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Insurance facts and figures 2010

What would you like to change?

How prepared are you for regulation & reporting changes?

Insurance

facts and figures 2010

PRICEWATERHOUSECOOPERS

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This publication is designed to provide an overview of the accounting, tax and regulatory environment relating to insurance in Australia. Information contained in this booklet is based on the law and Government announcements as at 16 April 2010.

The information presented in this publication should be used as a guide only and does not represent advice. Before acting on any information provided in this publication, readers should consider their own circumstances and their need for advice on the subject. PricewaterhouseCoopers insurance experts will be pleased to assist – please contact your usual PwC contact or one of the experts listed at the end of this publication.

Insurance Facts & Figures 2010

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Insurance facts and figures 2010

Contents

Glossary

AASB	Australian Accounting Standards Board
AASBs	AASB Standards
ACCC	Australian Competition and Consumer Commission
ADI	Authorised Deposit-Taking Institution
AFSL	Australian Financial Services Licence
AHIA	Australian Health Insurance Association
AML	Anti-Money Laundering
APRA	Australian Prudential Regulation Authority
ARPC	Australian Reinsurance Pool Corporation
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
ATO	Australian Taxation Office
AUASB	Auditing and Assurance Standards Board
AUSTRAC	Australian Transaction Reports and Analysis Centre
BCM	Business Continuity Management
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CPI	Consumer Price Index
CTF	Counter-Terrorism Financing
CTP	Compulsory Third Party
DAC	Deferred Acquisition Costs
DAM	Decreasing Adjustment Mechanism
DOFI	Direct Offshore Foreign Insurer
ECS	Exceptional Claims Scheme
FASB	Financial Accounting Standard Board
FATF	Financial Action Task Force
FCR	Financial Condition Report
FID	Financial Information Declaration
FOS	Financial Ombudsman Service
FSR	Financial Services Reform
GAAP	Generally Accepted Accounting Principles
GST	Goods and Services Tax
HCCS	High Cost Claims Scheme
HPPA	Hospital Purchaser Provider Agreements
IAA	Institute of Actuaries of Australia
IASB	International Accounting Standards Board
IBNER	Incurred But Not Enough Reported
IBNR	Incurred But Not Reported
ICA	Insurance Council of Australia
IFRS	International Financial Reporting Standards
ILVR	Insurance Liability Valuation Report
KYC	Know Your Customer
LAT	Liability Adequacy Test
LMI	Lenders Mortgage Insurance
LVR	Loan-to-Value Ratio
MAA	Motor Accidents Authority
MCR	Minimum Capital Requirement
MDO	Medical Defence Organisation
MER	Maximum Event Retention
MII	Medical Indemnity Insurer
MOU	Memorandum of Understanding
MSE	Management Services Element
NIBA	National Insurance Brokers' Association
NOHC	Non-Operating Holding Company
OCR	Outstanding Claims Reserve
PAIRS	Probability and Impact Rating System
PDS	Product Disclosure Statement
PHIAC	Private Health Insurance Administration Council
PHIO	Private Health Insurance Ombudsman
PML	Probable Maximum Loss
PST	Pooled Superannuation Trust
RAS	Reinsurance Arrangement Statement
RD	Reinsurance Declaration
RE	Responsible Entity
REMS	Reinsurance Management Strategy
RHBO	Registered Health Benefits Organisation
RMD	Risk Management Declaration
RMS	Risk Management Strategy
ROCS	Run-off Cover Scheme
SEA	Segregated Exempt Assets
SO	Senior Officer from Outside Australia
SPV	Special Purpose Vehicle
Stage 2	Stage 2 of APRA's general insurance reforms
TOFA	Taxation of Financial Arrangements
UPR	Unearned Premium Reserve
VPST	Virtual Pooled Superannuation Trust

Foreword

Scott Fergusson

Welcome to the 2010 edition of PricewaterhouseCoopers' Insurance Facts and Figures.

We are proud to continue supporting the Australian insurance industry with this annual reference guide which aims to inform users on the key regulatory, accounting, and taxation principles and developments in the various sectors of the industry. The publication is also now available online in a user friendly form at www.pwc.com.au/industry/insurance where we also invite your valuable feedback on what you would like to change in future editions to best suit your needs.

As we focus on making this publication more useful to the reader, so too is the insurance industry prioritising its focus on the customer – arguably more than ever before. While attracting and retaining customers is key to ongoing profitability and growth for insurers, customers are increasingly empowered to change providers as a result of technology advancements, greater competition, and cost considerations following the GFC. In each sector of the industry we are seeing examples of how an insurer's ability to differentiate themselves in the market and add value to their customers is a key determinant to their ongoing survival and success.

The regulated environment in which insurers are executing their strategies also continues to evolve: APRA is working to better align its supervisory approach to life and general insurance, the IASB is aiming to release its exposure draft of the much awaited Insurance Contracts accounting standard, and the reform agenda for the health care and disability management systems in Australia is considerable.

In all, not only is the insurance industry a vital part of the Australian economic and social fabric, the current pace of evolution and innovation makes it a fascinating arena to work in.

Best wishes

Scott Fergusson
Partner

1 General Insurance

Introduction

Scott Hadfield

Last year it was all about the GFC and bushfires in Victoria. This year, the worst of the GFC has passed and business confidence has returned, albeit the markets are still a little edgy. Weather events however remain with hail being the talk of the town. Sydney's hail storm in 1998 remains the largest single event in Australia's history, but separate hail events in Melbourne and Perth have had a significant impact in the current year. Reinsurance appears to have contained the costs of those most affected, but the frequency of these 'infrequent' events raises questions about pricing and what event will be next.

In the direct market, the new entrants are growing in size and profile, however their overall impact is still relatively small. With players such as Coles, Australian Post and Progressive (one of the largest motor insurers in the US) the future will see more consumer choice and increased competition. Whether we see the commoditisation of insurance products that the UK has experienced in recent years is unknown, but if it were to happen, I believe it is still some way off.

On the reporting front, there is change coming:

- In the short term, general insurers will see revised reporting requirements to APRA, the output of a project that sought to align APRA reporting with that required under Australian Accounting Standards.
- In the medium term, APRA will be revising the capital standard as it seeks to align capital requirements across life and general insurers. We are not expecting the changes for general insurers to be significant.
- Over the horizon, the Insurance Contracts Project continues to develop. We can expect an exposure draft in mid 2010, but the final standard is still some way off. Although the project predates the IASB itself, there are still passionately debated topics that have yet to reach a conclusion. General insurers would do well to follow this debate as it nears completion, with hot topics to look out for including risk margins, diversification benefits and acquisition costs. The devil will be in the detail.

Overall, the industry continues to provide its challenges to CEOs, underwriters, and finance professionals. The mental stimulation is rewarding and those that respond to the changes with agility, innovation and speed will emerge the strongest.

1.1 Statistics

Top 15 general insurers

		Ranking Measure:						Performance:	
		Net earned premium revenue						Underwriting result	
	Entity / group	Year end	Current $m	Current Rank	Prior $m	Prior Rank	% Change	Current $m	Prior $m
1	QBE Insurance Group[1]	12/09	12,149	1	11,087	1	10%	1,262	1,275
2	Insurance Australia Group	06/09	7,233	2	7,295	2	-1%	-265	-40
3	Suncorp	06/09	5,980	3	5,867	3	2%	-270	170
4	Allianz Australia	12/09	2,071	4	1,983	4	4%	326	-255
5	Wesfarmers[2]	06/09	1,061	5	993	5	7%	10	78
6	Munich Reinsurance Company Australia	12/09	877	6	739	7	19%	134	-34
7	Zurich Australian Insurance	12/09	780	7	741	6	5%	56	-112
8	Genworth Financial Mortgage Insurance	12/09	490	8	367	8	34%	150	158
9	Swiss Re	12/09	414	9	325	9	27%	249	-11
10	Westpac Insurance[3]	09/09	299	10	217	13	38%	110	62
11	Commonwealth Insurance[4]	06/09	292	11	200	14	46%	-20	-33
12	Chubb Insurance	12/09	265	12	253	11	5%	-1	-12
13	AIG (American Home Assurance)	12/09	249	13	259	10	-4%	70	88
14	RAC Insurance[5]	06/09	237	14	221	12	7%	36	18
15	ACE Insurance	12/09	191	15	175	15	9%	6	-20
NR	Lloyd's*	12/09	1,182	NR	1,050	NR	13%	n/a	n/a

Performance:				Financial Position:							
Investment result		Result after tax		Net outstanding claims		Investments		Net assets		Total assets	
Current $m	Prior $m	Current $m	Prior $m	Current $m	Prior $m	Current $m	Prior $m	Current $m	Prior $m	Current $m	Prior $m
1,237	1,177	1,970	1,859	14,350	16,161	23,420	25,693	10,298	11,245	40,964	48,383
739	455	247	-226	6,406	6,416	10,563	10,034	4,836	4,351	19,315	19,380
732	437	394	189	6,059	5,881	9,482	9,634	8,019	7,333	20,791	19,701
96	500	335	209	3,406	3,626	4,362	4,176	1,808	1,652	7,986	7,932
n/a	n/a	64	92	513	448	1,003	871	1,371	1,320	3,561	3,321
23	189	67	84	1,166	1,207	1,525	1,783	531	498	2,922	2,817
95	72	106	-29	1,010	1,021	1,643	1,604	643	543	3,024	2,876
109	266	152	262	282	226	2,790	2,613	1,987	1,494	3,170	2,887
47	220	175	123	1,264	1,136	2,039	1,561	808	479	2,830	2,285
32	29	100	63	71	62	682	450	824	242	1,554	654
14	10	-7	-18	88	92	163	150	98	74	521	370
-10	133	-8	85	490	424	868	837	359	367	1,219	1,144
59	49	49	72	305	368	1,193	1,039	420	371	2,589	1,931
15	–	16	-4	39	41	196	178	216	200	430	393
17	47	16	17	223	219	349	341	199	186	1,154	1,083
n/a	n/a	n/a	n/a	920	945	1,162	1,401	n/a	n/a	1,612	1,401

Source: Published annual financial statements or APRA annual returns, including segment reporting for organisations with significant non-general insurance activities

Notes: World wide premium is included for those companies/groups based in Australia, while only premium under the control of the Australian operations are included for those with overseas parents.

Where a group has significant non-general insurance operations, only performance and position information relating to general insurance is disclosed (subject to availability). In some instances this involves estimating a notional tax charge for the result after tax. Outstanding claims are net of all reinsurance recoveries.

* Lloyd's Underwriters are authorised in Australia under special provisions contained in the Insurance Act 1973. Because of the unique structure of the Lloyd's market Lloyd's reports to APRA on a different basis from Australian general insurers. Lloyd's is required to maintain onshore assets in trust funds and as at 31 December 2009 its Australian assets comprised of $1,610m in trust funds and a statutory deposit of $2m.

1 QBE acquired Elders Insurance effective 30 September 2009. Comparative figures are for QBE only.

2 Disclosure of investment result from insurance operations was not available in Wesfarmers' financial statements.

3 Westpac acquired St George Insurance Australia on 1 December 2008. Comparative figures are for Westpac only.

4 The Commonwealth Bank acquired St Andrew's Insurance (Australia) on 19 December 2008. Due to inconsistencies in reporting dates, information for St Andrew's has not been included.

5 RAC Insurance changed its year end to June during the 2008 financial year resulting in accounts being prepared for the six months to 30 June 2008. Financial performance figures for the six months to 30 June 2008 have been extrapolated for comparative purposes.

