

Insurance Contracts

What will it mean for you ?

7 September 2010



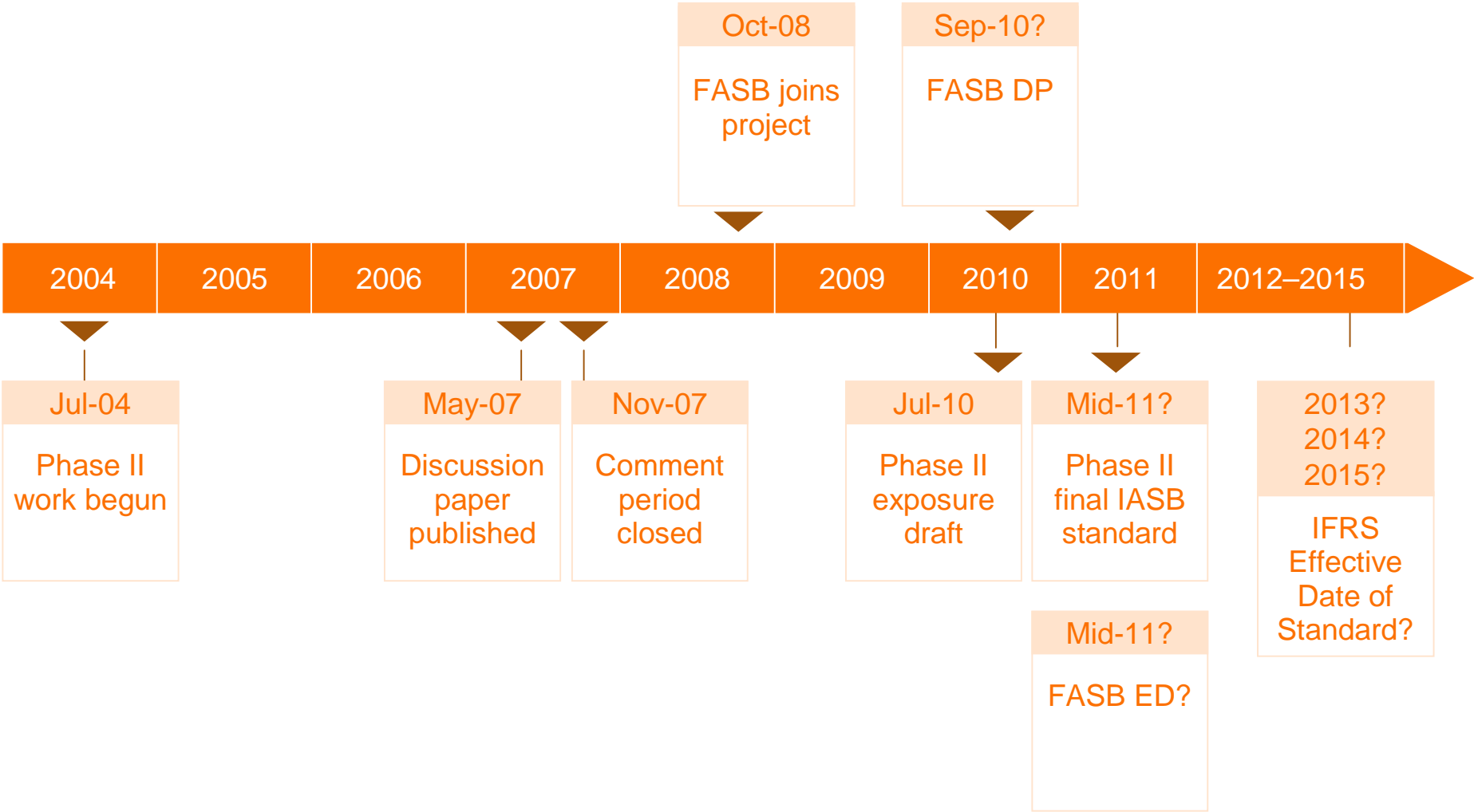
Agenda

Breakfast time	
Introduction	Kim Smith
“The Journey so far”	Scott Hadfield
Panel question time	Kim Smith
Wrap up	Kim Smith

