1.60	(55,000,000)	Monetary item - booked at average rate representing the various transaction date spot rates when claims/IBNR are recognised.
Commissions	(20,000,000)	1.50	(13,333,333)	Non-monetary item - booked at transaction date rate 1.5 and earned during Y1
Underwriting result	<u>12,000,000</u>		<u>11,666,667</u>	
Combined operating ratio (i.e. claims and commissions as a % of premium)	<u>90%</u>		<u>85%</u>	
Reported profit as a % of premium	<u>10%</u>		<u>15%</u>	