Top 10 government insurers

			Ranking Measure:					Performance:	
			Net earned premium					Underwriting	
	Entity	Year end	Current $m	Current Rank	Prior $m	Prior Rank	% Change	Current $m	Prior $m
1	WorkCover NSW	06/09	2,572	1	2,440	1	5%	-665	352
2	Victorian WorkCover Authority	06/09	1,608	2	1,656	2	-3%	-257	292
3	Transport Accident Commission (Vic)	06/09	1,195	3	1,132	3	6%	-592	-268
4	WorkCover Queensland	06/09	950	4	865	4	10%	-624	-295
5	NSW Self Insurance Corporation *	06/09	773	5	766	5	1%	-108	529
6	WorkCover Corporation (SA)	06/09	646	6	621	6	4%	122	-21
7	Motor Accident Commission (SA)	06/09	430	7	397	7	8%	-199	-122
8	Insurance Commission of WA	06/09	381	8	357	8	7%	-98	-10
9	Comcare (Cwlth) *	06/09	207	9	222	9	-7%	-32	12
10	Victorian Managed Insurance Authority	06/09	121	10	111	–	9%	-136	-54

Performance:				Financial Position:							
Investment		Result after tax		Outstanding claims		Investments		Net assets		Total assets	
Current $m	Prior $m	Current $m	Prior $m	Current $m	Prior $m	Current $m	Prior $m	Current $m	Prior $m	Current $m	Prior $m
-823	-76	-2,107	-187	11,508	9,993	9,480	13,114	-1,482	625	11,596	14,612
-1,330	-977	-1,254	-587	8,154	7,824	7,999	9,535	814	2,069	9,300	10,271
-803	-486	-971	-517	6,429	5,782	5,859	6,714	-338	772	7,100	7,503
-265	-80	-567	-259	2,166	1,720	2,341	2,788	648	1,218	2,982	3,127
-121	-357	-187	-518	4,612	3,927	3,799	4,136	108	330	5,199	4,566
-138	-73	-75	-140	2,286	2,374	1,182	1,337	-1,059	-984	1,390	1,528
-10	-22	-208	-146	1,811	1,617	2,060	2,041	70	278	2,104	2,093
-224	-95	-161	-34	1,426	1,328	1,948	2,138	704	880	2,516	2,745
20	18	14	70	1,601	1,242	186	179	199	189	2,475	2,436
-141	-84	-283	-144	1,039	858	848	992	-114	169	1,343	1,111

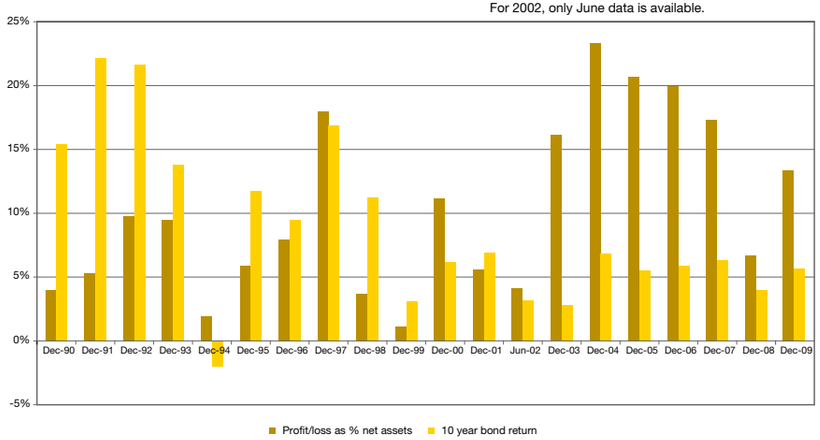
Source: Published annual financial statements

Notes: Outstanding claims are net of recoveries.

* Underwriting result has not been disclosed in financial statements and has been recalculated as net earned premium less net claims incurred

Direct insurers - comparison of profitability

We have not included 31 December 2002 data as APRA has not published statistics for this period. For 2002, only June data is available.



Direct insurer loss and expense ratios

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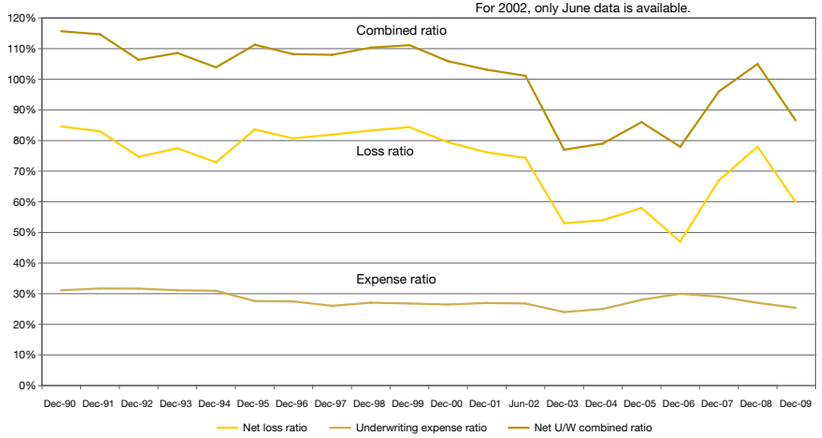
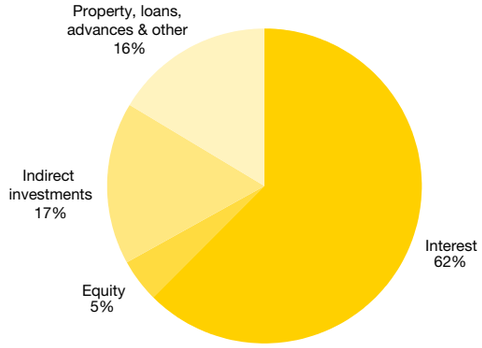
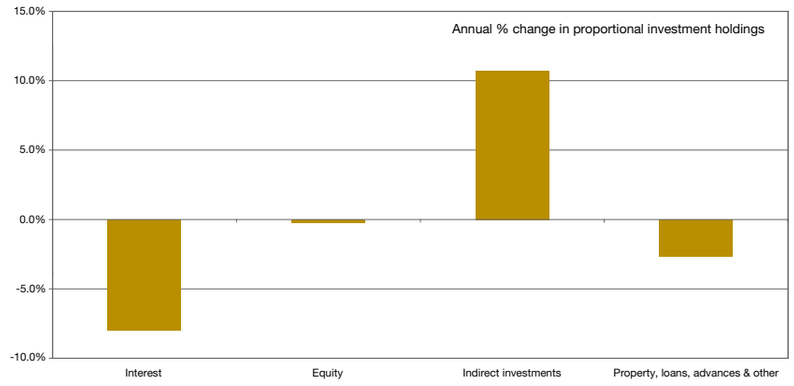


Direct insurers – Distribution of investments by type



Direct insurers – Movement in investments



Source: Selected statistics on general insurance industry, APRA, December 2009

Reinsurers – Profitability

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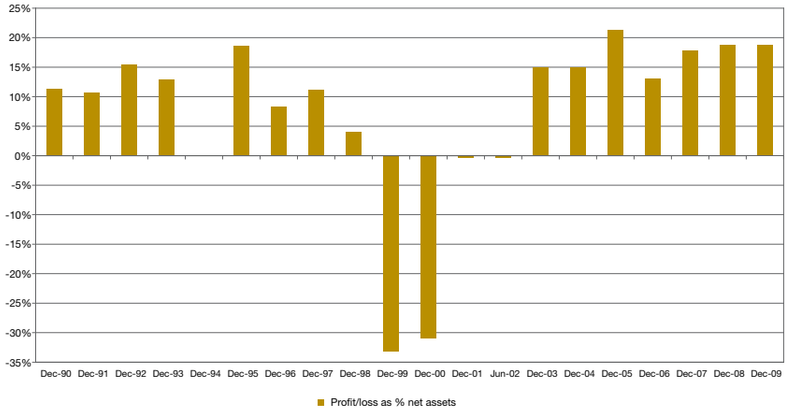

Reinsurers loss and expense ratios

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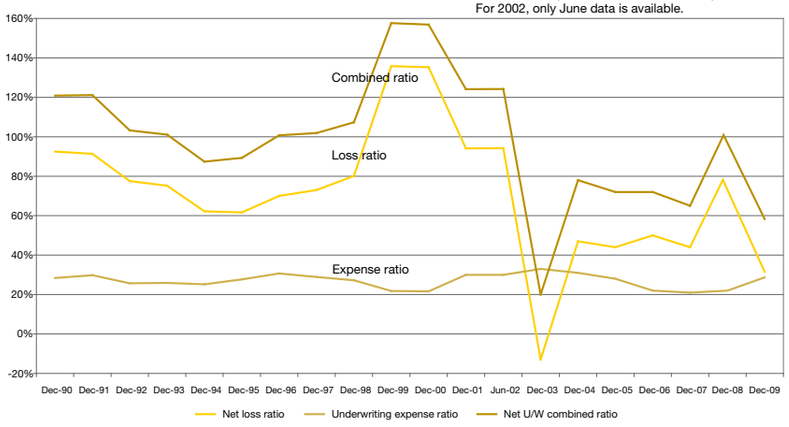
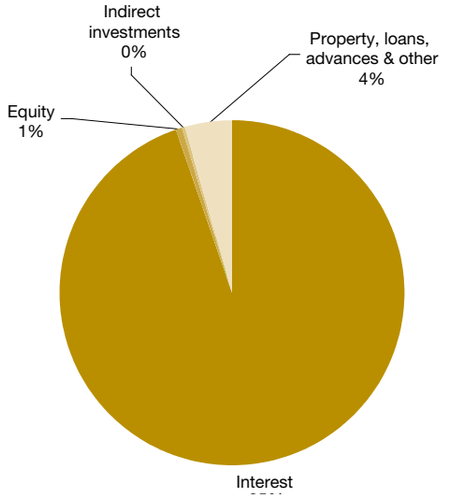
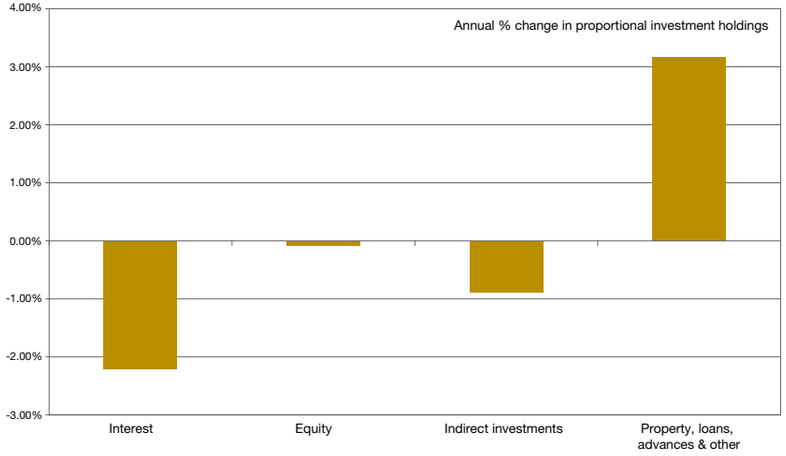


Reinsurers – Distribution of investments by type



Reinsurers – Movements in investments



Source: Selected statistics on general insurance industry, APRA, December 2009

Total private sector – comparison of profitability

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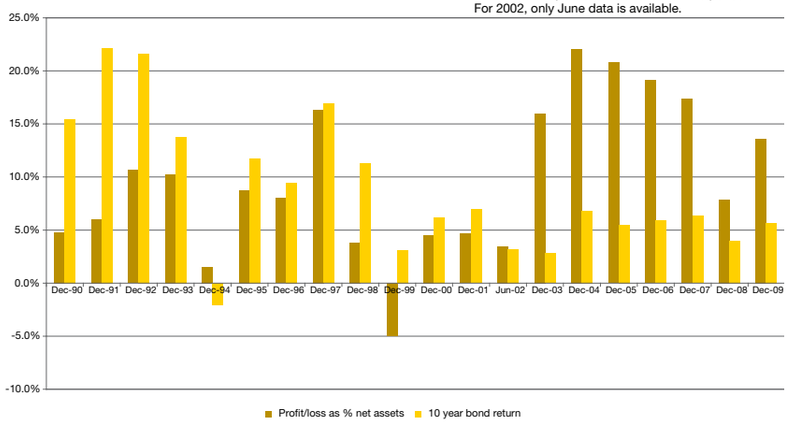

Total private sector loss and expense ratios

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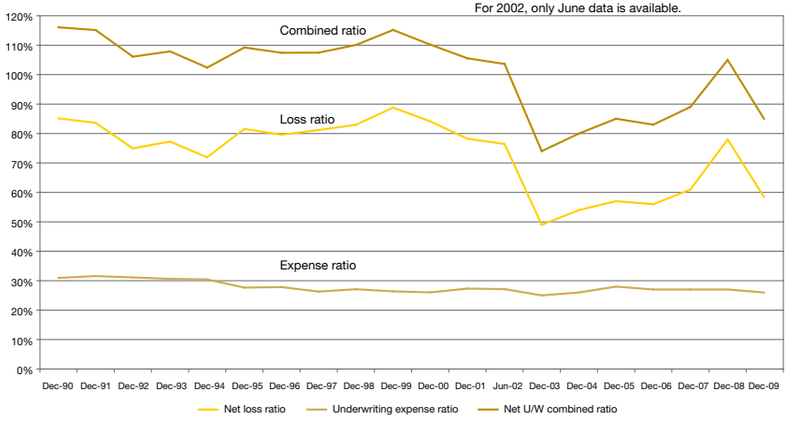
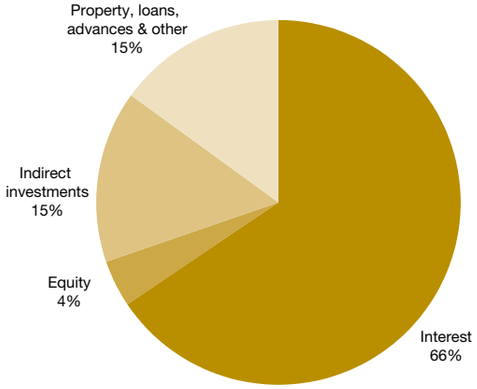
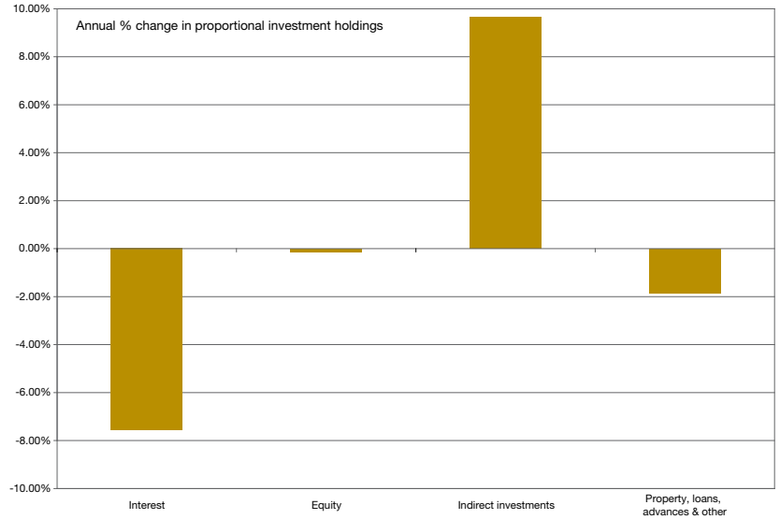