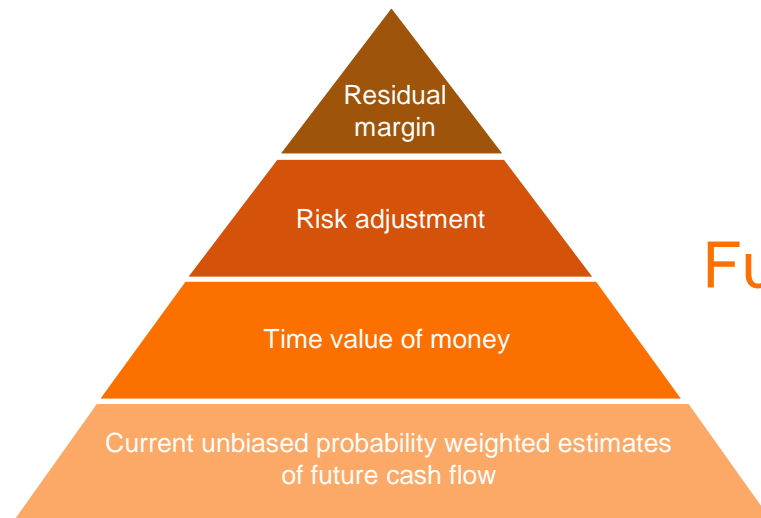
Introduction

- Largely based on AASB 1023
- More substantive change for Life / Health Insurers
- Technical Points;
 - Contract boundary
 - Acquisition costs
 - Unit of account (Diversification, LAT)
 - Transition
 - Disclosure
- Increased profit volatility
- IASB Timing / Final draft
- More than just an accounting issue (systems, people, rem, tax, regulation, distribution models)

Timeline



Measurement model – Overview

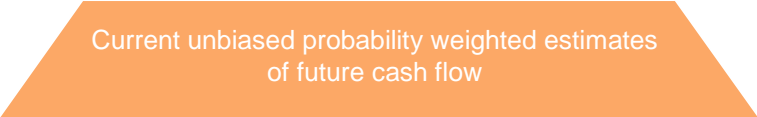


Fulfilment rather than an exit objective

- One model for all insurance contracts
- Combination of rights and obligations (inflows and outflows)
- Day 1 loss in income statement, no day 1 gain
- Margins are part of liability

Boundary of contract

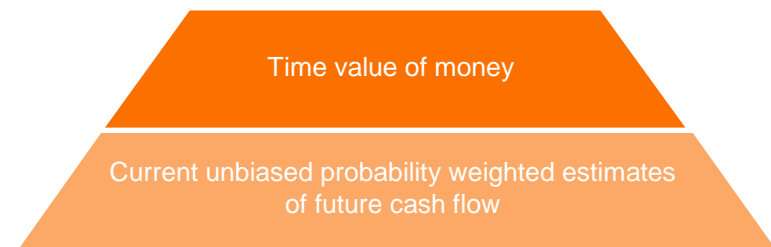
- Contract boundary is where insurer
 - Is no longer required to provide cover **or**
 - Has right or practical ability to reassess risk of particular policyholder and can reprice.
- Options and guarantees included on look through basis of expected future cash flows with no “deposit floor”.



Current unbiased probability weighted estimates
of future cash flow

Discount rate

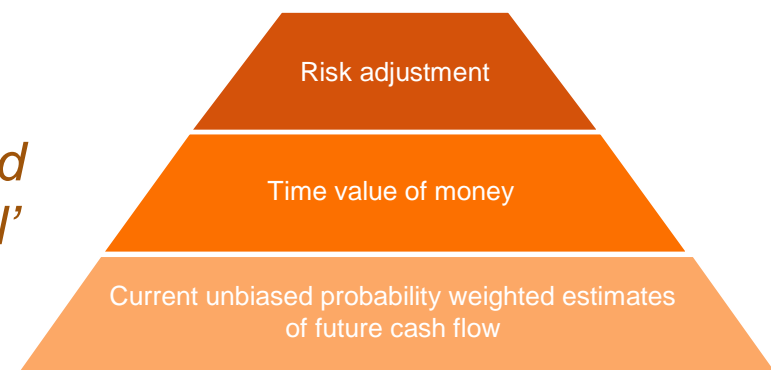
- Reflects characteristics of the liability
 - If liability independent of supporting asset, discount rate is risk free with adjustment for illiquidity
 - If liability linked to supporting assets then discount rate reflects that linkage.
- No adjustment for non-performance risk.



