20 December 2017

The Manager
Base Erosion and Profit Shifting Unit
Corporate Income Tax Division
Revenue Group
The Treasury
Langton Crescent
PARKES ACT 2600

Via email: BEPS@Treasury.gov.au

Dear Sir

Implementing the OECD Hybrid Mismatch Rules

We refer to exposure draft legislation released on 24 November 2017 ti implement the Organisation for Economic Co-operation and Development's ("OECD") rules at eliminating double non-taxation benefits from hybrid mismatch arrangements.

We wish to raise two matters that were addressed in the Government's Budget announcements that do not appear to have been reflected in the exposure draft legislation which we consider should be taken account.

1. Insurance Australia Group Business

Insurance Australia Group Limited ("IAG") is an Australian resident company operating in Australia, New Zealand, and Asia. IAG is the leading general insurance provider in New Zealand across both the direct and intermediated channels. Insurance products are sold directly to customers predominantly under the State and AMI brands, and through intermediaries (insurance brokers and authorised representatives) predominantly under the Lumley and NZI brands.

IAG is an Authorised Non-Operating Holding Company ("NOHC") and the head of a Level 2 insurance group which is regulated by the Australian Prudential Regulation Authority ("APRA").

2. IAG's issue of Reset Exchangeable Securities

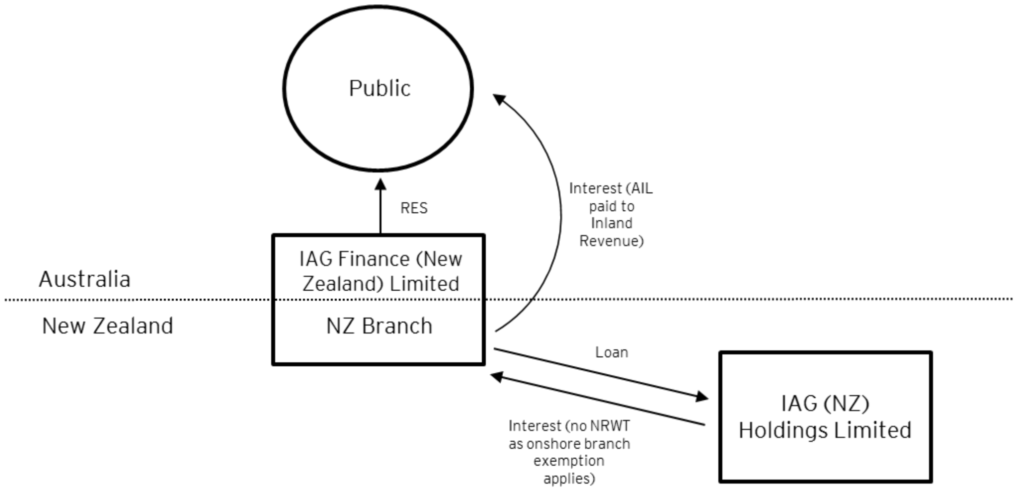
IAG's interests centre on the application of the proposals to regulatory capital for insurers. The New Zealand branch of IAG Finance (New Zealand) Limited, a wholly owned subsidiary of IAG, has issued perpetual reset exchangeable notes, known as Reset Exchangeable Securities ("RES") to Australian, predominantly retail, investors. The $550 million funds raised have been loaned to IAG (NZ) Holdings Limited to fund IAG's New Zealand operations. The RES qualify as regulatory capital for the IAG Group under APRA's prudential standards. The RES distributions are treated as equity for tax purposes in Australia (and are therefore required to be franked), however the distributions are deductible for the New Zealand branch.

The RES may be exchanged by IAG or the holder on a reset date, or upon certain events. The next reset date is 16 December 2019. On a reset date, IAG may convert RES into IAG ordinary shares, arrange a third party to acquire RES for their face value or redeem RES for their face value, subject to APRA approval.

The RES instrument, in its 2004 original form and its 2009 amended form, has been a key component of the IAG capital structure for 12 years. Since 2009, it has qualified under its terms as Additional Tier 1 ("AT1") capital, although since 2013 an increasing proportion has been reallocated to Tier 2 capital as a consequence of APRA's transitional arrangements for securities issued prior to the introduction of 'Basel III' on 1 January 2013[1].

These arrangements are summarised in Figure 1.

Figure 1: IAG Finance (New Zealand) Limited existing funding arrangements



3. Section 215-10

The Government's Budget announcement states that "where the AT1 capital is not wholly used in the offshore operations of the issuer, requiring the franking account of the issuer to be debited as if the returns were to be franked". This suggests that section 215-10 will have ongoing application. As such, we would strongly support the comments made by the Board of Taxation at B.19 namely "… further consideration should be given to amending the section to make it more workable in practice, and to extend its useability by … ***extending its application to regulated insurance entities***."

For the reasons outlined in the previous section, the ability for IAG to be able to issue unfranked AT1 to continue to fund its New Zealand operations is a desirable outcome. This can be facilitated by the extending the application of Section 215-10 to regulated

[1] The terms of securities issued by banks and insurers which are eligible as AT1 and Tier 2 regulatory capital are highly correlated, including since 2013 the requirement to meet the requirements of 'Basel III'.

general insurers. The extension to regulated general insurers should include their respective NOHC consistent with APRA's criteria for capital which facilitates issuance by an insurer or its NOHC.

This does not appear to have been reflected in the exposure draft legislation.

4. Transitional arrangements

The Government's announcement states that the new measures will not apply to AT1 instruments issued "by banks and other financial institutions" before the announcement until the next call date of the instrument occurring after the announcement.

The exposure draft legislation restricts the transitional arrangements to AT1 capital instruments issued by authorised deposit-taking institutions. We consider this should be extended to regulated general insurers. The extension to regulated general insurers should include the respective NOHC and its controlled entities. IAG Finance New Zealand Limited is a subsidiary of IAG, the RES are eligible as regulatory capital for the IAG Group

The exposure draft legislation refers to available call date. We recommend that the legislation refers to a scheduled call date. Otherwise, there would be a concern that the reference to an available call date could potentially refer to a call right triggered by a "Tax Event" thereby leading to investor uncertainty and the potential acceleration of the application of the measure.

5. Conclusion

We would welcome the opportunity to discuss these items should you require. Please do not hesitate to contact me on 03 9601 8249.

Yours faithfully

Craig Hespe
Head of Group Taxation