Total private sector – Distribution of investments by type



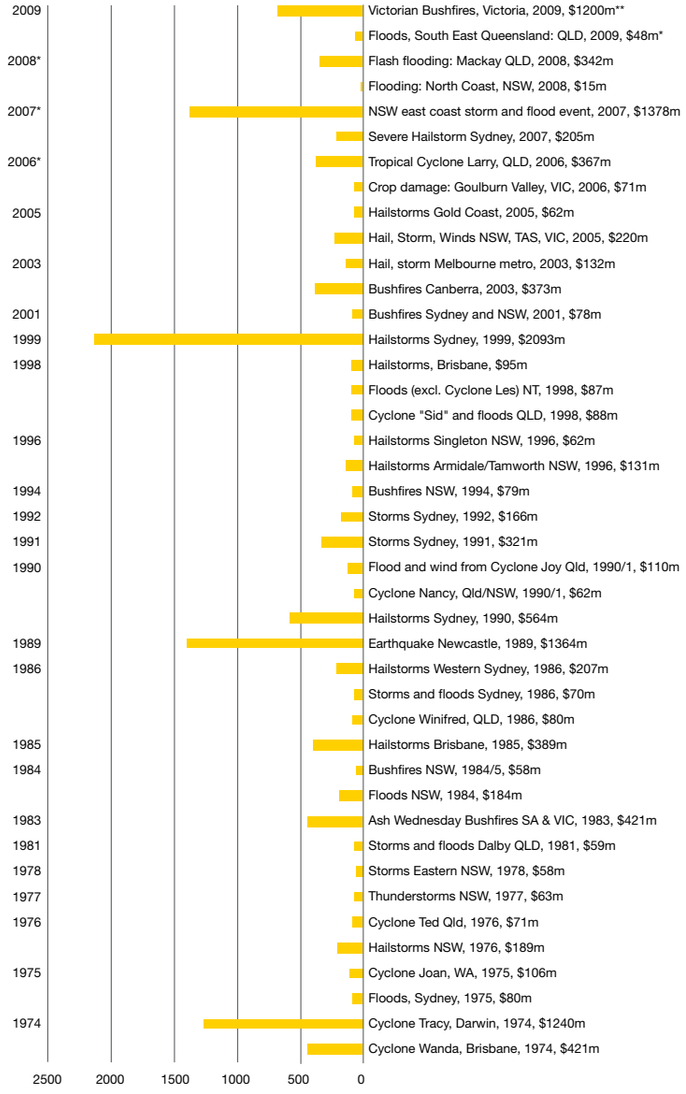
Total private sector – Movements in investments



Source: Selected statistics on general insurance industry, APRA, December 2009

Major Australian catastrophes

Original cost adjusted to June 2006 CPI

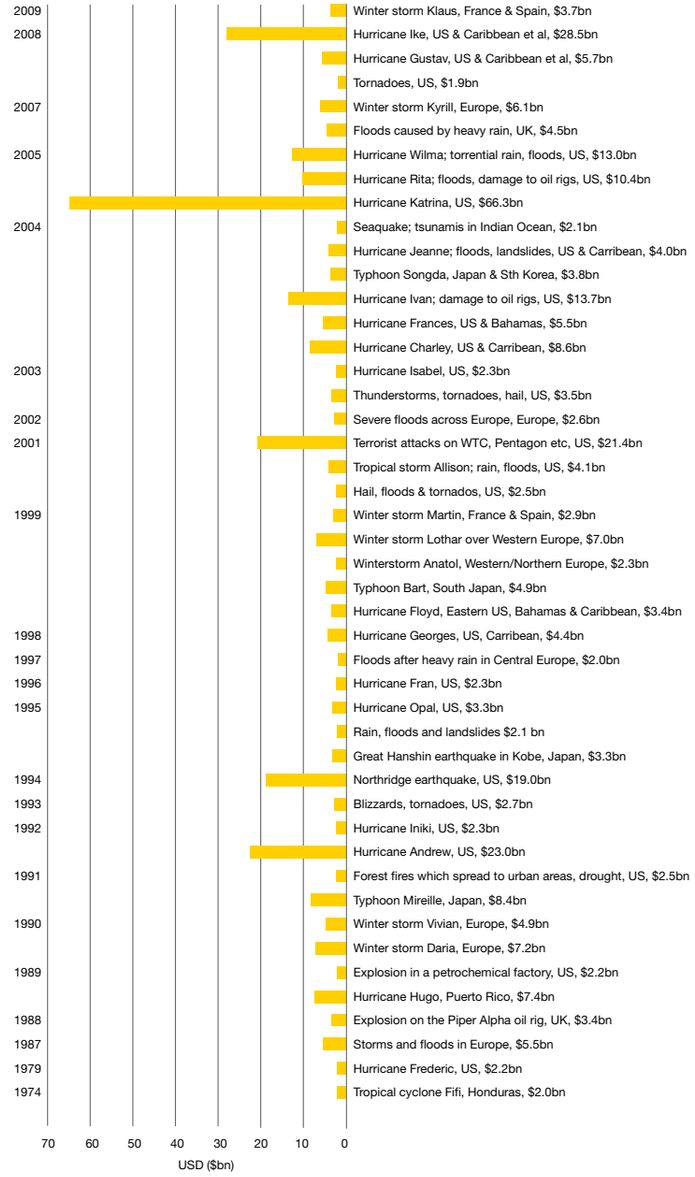


Source: Insurance Disaster Response Organisation, Major disaster event list since June 1967. Revised to March 2006.

* Source: Emergency Management Australia, EMA Disasters Database. 24 April 2009

** Source: Figure not supplied by EMA. Figure comes from Swiss Re, "Natural catastrophes and man-made disasters in 2009: catastrophes claim fewer victims, insured losses fall", No 1/2010

World catastrophes



Source: Swiss Re, Natural catastrophes and man-made disasters. 1970 – 2005, Sigma no.2/2006; Natural catastrophes and man-made disasters in 2007, Sigma 1/2008; National catastrophes and man-made disasters in 2008: North America and Asia suffer heavy losses Swiss Re No. 2/2009

1.2 Key developments

The general insurance sector has continued to evolve over the last twelve months, experiencing legislative regulatory and market change. In this section we discuss some of the developments that general insurers will need to be prepared for in the year ahead.

APRA regulatory changes

Capital adequacy

The Australian Prudential Regulation Authority (APRA) has undertaken a process to further review the prudential framework especially around capital requirements. The aim is to maintain a broadly consistent approach to the determination of regulatory capital for general insurers and authorised deposit-taking institutions as well as to achieve harmonisation of the regulatory framework between life and general insurers. A letter was issued by APRA in December 2009 to update local general insurers and authorised non-operating holding companies on the 2009 Basel proposals for regulatory capital requirements and that the definition of "eligible capital" for insurers is being considered as part of a broader review of general and life insurance capital standards. A discussion paper on the refined capital adequacy standards was released on 5 May 2010.

Level 3 supervision proposals

In March 2010, APRA released a discussion paper "Supervision of conglomerate groups" containing proposals on supervising conglomerate groups. Conglomerate groups are groups with APRA-regulated entities that have material operations in more than one APRA-regulated industry and/or have material unregulated entities.

APRA's proposed 'Level 3' supervision framework is designed to complement its existing industry-based supervision of stand-alone entities (Level 1 supervision) and its supervision of single industry groups (Level 2 supervision).

APRA's proposed Level 3 supervision framework aims to ensure that prudential supervision adequately captures the risks to which APRA-regulated entities within a conglomerate group are exposed and which, because of the operations or structures of the group, are not adequately captured by the existing prudential frameworks at Level 1 and (where it applies) Level 2. The proposed framework is a flexible one intended to ensure that group structures are not unduly restricted by supervisory intervention whilst giving both APRA and the group itself a better understanding of the risks that arise from the group and its activities.

Lenders Mortgage Insurance capital

APRA has also amended the Attachment A of the prudential standard GPS 116, which sets out the calculation of concentration risk capital charge for lenders mortgage insurers (LMI). The corresponding reporting standard GRS 170.1 'Maximum Event Retention and Risk Charge for Lenders Mortgage Insurers' has also been changed and both of these are effective from 1 May 2010. The amendments aim to replace the prescriptive approach in GPS 116 Attachment A with a principles-based approach. Overall, the process will have minimal impact on the LMI industry. In March 2010, APRA released a paper titled "Maximum event retention for lenders mortgage insurers" discussing these changes. More details are given under "Capital adequacy: concentration risk capital charge" in Section 1.4.

Prudential reporting

In December 2009, APRA released a discussion paper "Proposed Changes to the General Insurance Prudential Reporting" on changes to the general insurance prudential reporting requirements. The changes seek to align the current reporting requirements with those of Australian Accounting Standards while retaining certain prudential elements for capital adequacy purposes. The proposed changes are discussed in detail in the Financial Reporting Section 1.7.

Management of security risk in information and information technology

The use of IT information and systems is becoming increasingly important for financial institutions. In February 2010, APRA issued PPG 234 Management of security risk in information and information technology, reflecting the need for these institutions to safeguard IT assets. It is designed for use by senior management, risk management and IT security specialists.

The PPG addresses IT security risks and related controls, covering IT security risk, user awareness, access control, IT asset life-cycle management controls, monitoring and incident management, IT security reporting and metrics, and IT security assurance.

Remuneration governance

In November 2009, APRA released a paper "Remuneration: Extensions to governance requirements for APRA – regulated institutions". The paper covers changes to the prudential standards on governance and the associated prudential guide on governance, dealing with remuneration. The revised governance standards came into effect on 1 April 2010. Details are discussed under "Governance" at Section 1.6.

Builder's Warranty

Builders' warranty insurance provides cover to consumers should the builder die, disappear, become insolvent or have their license cancelled. Builders are legally prevented from building without it. Builders' warranty cover is compulsory in all states except Queensland and Tasmania for all residential building works over $12,000.

Following the withdrawal of major builders' warranty providers Lumley Insurance, CGU and Vero, concerns were raised about the lack of available cover. The Victorian Government, taking into account the withdrawal of the three major providers – has established a new scheme to provide builders' warranty cover from 31 March 2010. This is run by the Victorian Managed Insurance Authority. Builders with recent insurance coverage will be automatically eligible for VMIA cover for at least 12 months on comparable terms and conditions.

The NSW Government also decided to replace the privatised builders' warranty insurance market with a government scheme to ensure the provision of adequate and affordable insurance. It will underwrite the scheme from July 2010, replacing existing providers. NSW Treasury will manage the new scheme through the Self Insurance Corporation.

National Disability Scheme

Care and support and related services in Australia for people with disabilities are currently provided predominantly by a combination of an insurance system which provides fully-funded lifetime care benefits for eligible claimants, and a social welfare system comprising a wide range of Commonwealth and State/Territory-based programs. Both systems are in urgent need of reform.

In the case of the insurance system, which covers a range of injuries, the most significant of which are traumatic spinal cord injury and brain injury, there are wide differences in coverage and entitlement across jurisdictions and across causes of injury. Moreover, because much of this insurance is paid in lump sum form, beneficiaries typically pursue further benefits from the wider disability welfare system when their available reserves are extinguished.

In the case of the disability welfare system, Australian governments commit a very large quantum of revenue – approximately $20 billion per annum in total, of which about $8 billion is on community care and support. In spite of this significant budget, there is a large and expanding unmet need for care and support, and also a large volume of unpaid care and support provided by family and other informal carers.

As discussed in the Australia 2020 Summit, there is a view that the most appropriate way to satisfy the requirements of planning, efficiency and positive outcome realisation is through a social insurance type approach.

An increasing number of European economies (where the ageing population is a greater issue) have been moving to this approach over the past decade or two, primarily to formalise the revenue requirements of the welfare system.

In Australia and New Zealand, however, the best indicators of potential success of this approach are available through the funded (partially or fully) accident compensation schemes (workers and motor accident compensation in particular).