Risk adjustment

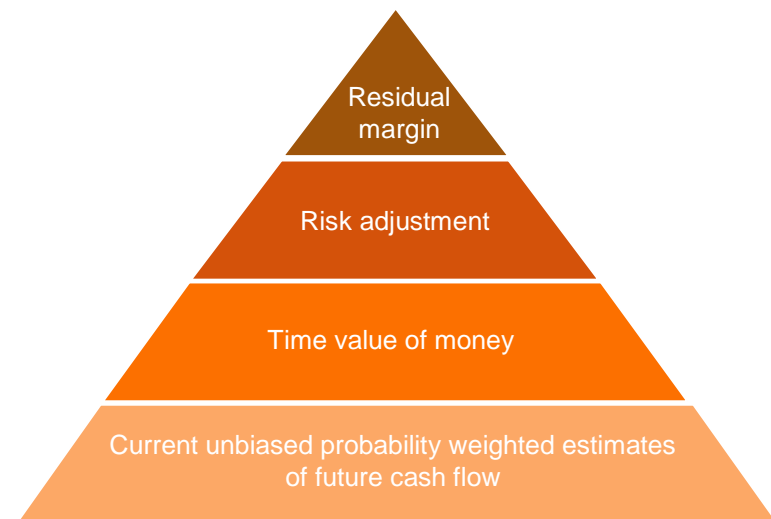
- Objective of risk margin to reflect the maximum amount that an insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected
- Limited range of permitted techniques
 - Confidence level, conditional tail expectation (or tail VAR) or cost of capital
 - Confidence level disclosures are required irrespective of technique used.
- Diversification at portfolio level.

‘Subject to broadly similar risks and managed together as a single pool’

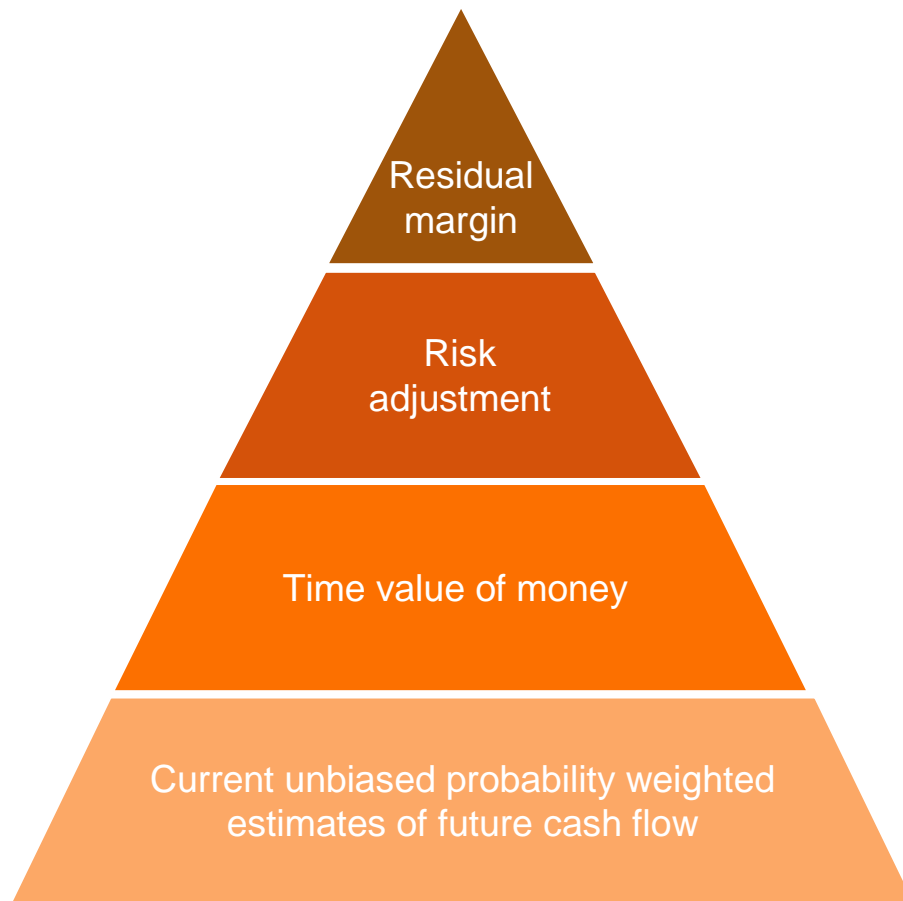


Residual margin

- Residual margin determined at inception within a portfolio by date of inception and by length of contract
- Residual margin amortised in systematic way over coverage period
 - Passage of time
 - Expected timing of claims and benefits if different.
- Interest accreted at locked in rate
- Residual margin cannot be negative.



Subsequent measurement



Remeasurement

X - amount initially recognised is unwound but not remeasured

✓ Updated for current estimates

✓ Updated for market rates

✓ Updated for current estimates

Short duration contract model

- Unearned premium method required for pre-claims liabilities of short-duration contracts
- Applies when:
 - Coverage period approximately 12 months or less
 - No embedded options or other derivatives that would significantly affect the variability of cash flows.
- Claims liabilities measured at present value of fulfillment cash flows (using the three building blocks).