The majority of these schemes continue on a path of reform that has been in process over the past twenty years. Characteristics of the reform with respect to care and support of people with major injuries typically include:

- Elimination or severe restriction in the availability of litigation as a pathway to compensation – and replacement with readier admission of eligibility on a "no fault" or "provisional liability" basis;
- Replacement of inappropriate mechanisms of assessing monetary entitlement with mechanisms based on functional need, attached to a personal plan and expectation of mutual obligation and personal outcomes;
- Far more sophisticated governance models, which increasingly consider both financial and service utilisation (prudential governance) but also rehabilitation, health, return to work and other social outcomes of beneficiaries.

It is proposed that a model that is developed from elements of schemes such as these could be applied to the system of care and support for people with disabilities, and could be implemented in a coordinated way as follows:

- Work towards developing a National Disability Scheme over a period of feasibility testing, which would include concept development, detailed analysis, stakeholder communication and structure and governance development;
- As part of this initiative, seek collaboration between the Commonwealth, States and Territories to work towards a comprehensive and national approach to providing care and support for people who sustain catastrophic traumatic injury. Such an approach would encourage modification of existing statutes of worker compensation, motor accident compensation, civil (public) liability (extended to general injury) and medical indemnity (extended to treatment injury).

QLD CTP Scheme review

A review of the QLD CTP scheme is currently being conducted. The scheme was last reviewed in 1999 and legislation requires a review of the scheme every ten years. The scheme review will focus on improving efficiency in the delivery of CTP insurance by ensuring administration and delivery costs are as low as possible, which will in turn benefit motor vehicle owners. The state government has indicated that this review will not examine claimant benefits given that substantial tort reforms have been introduced recently.

The government will be inviting consultation on this review, which is expected to be completed by mid 2010.

Fire Services Levy

The Victorian bushfire in 2009 has highlighted the proportion of properties that were not covered by fire insurance policies. Under the Metropolitan Fire Brigades Act 1958 and the Country Fire Authority Act 1958 (the Acts), insurers providing cover against fire risk in NSW, Victoria and Tasmania are, on a combined basis, required to contribute a set percentage of the annual budget for the states' fire services, called the Fire Services Levy (FSL). The amount payable by each insurer is determined based on the percentage of its premium compared to the premium of all other insurers. The cost of this is typically passed onto policyholders.

Since this levy is dependent on the level of fire risk in an area, insured properties located in the bush are likely to attract significantly higher levies than those in the city. This has discouraged the purchase of cover, causing inequities in the system where those who are insured subsidise the cost of firefighting for those who are uninsured. An estimated one-third of the properties involved in the Victorian Bushfires in 2009 were uninsured.

The Royal Commission into the Victorian Bushfires is considering alternatives to the fire services levy. For example, the removal of the levy in WA seven years ago has led to cheaper insurance and improved resources. In SA introduction of a property-based levy more than 10 years ago ensured all SA residents contribute an equal share to the emergency services.

As a result of the problems experienced in Victoria, the avenue for funding the cost of firefighting in Australia is being considered as part of the Henry review of Australia's tax system.

Catastrophic events

Following the Victorian bushfires in early 2009, the remainder of the year was a fairly benign period for catastrophic events in Australia. The first quarter of 2010 however has seen a number of significant events such as hailstorms in Perth and Melbourne as well as flooding in Queensland. These events have added immensely to the influx of claims and have challenged insurers and reinsurers to factor in the tendency of more extreme weather events in companies' product pricing and modelling of catastrophic losses.

Internet insurers

Over the last few years there have been new entrants to the Australian insurance market that operate purely over the internet, such as Budget Direct, Bingle and more recently Youi and Progressive Insurance. The cost advantage inherent in a business model built around the internet is likely to encourage more insurance providers to use the internet as a direct distribution channel in the future.

1.3 Regulation and supervision

Overview

The general insurance industry is primarily regulated by APRA and ASIC with additional regulation by a range of other bodies such as the ACCC and the ATO. This section provides an overview of the roles of APRA and ASIC. Further details around regulation and policyholder protection can be found at Chapter 6.

Australian Prudential Regulation Authority

APRA is the single Commonwealth authority responsible for licensing and prudential regulation for all general insurance companies. APRA is also empowered to appoint an administrator to provide investor or consumer protection in the event of financial difficulties experienced by general insurance companies.

APRA's powers to regulate and collect data from the insurance industry stem principally from the following acts:

- Insurance Act 1973 (the Insurance Act);
- Financial Sector (Collection of Data) Act 2001;
- Financial Sector (Shareholdings) Act 1998;
- Insurance (Acquisitions and Takeovers) Act 1991; and

As supervisor of general insurance companies, APRA administers the Insurance Act. APRA's stated objective in respect of general insurance is "to protect the interest of insurance policyholders, in particular, through the development of a well managed, competitive and financially sound general insurance industry".

Although APRA is responsible for the prudential regulation of insurers, it is not responsible for product disclosure standards, customer complaints or licensing of financial service providers (including authorised representatives and insurance brokers) as these responsibilities fall to the Australian Securities and Investments Commission (ASIC) under its Australian Financial Services Licence (AFSL) regime.

APRA co-operates with other regulators where responsibilities overlap. In particular, APRA works closely with ASIC and the Reserve Bank of Australia. It also liaises, when necessary, with the Federal Department of Treasury, the Australian Competition and Consumer Commission (ACCC) and the Australian Stock Exchange (ASX).

Since its establishment in 1998, APRA has been working to harmonise the regulatory framework of regulated institutions. The aim is to apply similar principles across all prudential regulation and to ensure that similar financial risks are treated in a consistent manner whenever possible.

Probability and Impact Rating System

APRA's primary objective is to minimise the probability of regulated institutions failing and to ensure a stable, efficient and competitive financial system. APRA uses its Probability and Impact Rating System (PAIRS) to classify regulated financial institutions in two key areas:

- The probability that the institution may be unable to honour its financial promises to beneficiaries – depositors, policyholders and superannuation fund members; and
- The impact on the Australian financial system should the institution fail.

As part of its role as a prudential regulator, APRA uses PAIRS to assess risk and to:

- determine where to focus supervisory effort;
- determine the appropriate supervisory actions to take with each regulated entity;
- define each supervisor's obligation to report on regulated entities to APRA's executive committee, board, and, in some circumstances, to the relevant government minister;
- provide a risk diagnostic tool; and
- ensure regulated entities are aware of how APRA determines the nature and intensity of their supervisory relationships.

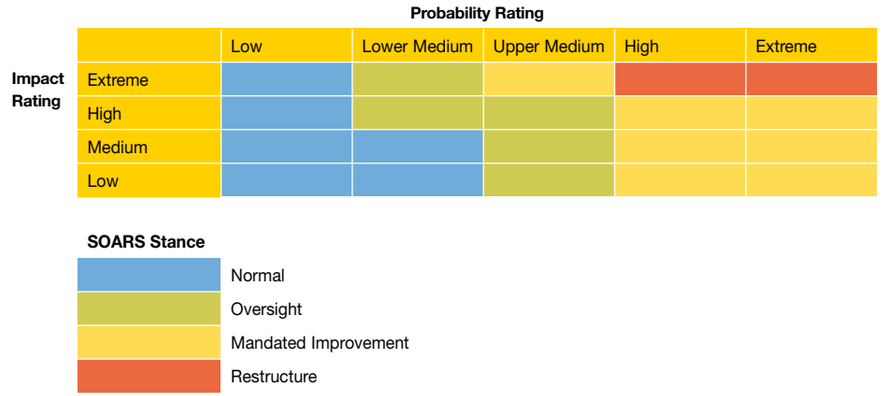
The PAIRS Supervisory Attention Index rises as the probability of failure and the potential impact of failure increase, ranging from "Low" to "Extreme". These ratings are not publicly available, and are used only to identify potential issues and seek remediation before serious problems develop.

Supervisory Oversight and Response System

The Supervisory Oversight and Response System (SOARS) is used by APRA to determine how supervisory concerns based on PAIRS risk assessments should be acted upon. It is intended to ensure that supervisory interventions are targeted and timely. All APRA-regulated entities that are subject to PAIRS assessment are assigned a SOARS stance. Supervisory strategies vary according to an entity's supervision stance.

The supervision stance of a regulated entity is derived from the combination of the Probability Rating and Impact Rating of the PAIRS process, as illustrated in figure 1.1 below.

Figure 1.1 – PAIRS and SOARS



Supervision and compliance

APRA achieves its prudential supervision objectives through administering the regulatory framework and monitoring the conduct of licensees through supervisory visits and the receipt from licensees of mandated financial and compliance reporting.

The regulatory framework comprises three tiers:

- **Tier 1** – The Insurance Act contains the high-level principles necessary for prudential regulation;
- **Tier 2** – Prudential standards providing principles based requirements for companies authorised under the Insurance Act; and
- **Tier 3** – Prudential practice guides providing non-binding guidance on prudential good practice and on how best to meet the requirements of the prudential standards.

Licensing

No private sector general insurance company may conduct insurance business in Australia unless authorised under the Insurance Act. Under Section 12 of the Insurance Act, APRA can authorise a body corporate which has applied in writing to carry on an insurance business. APRA can impose and vary licence conditions of an insurer under Section 13 and exempt an insurer from complying with all or part of the Insurance Act under Section 7.

In addition to requiring compliance with prudential standards, APRA may request additional information as it sees fit. The information expected to be provided includes:

- Details of the ownership structure, board and management (including resumes and the company's constitution);
- Applications for the proposed appointed auditor and appointed actuary;
- A three-year business plan with financial and capital adequacy projections, including sensitivity analysis;
- Systems and controls documentation (risk management strategy, reinsurance management strategy, business continuity plan and details of accounting and reporting systems);
- Details of subsidiaries and associates and any proposed relationships;
- An auditor's certificate verifying the level of capital and capital ratios of the applicant;
- An actuary's report in accordance with GPS 310;
- Written undertakings to comply with prudential standards at all times, consult and be guided by APRA on prudential matters and new business initiatives and provide relevant information required for the prudential supervision of the applicant; and
- For foreign-owned insurers, approval of foreign parent's home supervisor and details of the foreign parent's operations and an acknowledgement that APRA may discuss the conduct of the applicant with its head office and home supervisor.
- In order to underwrite workers compensation or CTP insurance, additional approval from state and territory government regulators is required under the relevant state or territory legislation.

Restructure of operations

The Insurance Act provides for the restructuring of insurance operations. Sections 17A to 17I of the Act allow for the assignment of insurance liabilities between insurers subject to the satisfaction of several steps, including:

- Approval of APRA;
- Informing affected policyholders; and
- Obtaining confirmation of the assignment from the Federal Court of Australia.

GPS 410 Transfer and Amalgamation of Insurance Business for General Insurers sets out more detailed information on the requirements for transferring insurance portfolios between registered insurers. In the event of revocation of an insurer's authorisation, APRA can stipulate the assignment of liabilities immediately prior to the revocation. It should be noted that APRA can revoke a licence only with the Federal Treasurer's approval, unless it is a request from an insurer with no remaining Australian insurance liabilities.

Under Section 29 of the Insurance Act, insurers must publish name changes in the daily press.

Section 116 addresses the issue of winding up an insurer and stipulates that assets in Australia can be applied only to settle liabilities in Australia (unless these are nil). For the purpose of this and the Section 28 solvency requirement, a reinsurance receivable from an overseas party is considered to be an asset in Australia if:

- the reinsurance contract relates to Australian liabilities; and
- reinsurance payments are made in Australia.

A liability is in Australia if the risk is in Australia or if the insurer has undertaken to satisfy the liability in Australia.

Prudential Standards

APRA's supervision currently spans two levels:

- **Level 1** – applicable to individual APRA-authorised general insurers on a stand-alone basis;
- **Level 2 –** applicable to consolidated general insurance groups incorporating all general insurers (both domestic and international) within the group. The group may be headed by an APRA-authorised insurer or an APRA-authorised non-operating holding company.

As discussed in Section 1.2, a new level of supervision (level 3) has been proposed and is now currently under industry discussion.

The main features of the prudential standards which set out the mandatory elements of the regulatory framework are outlined in Table 1.1.

The standards are supported by the following Prudential Practice Guides, which aim to assist insurers in complying with requirements outlined in the prudential standards as well as outlining prudent industry practices:

- GPG 200 Risk Management;
- GPG 220 Credit Risk;
- GPG 230 Operational Risk;
- PPG 231 Outsourcing;
- GPG 232 Custody Arrangements;
- PPG 233 Pandemic Planning and Risk Management;
- PPG 234 Management of Security Risk in Information and Information Technology
- GPG 240 Insurance Risk;
- GPG 245 Reinsurance Management Strateqy
- GPG 250 Balance Sheet and Market Risk
- GPG 510 Governance;
- PPG 511 Remuneration; and
- GPG 520 Fit and Proper.