Short duration contract model (continued)

Initial recognition

- Premium (plus present value of any future premiums within the contract boundary) less any incremental acquisition costs
- Onerous contract test.

Subsequent measurement

- Reduce the initial liability in a systematic way
 - Passage of time
 - Expected timing of claims and benefits if different.
- Onerous contract test
- Accrete interest at current interest rate.

Exposure draft: Insurance contracts

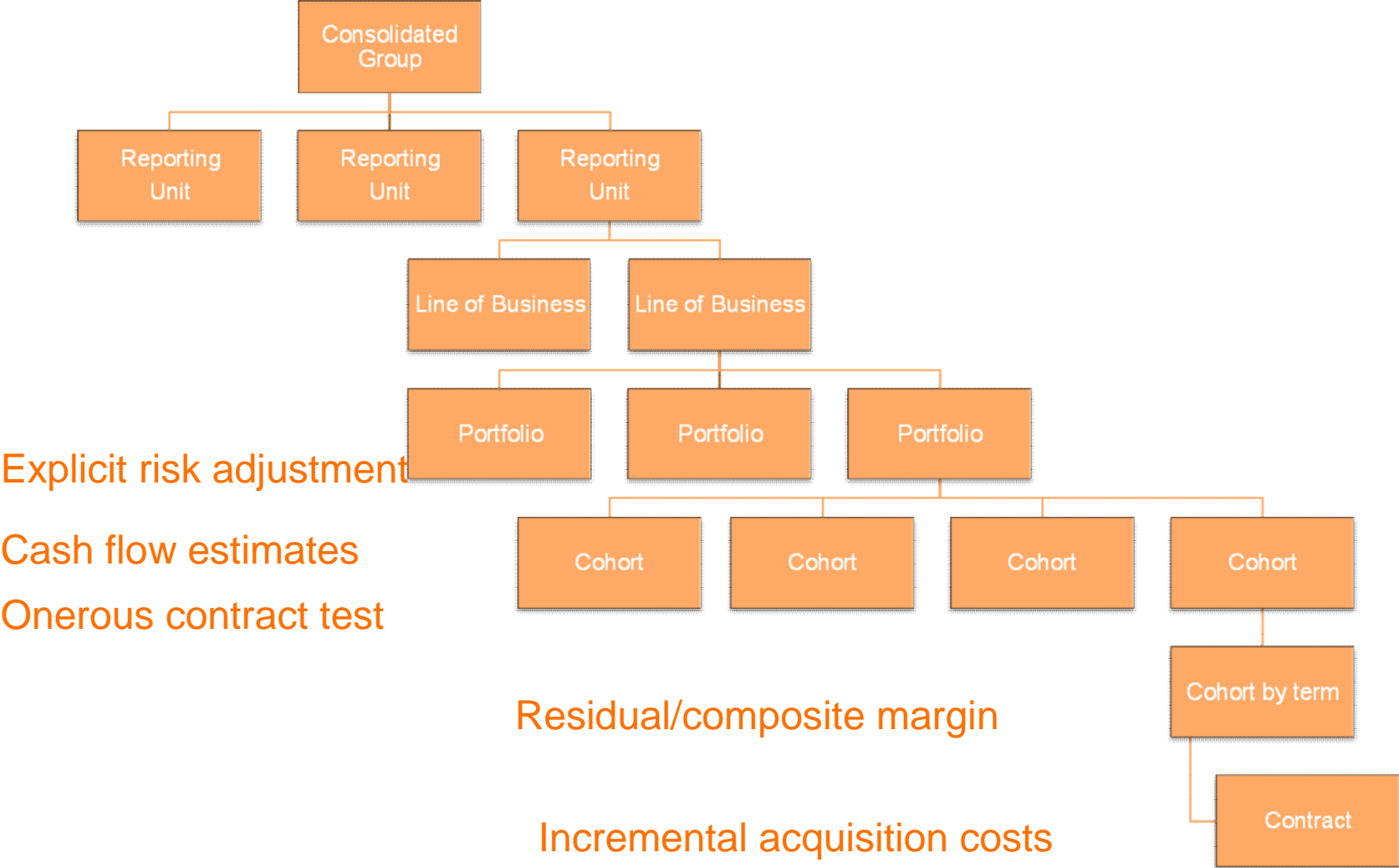
Other specific guidance

- Acquisition costs
- Level of measurement
- Recognition / derecognition
- Unbundling
- Presentation and disclosure
- Transition

Acquisition costs

- Incremental acquisition costs at the contract level are included in the contract cash flows
- Reduces residual margin
- All other acquisition costs are expensed
- Different from treatment for investment contracts under IAS 18 or Revenue Recognition Exposure Draft.