Table 1.1 – Summary of current GI prudential standards

Standard	Amended / Effective	Details
Level 1 Prudential Standards		
GPS 001 Definitions	Dec-09	
GPS 110 Capital Adequacy	Jul-08	See Section 1.4
GPS 112 Capital Adequacy: Measurement of Capital	Jul-08	See Section 1.4
GPS 113 Capital Adequacy: Internal Model-based Method	Mar-09	See Section 1.4
GPS 114 Capital Adequacy: Investment Risk Capital Charge	Jul-08	See Section 1.4
GPS 115 Capital Adequacy: Insurance Risk Capital Charge	Jul-08	See Section 1.4
GPS 116 Capital Adequacy: Concentration Risk Capital Charge	May-10	See Section 1.4
GPS 120 Assets in Australia	Jul-08	See Section 1.4
GPS 220 Risk Management	Jul-08	See Section 1.5
GPS 222 Business Continuity Management GGN 222.1 Risk Assessment and Business Continuity Management	Apr-05	See Section 1.5
GPS 230 Reinsurance management	Jul-08	See Section 1.5
GPS 231 Outsourcing	Jul-08	See Section 1.5
GPS 310 Audit and Actuarial Reporting and Valuation	Jul-08	See Section 1.6
GPS 410 Transfer and Amalgamation of Insurance Business for General Insurers	Jul-02	See Section 1.5
GPS 510 Governance	Apr-10	See Section 1.6
GPS 520 Fit and Proper	Jul-08	See Section 1.6
Level 2 Prudential Standards		
GPS 111 Capital Adequacy: Level 2 Insurance Groups	Mar-09	See Section 1.4
GPS 221 Risk Management: Level 2 Insurance Groups	Mar-09	See Section 1.5
GPS 311 Audit and Actuarial Reporting and Valuation: Level 2 Insurance Groups	Mar-09	See Section 1.6

Licensing of compulsory insurance classes

While licenses to write most classes of insurance business are provided by APRA, state and territory governments issue licenses to write certain compulsory classes of business, such as:

- Workers compensation; and
- Compulsory third party (CTP).

The status of these lines of business is shown below by state or territory.

Table 1.2 – State and territory regulation of workers compensation and CTP insurance

State/Territory	Workers' compensation	CTP
ACT	Privatised	Monopoly private sector insurer (IAL)
NSW	Privatised administrator; risk borne by State	Privatised
NT	Privatised	Terriroty monopoly
QLD	State monopoly	Privatised
SA	State monopoly with claims managed by licensed private setor insurers	State monopoly with claims managed by licensed private sector insurers
TAS	Privatised	State monopoly
VIC	Privatised administrator; risk borne by State	State monopoly
WA	Privatised	State monopoly

Australian Securities and Investments Commission

ASIC is the single Commonwealth regulator responsible for market integrity and consumer protection functions across the financial system. It is responsible for:

- Corporate regulation, securities and futures markets;
- Market integrity and consumer protection in connection with life and general insurance and superannuation products, including the licensing of financial service providers; and
- Consumer protection functions for the finance sector.

Most insurers require an Australian Financial Services Licence (AFSL), and as such, a dual licensing system exists with overlapping requirements under both ASIC and APRA.

Australian Financial Services Licence

The Corporations Act requires all sellers of insurance products to retail clients, including registered insurers and brokers, to obtain an AFSL.

To obtain a licence, the applicant must meet the obligations under Section 912A and demonstrate that they will provide financial services efficiently, honestly and fairly. Specific provisions under the Corporations Regulations require that financial services licensees have in place the following:

- Documented procedures to monitor, supervise and train representatives;
- "Responsible officers" (senior management responsible for day-to-day business decisions) with minimum standards of knowledge and skills in financial services;
- Adequate resources (financial, technological and human) to provide services covered by the licence. These requirements do not apply to APRA-regulated entities (such as registered insurers), but do apply to any non-APRA-regulated subsidiaries;
- Adequate risk management systems. These requirements do not apply to APRA-regulated entities, but do apply to any non-APRA-regulated subsidiaries;
- Adequate compliance framework (AS3806, the Australian Standard on Compliance Programs, acts as a guide to minimum requirements);
- Internal and external dispute resolution procedures (where dealing with retail clients);
- Adequate compensation requirements (where dealing with retail clients as described in Section 912B). This typically is achieved through membership of a guarantee fund or obtaining professional indemnity insurance cover; and
- Register of representatives, i.e. directors and employees of the insurer and its related bodies corporate, as well as authorised representatives and insurance brokers.

Once ASIC has granted an AFSL pursuant to Section 913B of the Corporations Act, any variations to authorisations and conditions of the licence can be made electronically via the ASIC website.

Insurers that are regulated by APRA are exempted from the financial obligations of an AFSL as their financial position is separately monitored by APRA through quarterly statistical reporting.

Ongoing notification obligations

Licence holders are required to meet ongoing notification obligations, which include requirements to notify ASIC about:

- Breaches and events;
- Changes in particulars (form F205 for change of name of corporate entities, form FS20 for all others);
- Authorised representatives (forms FS30, FS31, FS32);
- Financial statements and audit (forms FS70 and FS71); and
- Appointment/removal of auditor (forms FS06, FS07, FS08 and FS09).

Section 989B of the Corporations Act also outlines ongoing financial reporting and audit obligations. A licensee is required to prepare and lodge an audited income statement and a balance sheet within four months of the end of its financial year (disclosing entities are required to lodge within three months).

ASIC has released Class Order 06/68 which grants relief to local branches of foreign licensees from preparing and lodging accounts in accordance with Section 989B of the Corporations Act. This relief is only available where the foreign licensee lodges accounts, prepared and audited in accordance with the requirements of its local financial reporting jurisdiction with ASIC once every calendar year.

Ownership restrictions

The Financial Sector (Shareholdings) Act limits shareholdings to 15 per cent of an insurer, unless otherwise approved by the Federal Treasurer. The Insurance (Acquisitions and Takeovers) Act complements this legislation by requiring government approval for offers to buy more than 15 per cent of an insurer.

1.4 Solvency and capital adequacy

Overview

Under Section 28 of the Insurance Act, authorised insurers are required to hold eligible assets in Australia that exceed liabilities in Australia, unless otherwise approved by APRA. Section 116A of the Insurance Act and GPS 120 Assets in Australia provide further details of excluded assets and liabilities.

GPS 110 Capital Adequacy aims to ensure the security of policyholder obligations of all insurers is established at an appropriate level by requiring that each insurer maintains at least a minimum amount of capital. In 2008 a number of changes were made to GPS 110 and GPS 120 with the aim of maintaining consistency between the definition of capital base for the general insurers and ADIs after the introduction of Basel II regime. These changes also aimed at increasing the security of reinsurance recoverables, especially those due from non-APRA authorised reinsurers.

The following sections give an overview of the various Prudential Standards for Capital Adequacy and Assets in Australia.

Capital adequacy standards

GPS 110 to GPS 116 form part of a comprehensive set of prudential standards that deal with the measurement of a general insurer's capital adequacy.

GPS 110 Capital Adequacy aims to ensure that general insurers maintain adequate capital to act as buffer against the risk associated with their activities and sets out the overall framework adopted by APRA to assess the capital adequacy of a general insurer.

The key requirements of this Prudential Standard are that a general insurer must:

- maintain minimum levels of capital determined according to the Internal Model-based Method or the Prescribed Method;
- determine its Minimum Capital Requirement (MCR) taking into account the various risks that may threaten its ability to meet policyholder obligations;
- make certain disclosures about its capital adequacy position; and
- seek APRA's consent for reductions in capital.

Capital base and MCR

GPS 110 specifies that the capital base for Category A to C insurers (where Category A to E insurers are defined in GPS 001) must exceed the greater of $5 million and the MCR. In case of Category D or Category E insurer the MCR cannot be less than $2 million. Where APRA is not satisfied as to the margin by which the capital base exceeds the minimum capital requirement, it can require the insurer to submit a capital plan detailing the proposed actions to improve solvency.

By the nature of its Australian balance sheet, a Category C insurer will not typically have capital instruments of the type specified in GPS 112. Category C insurers are nevertheless required to meet a variant of the MCR. Specifically, Category C insurers are required to maintain assets in Australia (where the assets are the ones that are recognised by GPS120 as assets in Australia) that exceed their liabilities in Australia (less technical provisions in excess of those required by Prudential Standard GPS 310 Audit and Actuarial Reporting and Valuation) by an amount that is greater than the MCR determined by this Prudential Standard.

The capital base is calculated by measuring available capital taking into account the quality of the support provided by various types of capital instruments and the extent to which each instrument:

- provides a permanent and unrestricted commitment of funds;
- is freely available to absorb losses;
- does not impose unavoidable servicing charges against earnings; or
- ranks behind policyholders and creditors in the event of wind-up.

The MCR represents an allowance for the following risks:

- Insurance risk – The possibility that the actual value of premium and claims liabilities will be greater than the value determined under prudential standards (GPS 310);
- Investment risk – The risk that on-balance sheet assets and off-balance exposures will be realised at a different value to their reported amounts; and
- Concentration risk – The largest loss to which an insurer will be exposed (taking into account the probability of that loss) due to the concentration of policies, after netting out any reinsurance recoveries and allowing for the cost of one reinstatement premium for the insurer's catastrophe reinsurance.

Capital buffer

Capital buffer is the excess capital provided to cater for the possibility of unusual or extreme economic shocks that would otherwise damage policyholder interests. The following table gives the capital buffer by the category/type of the insurer.

Table 1.3 – Capital buffer requirement

Category/Type of Isurer	Capital buffer	Where MCR is
A, B & C	20% of MCR	not specified
D & E	50% of MCR	MCR < $4M
D & E	at least $6M (after deductions)	$4M<MCR<$5M
D & E	20% of MCR	MCR > $5M
Medical Indemnity	50% of MCR	not specified

Source: APRA, GPG 110

Measurement of capital

GPS 112 Capital Adequacy: Measurement of Capital sets out the essential characteristics that an instrument must have to qualify as Tier 1 or Tier 2 capital for inclusion in the capital base that is used to assess the capital adequacy of an insurer. Tier 1 capital comprises the highest quality capital components. Tier 2 capital includes instruments which fall short of the quality of Tier 1 capital but nonetheless contribute to the overall strength of an institution as a going concern.

The key requirements of this standard are that a general insurer must:

- include only eligible capital as a component of capital for regulatory capital purposes;
- make certain deductions from capital; and
- meet certain limitations with respect to Tier 1 capital and Tier 2 capital.

Figure 1.2 summarises the calculation of the capital base.

Figure 1.2 – Capital base calculation based on GPS 112 Capital Adequacy: Measurement of Capital

TIER 1 CAPITAL

Fundamental Tier 1 Capital
(must be at least 75% of net Tier 1 Capital)

- Paid up ordinary shares;
- Reserves (excluding asset revaluation reserves);
- Retained earnings;
- Current year after tax earnings less expected dividends;
- Technical provisions in excess of those required by GPS 310;

Plus

Residual Tier 1 Capital

- Non-innovative Residual Tier 1 capital – comprising perpetual non-cumulative preference shares that satisfy the relevant criteria; and
- Innovative Tier 1 capital – comprising all other Residual Tier 1 capital instruments that satisfy the relevant criteria.

Less

Deductions from Tier 1 Capital

+

TIER 2 CAPITAL

Eligible to a maximum of 100% of net Tier 1 Capital

Upper Tier 2 Capital

- perpetual cumulative preference shares;
- perpetual cumulative mandatory convertible notes;
- perpetual cumulative subordinated debt;
- any capital amounts otherwise meeting APRA's requirements for Tier 1 capital instruments that are ineligible for inclusion as Tier 1 capital as a result of the limits in GPS 112;
- any other hybrid capital instruments of a permanent nature approved, in writing, by APRA;
- 45 per cent of pre-tax revaluation reserves of each of the following (subject to certain conditions)

  (i) property not held at fair value; and

  (ii) investments in subsidiaries not held at fair value, other than subsidiaries that APRA deems part of an Extended Licensed Entity (ELE). The amount recognised must be net of any fair value gains and losses and any gains or losses on hedges offsetting revaluations included in reserves; and
- 45 per cent of the post-acquisition reserves of associates as defined in the Australian Accounting Standards.

Plus

Lower Tier 2 Capital

(Must be less than 50% of net Tier 1 Capital)

- Term subordinated debt;
- Limited life redeemable preference shares; and
- Any other similar limited life capital instruments.

=

CAPITAL BASE

Internal model-based method

GPS 113 Capital Adequacy: Internal Model-based method, effective 31 March 2009, sets out the requirements that a general insurer or an insurance group must follow in order to use the Internal Model-based method to calculate their MCR. A general insurer using the Internal Model-based Method is expected to include the three risks covered in the Prescribed Method (insurance, investment and concentration risks) as well as other relevant risk factors, within its method of calculation.

The key requirements to obtain and maintain approval for the use of an Internal Model-based Method are:

- the insurer or insurance group must have an advanced approach to risk management and capital management which includes an appropriate Economic Capital Model (ECM);
- governance arrangements for the development and use of the ECM must be suitable;
- the ECM must be used by the insurer or insurance group for its own purposes or the purposes of the group and be embedded in management, operations and decision making processes; and
- the ECM must be technically sufficient to produce a reliable estimate of the capital required by the insurer or insurance group.

Investment risk capital charge

GPS 114 Capital Adequacy: Investment Risk Capital Charge sets out the calculation of Investment Risk Capital Charge under the Prescribed Method of calculating the MCR. Credit risk, market or mismatch risk and liquidity risk may all cause adverse movements in the value of assets recorded by a general insurer.

The investment risk capital charge is calculated by classifying each asset according to its quality and multiplying it by an investment capital factor as determined by APRA. Adjustments are made for off-balance sheet exposures and assets subject to charges or guarantees. Where a significant exposure to a single asset (e.g. property) or counterparty (e.g. single reinsurer) exists, the insurer may have to hold additional capital depending on the credit rating of the counterparty. The relevant investment capital factors for various assets and counterparty grades are listed in Table 1.4 and Table 1.5 respectively and the criteria for different counterparty ratings are set out in Table 1.6.

Wholly owned subsidiaries that meet certain requirements may be consolidated in determining the investment risk capital charge.

Table 1.4 – Investment capital factors

	Asset	Investment Capital Factor
1	Cash (notes and coins) Debt obligations of: the Commonwealth Government; an Australian State or Territory government; or the national government of a foreign country where: – the security has a Grade 1 counterparty rating; or, if not rated, – the long-term, foreign currency counterparty rating of that country is Grade 1 Assets in respect of anticipated recoveries from the Commonwealth Government or from an Australian State or Territory government GST receivables (input tax credits)	0.5%
2	Any debt obligation that matures or is redeemable in less than one year with a counterparty rating of Grade 1 or 2 (excluding subordinated debt and debt obligations of government dealt with specifically in this Table) Cash management trusts with a counterparty rating of Grade 1 or 2	1%
3	Any other debt obligation (that matures or is redeemable in one year or more) with a counterparty rating of Grade 1 or 2 (excluding subordinated debt and debt obligations of government dealt with specifically in this Table) Reinsurance assets due from APRA-authorised reinsurers with a counterparty rating of Grade 1 or 2 (subject to any determination by APRA under paragraph 13 of GPS 114)	2%
4	Reinsurance assets due from non-APRA-authorised reinsurers with a counterparty rating of Grade 1 or 2 except for reinsurance recoverables specified under paragraph 5 of Attachment A of GPS 114	3%
5	Unpaid premiums due less than 6 months previously (subject to any determination by APRA under paragraph 13 of GPS 114) Unclosed business Any other debt obligation with a counterparty rating of Grade 3 (excluding subordinated debt) Reinsurance assets due from APRA-authorised reinsurers with a counterparty rating of Grade 3 (subject to any determination by APRA under paragraph 13 of GPS 114) Cash management trusts with a counterparty rating of Grade 3	4%
6	Any other debt obligation with a counterparty rating of Grade 4 (excluding subordinated debt) Reinsurance assets due from APRA-authorised reinsurers with a counterparty rating of Grade 4 (subject to any determination by APRA under paragraph 13 of GPS 114) Reinsurance assets due from non-APRA-authorised reinsurers with a counterparty rating of Grade 3 except for reinsurance recoverables specified under paragraph 5 of Attachment A of GPS 114 Cash management trusts with a counterparty rating of Grade 4	6%
7	Any other debt obligation with a counterparty rating of Grade 5 (excluding unlisted subordinated debt) Reinsurance assets due from APRA-authorised reinsurers with a counterparty rating of Grade 5 Unpaid premiums due more than 6 months previously Cash management trusts with a counterparty rating of Grade 5 Listed subordinated debt	8%

	Asset	Investment Capital Factor
8	Reinsurance assets due from non-APRA-authorised reinsurers with a counterparty rating of Grade 4 except for reinsurance recoverables specified under paragraph 5 of Attachment A of GPS 114	9%
9	Unlisted subordinated debt	10%
10	Reinsurance assets due from non-APRA-authorised reinsurers with a counterparty rating of Grade 5 except for reinsurance recoverables specified under paragraph 5 of Attachment A of GPS 114	12%
11	Listed equity instruments Listed trusts except where otherwise provided for in Attachment A of GPS 114	16%
12	Direct holdings of real estate Unlisted equity instruments Unlisted trusts except where otherwise provided for in Attachment A of GPS 114 Other assets not assigned an Investment Capital Factor elsewhere in this Table (other than hybrid instruments with both equity and debt features (see paragraph 3 of Attachment A of GPS 114)	20%
13	Loans to directors of the insurer or directors of related bodies corporate (or a director's spouse) Unsecured loans to employees exceeding $1,000 Assets under a fixed or floating charge (refer to paragraphs 27 to 28 of GPS 114)	100%
14	Amounts required to be deducted from an insurer's capital base under Prudential Standard GPS 112 Capital Adequacy: Measurement of Capital Amounts recorded on the balance sheet in relation to instruments subject to paragraphs 39 to 54 of GPS 114	0%

Source: APRA, Attachment A of GPS 114

Table 1.5 – Investment capital factors for reinsurance recoverables due from non-APRA authorised reinsurers

Counterparty Grade	Investment Capital Factor
1	20%
2	40%
3	60%
4	100%
5	100%

Source: APRA, Attachment A of GPS 114

Table 1.6 – Counterparty grades

Grade	Standard & Poor's	Moody's	AM Best	Fitch
1	AAA	Aaa	A++	AAA
2	AA+ AA AA-	Aa1 Aa2 Aa3	A+	AA+ AA AA-
3	A+ A A-	A1 A2 A3	A A-	A+ A A-
4	BBB+ BBB BBB-	Baa1 Baa2 Baa3	B++ B+	BBB+ BBB BBB-
5	BB+ or below	Ba1 or below	B or below	BB+ or below

Source: APRA, Attachment B of GPS 114

Note: Unrated assets or exposures must be classified as Grade 4.
Refer to GPS 114 for more details on the counterparty ratings.

Insurance risk capital charge

GPS 115 sets out the calculation of the Insurance Risk Capital Charge under the Prescribed Method for calculating MCR.

Insurance risk comprises two components: outstanding claims risk and premium liability risk. Both must be valued to allow for a margin that results in a 75 per cent probability of sufficiency. The method for valuing liabilities is detailed in GPS 310 Audit and Actuarial Reporting and Valuation. It should be noted that premium liabilities are not brought to account for financial statements purposes and that it is possible for directors to decide a different outstanding claims liability is more appropriate for statutory reporting purposes.

For capital adequacy purposes, any excess prudential margin over the 75 per cent sufficiency level, net of tax, can be included as part of the capital base. The actual capital charge for both risks is calculated using different capital factors for each class of business and for direct and inwards reinsurance business.

The relevant factors for direct insurance and reinsurance are listed in Tables 1.7 and 1.8 respectively.

Table 1.7 – Insurance risk capital factors – Direct insurance

Class of business	Outstanding Claims Risk Capital Factor	Premium Liability Risk Capital Factor
Householders Commercial Motor Domestic Motor Travel	9%	13.5%
Fire and ISR Marine and Aviation Consumer Credit Mortgage Other Accient Other	11%	16.5%
CTP Public and Product Liability Professional Indemnity Employers' Liability	15%	22.5%

Source: APRA, Attachment A of GPS 115

Table 1.8 – Insurance risk capital factors – Inwards reinsurance

Class of business	Outstanding Claims Risk Capital Factor	Premium Liability Risk Capital Factor
Property		
• Facultative Proportional	9.0%	13.50%
• Treaty Propotional	10.0%	15.0%
• Facultative Excess of Loss	11.0%	16.50%
• Treaty Excess of Loss	12.0%	18.0%
Marine & Aviation		
• Facultative Proportional	11.0%	16.50%
• Treaty Propotional	12.0%	18.00%
• Facultative Excess of Loss	13.0%	19.50%
• Treaty Excess of Loss	14.0%	21.00%
Casualty		
• Facultative Proportional	15.0%	22.50%
• Treaty Propotional	16.0%	24.00%
• Facultative Excess of Loss	17.0%	25.50%
• Treaty Excess of Loss	18.0%	27.00%

Source: APRA, Attachment A of GPS 115

Concentration risk capital charge

The concentration risk capital charge takes into account the highest aggregation risk of an insurer. GPS 116 Capital Adequacy: Concentration Risk Capital Charge sets out the calculation of the concentration risk capital charge under the Prescribed Method for calculating MCR. The concentration risk capital charge is equivalent to the maximum event retention (MER) after taking into account acceptable reinsurance arrangements less the cost of one reinstatement premium for those reinsurance arrangements.

Lenders mortgage insurance (LMI)

There are specific requirements for the concentration risk capital charge calculation for lenders mortgage insurers (LMI). Attachment A of GPS 116 sets out the method of calculating MER for LMIs.

The basic model for calculating the MER charge for LMI involves the following:

- The model is based on the hypothesis of a three-year downturn in the housing market;
- The probabilities of default to be applied allow for a three-year horizon. These vary by loan-to-value ratio (LVR) and have been calibrated to create a stressed scenario of "catastrophic" loss that would happen once in every 250 years. The probability of claim in year two is calibrated to be twice that in year one and three (based on the "head- and- shoulders" scenario that is generally observed during periods of economic stress);
- The losses given default to be applied are allowed to vary with the LVR;
- The seasoning factors allow for the age of the loans;
- Additional capital penalties will be applied to non-standard loans, top cover or pool cover;
- Available reinsurance recoveries over the three years can be recognised. Various constraints have been imposed in determining the extent to which recoveries can be recognised; and
- An allowance for claims handling expenses has been made.

Note that ADIs are only able to claim capital concessions if mortgage insurance is provided by "acceptable" LMIs as defined by APRA. In general, "acceptable" LMIs are those authorised by APRA. For overseas subsidiaries of Australian ADIs, APRA will accept the host supervisors' requirements on what constitutes an acceptable LMI in those jurisdictions. These requirements are set out in Attachment C of APS 112 Capital Adequacy: Standardised Approach to Credit Risk.

APRA has amended Attachment A of GPS 116 and the corresponding reporting standard GRS 170.1 'Maximum Event Retention and Risk Charge for Lenders Mortgage Insurers'. The amended standards are effective from 1 May 2010. The amendments aim to reduce the prescriptive approach in GPS 116 Attachment A relating to the calculation of allowable reinsurance in the MER calculation for LMI. Instead a principles-based approach to the calculation of allowable reinsurance has been taken. The revisions are not intended to change the foundations on which the MER for an LMI is based or to materially alter the level of capital required by the LMI industry. Overall, the process will have minimal impact on the LMI industry.

The proposals taking effect from 1 May 2010 are:

- Reinsurance principles – APRA will implement its proposed principles-based approach to the calculation of allowable reinsurance.
- Capitalised premium – APRA has reiterated that capitalised premium should be included in the loan-to-valuation ratio (LVR) calculation for PML purposes, irrespective of whether or not the premium is insured.
- PML for pooled policies – APRA has clarified the calculation of PML for pooled policies as well as a number of other definitions in the prudential standard.
- Reinsurance cover for new business – APRA will not require an LMI to include new business in the calculation of PML. Instead, APRA requires that an LMI describe in detail in its Reinsurance Management Strategy (REMS) how it will manage its future reinsurance needs and the mitigants it has in place for risks in relation to future reinsurance arrangements.

Level 2 Insurance Groups

Under the prudential standard GPS111 Capital Adequacy: Level 2 Insurance Groups, the MCR and capital base of the group is determined on a consolidated group basis using requirements similar to those that apply to Level 1 general insurers. The Board of the group is responsible for capital management of the group and of non-consolidated subsidiaries.

The impact of intra-group transactions is assessed at the group level and may result in eligible capital instruments of entities within the group being excluded from the capital base of the group as a whole.

The value of non-consolidated subsidiaries is deducted from the group's capital base and thus any deficiency in an undercapitalised non-consolidated subsidiary may result in a reduction in the group's eligible capita.

The following also apply to the capital requirements of the group:

- Level 1 insurers within the group are required to meet the MCR on an individual basis;
- The concentration risk capital charge is to be calculated in a manner consistent with the requirements for Level 1 insurers;
- The MER calculation may take into account inwards reinstatement premiums if the group has contractually binding netting arrangements in place;
- APRA will not prescribe were the surplus capital of the group can be held;
- APRA's assessment of capital instruments will not affect any foreign subsidiaries that have issued capital instruments;

Assets in Australia

GPS 120 Assets in Australia, sets out requirements applying to general insurers in relation to when assets are eligible to be counted as assets in Australia. Section 28 of the Insurance Act requires that all insurers are to maintain assets in Australia of a value that equals or exceeds the total amount of the general insurer's liabilities in Australia.

The list of assets that cannot be included as assets in Australia includes:

- Goodwill;
- Other intangible assets;
- Net deferred tax assets; and
- Assets under charge or mortgage (to the extent of the indebtedness).

Investment policy

There are no absolute restrictions on investments that may be held by insurance companies except the trust account requirements of the Financial Services Reform (FSR) Act 2001. Under Section 1017E of the FSR Act, where monies received cannot be applied to the issue of a product within one business day of receipt (i.e. unmatched cash), the monies must be held in a trust account. However, in calculating the minimum capital requirement of an insurer under GPS 110, the capital charge assigned to each asset type is given a different weighting, taking into account its nature and the credit rating of any counterparties. These are detailed in Tables 1.5 and Table 1.6. Significant individual exposures may require an additional capital charge. APRA also has the power under Section 49N to direct an insurer to record an asset at a specified value, subject to approval of the Federal Treasurer.