Level of measurement



Recognition/derecognition



- Recognition when insurer becomes party to a contract being earlier of:
 - Insurer bound by terms of contract
 - Insurer first exposed to risk (which can be before coverage commences).
- Derecognition
 - IAS 39 principle of extinguishment (discharged, cancelled or expires).

Unbundling

- Unbundle where components are not closely related to insurance
- Three specific examples:
 - Account balance
 - Embedded derivatives (IAS 39)
 - Unrelated goods and services.
- Unbundling prohibited for closely related components.

Exposure draft: Insurance Contracts

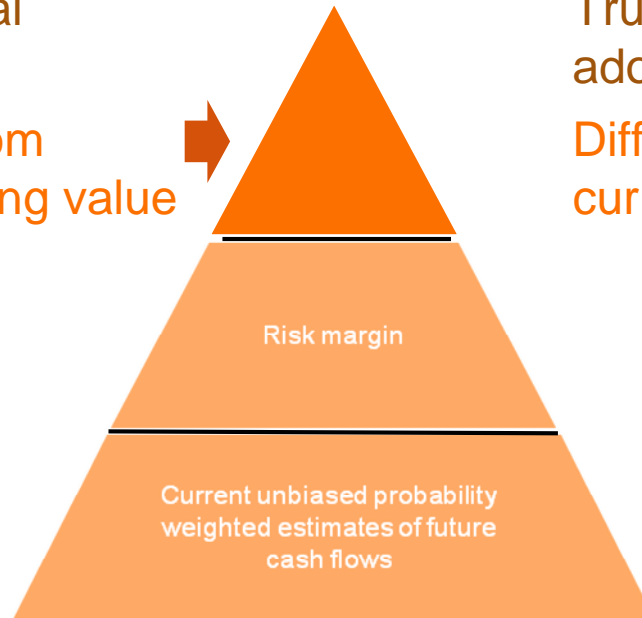
Presentation and Disclosure

	Inception 1 January	Six month to 30 June	Six months to 31 December
Change in risk margin		21	26
Residual margin		13	13
Underwriting margin	-	34	39
Acquisition costs	10	-	-
Experience adjustments		(10)	(10)
Changes in estimates		(20)	0
Net gain at inception	-	0	0
Investment income		40	38
Interest on insurance liability	-	(25)	(23)
Profit/(Loss)	(10)	19	44

Transition

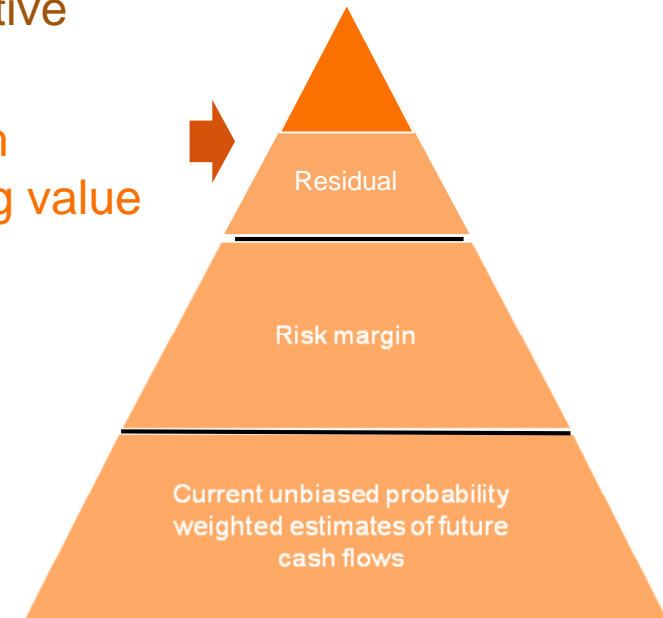
IASB proposal

Difference from
current carrying value



True retrospective adoption

Difference from
current carrying value



- Each portfolio measured using building block approach but with no residual margin
- Difference between this amount and the existing net insurance liability recorded under the previous GAAP is reflected in opening retained earnings

Exposure draft: Insurance contracts

Panel session: The key issues unveiled.....

Facilitator: Kim Smith (PwC)

Wrap up

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Remember you need to act quickly...the comment period ends on 30
November 2010

Thank you for joining us.

<http://pwc.com.au/industry/insurance>