1.5

Management of risk and reinsurance

Risk management

GPS 220 Risk Management aims to ensure that a general insurer has systems for identifying, assessing, mitigating and monitoring the risks that may affect its ability to meet its obligations to policyholders. These systems – together with the structures, processes, policies and roles supporting them – are referred to as a general insurer's risk management framework.

The prudential standard requires that a general insurer:

- includes a documented Risk Management Strategy (RMS) in its risk management framework;
- has sound risk management policies and procedures and clearly defined managerial responsibilities and controls;
- submits its RMS to APRA when any material changes are made;
- has a dedicated risk management function (or role) responsible for assisting in the development and maintenance of the risk management framework;
- submits a three-year rolling Business Plan to APRA and re-submits after each annual review or when any material changes are made;
- submits a Risk Management Declaration (RMD) to APRA on an annual basis; and
- submits a Financial Information Declaration (FID) to APRA on an annual basis.

Risk Management Framework

The risk management framework of a general insurer should consider, at a minimum, the following risks:

- Balance sheet and market risk;
- Credit risk;
- Operational risk;
- Insurance risk;
- Reinsurance risk;
- Concentration risk; and
- Risks arising from the business plan.

The framework should also cover other elements such as the interaction between the risk management role and the board; the processes used to identify, monitor and mitigate risks; and the mechanisms for monitoring the minimum capital requirements (MCR).

The general insurer is also required to have this risk management framework reviewed by operationally independent, appropriately trained and competent members of staff. The frequency and scope of this review will depend on the size, business mix, complexity of the insurer's operations and the extent of any change in the business mix or risk profile. The review must cover the RMS, the risk management role and the system of internal control.

To assist general insurers in developing their own risk management framework, APRA has released the following non-binding prudential practice guides (GPG 200 – GPG 520).

Risk Management Strategy (RMS)

An insurer's RMS must set out the following (among other requirements):

- The risk governance relationship between the Board, Board committees and senior management;
- Describe processes for identifying, assessing, mitigating, controlling, monitoring and reporting risk issues;
- The roles and responsibilities of the persons with managerial responsibility for the risk management framework; and
- An overview of mechanisms for ensuring continued compliance with the minimum capital requirements and all other prudential requirements.

Risk Management Declaration (RMD)

The board of a general insurer is required to submit a RMD to APRA stating that:

- it has systems in place for the purpose of ensuring compliance with the Insurance Act, the Financial Sector (Collection of Data) Act, and the regulations, prudential standards reporting standards, authorisation conditions, directions and any other requirements imposed by APRA, in writing;
- the board and senior management are satisfied with the efficacy of the processes and systems surrounding the production of financial information at the insurer;
- here is an RMS in place that sets out its approach to risk management, which was developed in accordance with the requirements of GPS 220;
- there is a Reinsurance Management Strategy (REMS) in place for selecting and monitoring reinsurance programs, which was developed in accordance with GPS 230;
- over the last financial year, the insurer has substantially complied with its RMS and REMS obligations and that these strategies are operating effectively in practice, having regard to the risks they are designed to control; and
- copies of the insurer's current RMS and REMS have been lodged with APRA.

This declaration is to be signed by two directors (or the senior officer if a branch) and is due within four months of the financial year-end. If this declaration contains any qualifications, the deviation from the risk management framework should be disclosed, as well as any mitigating factors or steps taken to rectify.

Financial Information Declaration (FID)

An insurer is required to submit an FID to APRA on or before the day that the annual statutory accounts are required to be submitted to APRA. The FID must be signed by the CEO and CFO, stating that:

- the financial information lodged with APRA by the insurer has been prepared in accordance with relevant legislation, prudential standards and any other mandatory professional standard and is accurate and complete;
- the information provided to the Appointed Auditor and Appointed Actuary is accurate and complete.

Level 2 Insurance Groups

The prudential standard GPS 221 Risk Management: Level 2 Insurance Groups, sets out the risk management requirements for Level 2 general insurance groups. The requirements of GPS221 are based on the principles applying to Level 1 general insurers.

The group is required to maintain a group-wide risk management framework, including the following:

- a documented, group-wide Reinsurance Management Strategy, setting out sound reinsurance management policies and procedures and clearly defined managerial responsiblities and controls;
- policies relating to outsourcing arrangements for material business activities, setting out appropriate procedures for due diligence, approval and on-going monitoring of such arrangements; and
- business continuity management appropriate to the nature and scale of the operations

The requirements for documentation of reinsurance arrangements do not apply to foreign entities within the group, however APRA must be provided with details of the effects of any limited risk transfer arrangements entered into by foreign entities within the group.

Level 1 insurers within the group do not have to comply with risk management requirements on an individual basis if the Level 2 group can satisfy these requirements in relation to each Level 1 insurer within the group.

The group must submit the following to APRA on an annual basis:

- Risk Management Declaration;
- Financial Information Declaration; and
- Reinsurance Arrangements Statement

Business continuity management

The prudential standard GPS 222 Business Continuity Management and associated guidance note on business continuity management (BCM) GGN 222.1 Risk Assessment and Business Continuity Management, aim to ensure that general insurers have a holistic approach to BCM rather than focusing just on data recovery. The standard expects that this “whole of business” approach and the BCM itself should be commensurate with the nature and scale of the entity.

Key requirements of the prudential standard include:

- The board of directors and senior management of a general insurer must consider business continuity risks and controls as part of the company’s overall risk management systems when completing Board Declaration submitted to APRA annually;
- A general insurer must identify critical business functions, resources and infrastructure which, if disrupted, would have a material impact on the company’s business operations, reputation or profitability;
- A general insurer must assess the impact of plausible disruption scenarios on critical business functions, resources and infrastructure and have in place appropriate recovery strategies to ensure all necessary resources are readily available to withstand the impact of the disruption;
- A general insurer must develop, implement and maintain through review and testing procedures, a Business Continuity Plan (BCP) that documents procedures and information which enable the company to respond to disruptions and recover critical business functions;
- The BCP must be reviewed at least annually by responsible senior management and periodically through insurer’s internal audit function or an external expert; and
- An insurer must notify APRA as soon as possible and no later than 24 hours after experiencing a major disruption that has the potential to materially impact policy holders.

Reinsurance Management

GPS 230 aims to ensure that a general insurer, as part of its overall risk management framework, has a specific reinsurance management framework to manage the selection, implementation, monitoring, review, control and documentation of reinsurance arrangements. These systems, together with the structures, processes, policies and roles supporting them, are referred to as a general insurer's risk management framework. There must be a clear link between this framework and the insurer's Reinsurance Management Strategy (REMS).

GPS 230 requires that a general insurer:

- has in its reinsurance management framework a documented REMS, sound reinsurance management policies and procedures and clearly defined managerial responsibilities and controls;
- submits its REMS to APRA when any material changes are made;
- submits a Reinsurance Arrangements Statement (RAS) detailing its reinsurance arrangements to APRA at least annually; and
- makes an annual reinsurance declaration (RD) based on the "two-month rule" and "six-month rule" and submits the declaration to APRA.

The concepts above; reinsurance management framework, REMS, RAS, RD and the "two-month" and "six-month" rules are explained below.

Reinsurance Management Framework and REMS

The reinsurance management framework should include both reinsurance and retrocession arrangements and have a clear link to the risk management strategy. It should include clearly defined management responsibilities and controls, policies and procedures to manage the selection, implementation, monitoring, review, amendment and documentation of reinsurance arrangements of the general insurer, and a written, board approved REMS.

The REMS should document the objectives and strategy for reinsurance management including the risk appetite of the general insurer, the policies for setting and monitoring aggregate retentions and upper limits on policies, the methods for choosing appropriate reinsurance participants and the process used for setting and monitoring the MER. Members of global groups are expected to provide details of global reinsurance arrangements. The GPG 245 Reinsurance Management Strategy specifies that Category D insurer and Category E insurer should target to cede no more than 90% of their premium and for the other insurers the limit is 60%.

The general insurer is also required to have this reinsurance management framework reviewed by operationally independent, appropriately trained and competent members of staff. The frequency and scope of this review will depend on the size, business mix, complexity of the insurer's operations and the extent of any change in the reinsurance program or risk appetite. As with the risk management strategy, the REMS is subject to an annual review by the Appointed Auditor, providing limited assurance to APRA that the insurer has complied with the REMS at all times during the reporting period.

Reinsurance Arrangements Statement (RAS)

General insurers are required to submit a RAS. The RAS provides evidence of the implementation of the REMS and details:

- schematics of the insurer's reinsurance program that depict retention levels, aggregate deductibles, policy layers, stop-loss policies, reinstatements, loss participation clauses and event limit clauses;
- the parameters for each class of business that represent the highest potential loss exposure and how the program reduces the gross loss to the general insurer;
- details of the MER calculation including modelling of catastrophes, PML and realistic disaster scenarios; and
- details of Limited Risk Transfer Arrangements, including those that have not been approved by APRA.

If the reinsurance program has a common date of renewal then this statement is due annually within two months of the renewal date. If there are multiple inception dates then this statement must be submitted to APRA every six months.

Reinsurance Declaration (RD)

General insurers are also required to submit an annual RD to APRA on the same day that the yearly statutory accounts are due. This declaration must be signed by both the CEO and the chief reinsurance officer (CRO) and state that all reinsurance arrangements placed are "legally binding" under either APRA's "two-month" rule or "six-month" rule.

If there are any reinsurance arrangements in place that do not meet the requirements of the "two-month" rule or "six-month" rule then they should be disclosed on the declaration. Recoveries arising from these arrangements will not be eligible for inclusion as Tier 1 Capital (thus reducing the insurer's capital adequacy) subject to transition rules described in attachment H to GPS 110.

The “two-month” and “six-month” rules

The “two-month” rule states that within two months of the inception date, the general insurer either:

- has a placing slip pertaining to the reinsurance arrangements that has been signed and stamped by all participating reinsurers and contains a slip wording, with no outstanding terms or conditions to be agreed; or
- has a placing slip pertaining to the reinsurance arrangements that has been signed and stamped by all participating reinsurers, with no outstanding terms or conditions to be agreed; or
- does not have a placing slip, but has a cover note issued by the participating reinsurer (in the case of direct placements with reinsurers) or from its appointed reinsurance broker (in the case of intermediated reinsurance placements). The insurer also must have systems to verify that the content of the cover note is the same as the placing slip agreed between the insurer and the reinsurer.

The “six-month” rule requires that within six months of the inception date, the general insurer either:

- has a placing slip pertaining to the reinsurance arrangements that has been signed and stamped by all participating reinsurers and contains a slip wording, with no outstanding terms or conditions to be agreed; or
- has in its possession a full treaty contract wording (including any appending contract wordings and/or schedules) that has been signed and stamped by all contracting parties, namely the insurer and all participating reinsurers.

Outsourcing

GPS 231 Outsourcing aims to ensure that all outsourcing arrangements involving material business activities entered into by a general insurer are subject to appropriate due diligence, approval and on-going monitoring.

The key requirements of the standard are:

- A general insurer must have a policy relating to outsourcing of material business activities;
- A general insurer must have sufficient monitoring processes in place to manage the outsourcing of material business activities;
- A general insurer must have a legally binding agreement in place for all material outsourcing arrangements with third parties, unless otherwise agreed by APRA;
- A general insurer must consult with APRA prior to entering agreements to outsource material business activities to service providers who conduct their activities outside Australia; and
- A general insurer must notify APRA after entering into agreements to outsource material business activities.

Transfer and amalgamation of insurance business for general insurers

GPS 410 Transfer and Amalgamation of Insurance Business for General Insurers aims to ensure that affected policyholders, and other interested members of the public, are informed and given accurate information about the transfer or amalgamation of an insurer’s insurance business.

The key requirements of GPS 410 are as follows:

- Prior to making an application to the Court for a transfer or amalgamation of its insurance business, an insurer must:
  - provide a copy of the scheme and any relevant actuarial reports to APRA;
  - publish a notice of intention to make the application in the Government Gazette and relevant newspapers;
  - send a summary of the scheme (approved by APRA) to every affected policyholder and make a copy available for public inspection.
- After gaining Court approval, the insurer must give APRA a statement of the nature and terms of the transfer or amalgamation, and the Court order confirming the scheme.

Government schemes to limit gross exposure

Medical indemnity insurance

Two schemes cover doctors with medical indemnity insurance, the High Cost Claims Scheme (HCCS) and the Exceptional Claims Scheme (ECS).

HCCS aims to minimise the impact that large claims may have on the ability of medical indemnity insurers to provide cover. It covers half the cost of each medical indemnity claim over $300,000, up to a cost of $20 million per claim.

ECS assumes liability for 100 per cent of any damages payable against a doctor that exceed the doctor’s insurance contract limit. The doctor must have medical indemnity insurance cover to at least $20 million for claims notified from 1 July 2003. The ECS will cover the same events and incidents as the doctor’s insurance policy, but will not cover claims from the treatment of public patients in public hospitals or claims from the treatment of patients overseas.

Terrorism insurance

The Terrorism Insurance Act 2003 rendered terrorism exclusion clauses ineffective and established the Australian Reinsurance Pool Corporation (ARPC) to manage a scheme for terrorism insurance coverage for commercial property, business interruption and public liability businesses.

The scheme was introduced in response to the progressive withdrawal of cover by insurers and reinsurers in the aftermath of the 11 September 2001 terrorist attacks. The scheme began on 1 July 2003 and covers any declared terrorist incident, except damage from nuclear causes. Various types of coverage are also excluded.

There is a two-tier reinsurance premium structure under the scheme. Insurance companies pay an initial standard rate (based on the class of business covered and geographical location of the property). This has built up a $300 million pool of funds.

There is a maximum post-terrorism event rate (again based on the class of business covered and geographical location of the property) for replenishing the scheme in the event of a major incident. The $300 million pool will be supplemented by another $10 billion from the Australian Government. Insurance companies must retain $1 million of claims cost per annum when reinsuring with the ARPC.

1.6 Governance and assurance

Audit and Actuarial Reporting and Valuation

GPS 310 outlines the roles and responsibilities of a general insurer's Appointed Auditor and Appointed Actuary. It also outlines the obligations of a general insurer to make arrangements to enable its Appointed Auditor and Appointed Actuary to fulfill their responsibilities. In addition, the Prudential Standard establishes a set of principles and practices for the consistent measurement and reporting of insurance liabilities for all general insurers.

The key requirements of GPS 310 Audit and Actuarial Reporting and Valuation are:

- An insurer must make arrangements to enable its Appointed Auditor and Appointed Actuary to undertake their roles and responsibilities;
- An insurer is exempt from the requirement to have an Appointed Actuary in certain circumstances;
- The Appointed Auditor must audit, and provide an opinion to the board on, the yearly APRA statutory accounts of the general insurer;
- The Appointed Auditor must review other aspects of the general insurer's operations on an annual basis and prepare a report on these matters to the board;
- The Appointed Auditor may also be required to undertake other functions, such as a special purpose review (see "APRA targeted reviews" below);
- The Appointed Actuary must prepare a Financial Condition Report (FCR) and an Insurance Liability Valuation Report (ILVR) and provide these reports to the board;
- The Appointed Actuary must apply GPS 310 when valuing the general insurance liabilities for the purposes of GPS 110 Capital Adequacy for General Insurers and for the purpose of reporting requirements under the Financial Sector (Collection of Data) Act;
- A general insurer must arrange to have the ILVR of its Appointed Actuary peer-reviewed by another actuary; and
- A general insurer must submit all certificates and reports required to be prepared by its Appointed Auditor and Appointed Actuary to APRA.

Level 2 Insurance groups

The prudential standard GPS 311 Audit and Actuarial Reporting and Valuation: Level 2 Insurance groups requires a Level 2 insurance group to:

- appoint a Group Auditor and Group Actuary;
- make arrangements to enable its Group Auditor and Group Actuary to undertake their roles and responsibilities;
- ensure that on an annual basis its Group Auditor conducts a limited assurance review of the annual accounts of the group and reviews other aspects of the group's operations;
- ensure that its Group Actuary prepares an Insurance Liability Valuation Report annually which is addressed to the Board of the parent entity of the group;
- ensure that its Group Auditor and Group Actuary undertake other functions such as special purpose reviews where required;
- for the purposes of the capital standards and reporting requirements under the Financial Sector (Collection of Data) Act 2001, ensure that the group's insurance liabilities are valued in accordance with this Prudential Standard; and
- submit to APRA all reports required under this Prudential Standard prepared by its Group Auditor and Group Actuary.

APRA targeted reviews

Both the Insurance Act and the prudential standards stipulate that the Appointed Auditor (or Appointed Actuary) may be required to undertake other functions specified by APRA in consultation with the general insurer.

In 2003, APRA began a process of "targeted reviews" of general insurers, similar to the process it had implemented with the authorised deposit-taking institutions.

These reviews highlight a particular area that APRA is interested in and require the general insurer to engage the Appointed Auditor to prepare a report in respect of that selected area of operation. Apart from highlighting areas where further improvement could be sought, these reviews provide APRA with an industry snapshot that helps to identify and promote best practices.

The last targeted review focused on Reinsurance documentation was carried out during 2006/07 and the report was issued by APRA in May 2008.

Governance

GPS 510 Governance sets out what APRA consider to be the minimum requirements which must be met to achieve good governance. A sound governance framework is important in helping maintain public confidence in regulated entities. The actual governance arrangements in place will vary from entity to entity depending on the size, complexity and risk profile of each entity.

In November 2009, APRA released a paper on "Remuneration: Extensions to governance requirements for APRA – regulated institutions". The paper covers prudential standards on governance and an associated prudential practice guide (PPG), dealing with remuneration. The revised governance standards came into effect on 1 April 2010.

APRA's approach to governance remains unchanged in most respects but some requirements have been modified. The key modifications are:

- narrowing the group of 'responsible persons' for whom the Board Remuneration Committee must make individual recommendations to the Board;
- removing the requirement that the Board of a foreign branch approve the Remuneration Policy. Instead, the senior officer outside Australia with delegated authority from the Board may approve the Remuneration Policy;
- clarifying in the PPG that basing the remuneration of risk and financial control executives on the performance of the institution is acceptable where there are proper safeguards to ensure that the integrity of their functions is not compromised; and
- excluding contractual arrangements with third parties from the coverage of the Remuneration Policy where the risk from incentive payments is explicitly addressed in the institution's risk management framework and overseen by another Board Committee.

The key requirements, including the amendments, stipulated in GPS 510 are:

- specific requirements with respect to Board size and composition;
- the chairperson of the Board must be an independent director;
- a Board Audit Committee must be established;
- regulated institutions must have a dedicated internal audit function;
- certain provisions dealing with independence requirements for auditors consistent with those in the Corporations Act 2001;
- the Board must have a Remuneration Policy that aligns remuneration and risk management;
- a Board Remuneration Committee must be established; and
- the Board must have a policy on Board renewal and procedures for assessing Board performance.

All insurers, except Category C insurers, have to comply with this prudential standard in its entirety. Category C insurers only have to comply with those provisions of this Prudential Standard specific to Category C insurers.

Fit and proper

GPS 520 Fit and Proper applies to all general insurers and authorised non-operating holding companies. The key requirements of this standard are that:

- An institution must have and implement a written fit and proper policy that meets the requirements of the standard;
- The fitness and propriety of a responsible person must generally be assessed prior to their initial appointment and then re-assessed annually (or as close to annually as practicable);
- An institution must take all prudent steps to ensure that a person is not appointed to, or does not continue to hold, a responsible person position for which they are not fit and proper; and
- Information must be provided to APRA regarding responsible persons and the institution's assessment of their fitness and propriety.

The standard stipulates who are regarded as responsible people at different types of institutions and sets out additional restrictions on the Appointed Actuary and Appointed Auditor roles. However, it leaves the determination of what is an appropriate fit and proper policy in the hands of the general insurer.

1.7 Financial reporting

Accounting standards

Australian general insurers are required to prepare financial statements that comply with the Australian Accounting Standards (AASB). Specific AASBs relevant to general insurance include:

- AASB 4 Insurance Contracts defines what constitutes an insurance contract.
- AASB 1023 General Insurance Contracts defines a general insurance contract (i.e. an insurance contract that is not a life insurance contract as defined in the Life Act), and a non-insurance contract (a contract regulated by the Insurance Act that does not meet the AASB 4 Insurance Contracts definition of insurance).

AASB 1023 prescribes accounting treatment for:

- General insurance contracts (including general reinsurance contracts) that a general insurer issues and to general reinsurance contracts that it holds;
- Certain assets backing general insurance liabilities;
- Financial liabilities and financial assets that arise under non-insurance contracts; and
- Certain assets backing financial liabilities that arise under non-insurance contracts. The treatment of the remaining balances, transactions and operations of a general insurer are prescribed by the AASBs applicable to these transactions or balances.

Key accounting issues dealt with by AASB 1023 and summarised in this chapter include:

- Definition of insurance risk;
- Definition of an insurance contract;
- Definition of premium revenue and earning pattern;
- Measurement of outstanding claims;
- Explicit risk margins;
- Fair value accounting of investments backing general insurance liabilities;
- Deferral of acquisition costs and liability adequacy testing for unearned premiums;
- Accounting for inwards reinsurance;
- Portfolio transfers within a group;
- Non-insurance contracts; and
- Financial statement disclosure principles and requirements

Definition of an insurance contract

AASB 4 and AASB 1023 include a definition of an insurance contract. An insurance contract is defined as a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

Insurance risk is risk other than financial risk. Financial risk is defined as the risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

Insurance risk is significant if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance.

A contract that transfers financial risk alone, or only insignificant amounts of insurance risk, is treated under AASB 139, to the extent that it gives rise to a financial asset or financial liability.

Definition of premium and earning pattern

AASB 1023 clarifies the measurement of premium revenue. Premium revenue comprises premiums from direct business (including underwriting pools written by the entity) and premiums from reinsurance business (including underwriting pools written by other members of the pool). They cover anticipated claims, reinsurance premiums, administrative, acquisition and other costs, and a profit component.

Premium revenue includes fire service levies collected from policyholders as there is no direct nexus between fire brigade charges and the levy that insurers charge policyholders. The fire brigade expense is brought to account in accordance with the earning of the premium to which it relates.

In contrast, stamp duty and the Goods and Services Tax (GST) effectively represent collection of tax on behalf of the government and are therefore not included as revenue of the insurer.

Premium revenue is recognised from the risk attachment date in accordance with the pattern of the incidence of risk. AASB 1023 provides additional guidance on how the pattern of the incidence of risk is determined. Premiums received in advance are recognised as part of the unearned premium liability. Unclosed business is estimated and the premium relating to unclosed business is included in premium revenue. Premium revenue is only recognised as income when it has been earned, which is in proportion to the incidence of the risk covered over the life of the insurance contract.

Measuring premium revenue involves:

- Estimating the total amount of premium revenue;
- Estimating when claims are expected to occur, and hence estimating the pattern of risk exposure, which provides the earning pattern; and
- Recognising the premium when it is earned.

For most contracts the period of the contract is one year and the exposure pattern of the incidence of the risk will be linear. For some reinsurance contracts written on a “risk attaching” basis, a 12-month contract may result in up to 24 months of exposure.

The insurer must also recognise a liability item on the balance sheet for the unearned premium, where this exists.

Measurement of outstanding claims

AASB 1023 requires that the liability for outstanding claims “… shall be measured as the central estimate of the present value of expected future payments for claims incurred with an additional risk margin to allow for the inherent uncertainty in the central estimate”.

Expected future payments include amounts related to:

- Unpaid reported claims;
- Claims incurred but not reported (IBNR);
- Adjustments in light of the most recently available information for claims development and claims incurred but not enough reported (IBNER); and
- Claims handling costs.

The liability for outstanding claims reflects the amount that, if set aside at balance date, would accumulate to enable payment of claims as they fall due. The standard requires that outstanding claims should be discounted to net present value unless the claims are to be settled within a year and the discounting would not have a material impact. While it does require outstanding claims in all classes of business to be discounted, it recognises that such discounting will have significant application to “long tail” classes of business (mainly liability, Compulsory Third Party (CTP) and workers compensation) where a high proportion of such claims are settled outside a 12-month period.

AASB 1023 requires that the discount rate or rates selected should be “risk- free rates that are based on current observable, objective rates that relate to the nature, structure and term of the outstanding claims liabilities … typically government bond rates”.

The standard requires that expected future payments should account for future claim cost escalation created by inflation and superimposed inflation. Superimposed inflation is defined as the level of inflation in excess of normal economic inflation indices. The disclosure of superimposed inflation assumptions differs between companies. Some companies make explicit disclosures while others include superimposed inflation within composite inflation assumptions.

Regulatory valuation

GPS 310 sets out the requirements for the valuation of the insurance liabilities for regulatory reporting. Where an insurer's board decides not to accept the appointed actuary's valuation of insurance liabilities or to adopt a valuation (higher or lower) not in accordance with the principles of this standard, details should be included in the insurer's published annual financial report.

For the main differences in treatment between financial reporting and APRA regulatory reporting, see Table 4.5.

Explicit risk margins

As noted above, an additional explicit risk margin is required to be included as part of the outstanding claims liability. The margins are set with regard to the robustness of the valuation models, available data, past experience and the characteristics of the classes of business written. For outstanding claims, since the risk margin is applied to the net liability, the risk margin should also allow for uncertainty in reinsurance and other recoveries due.

Similar to the APRA requirements, risk margins can allow for diversification. The risk margin for the entire company can then be allocated to individual classes of business.

Assets backing general insurance liabilities

Under AASB 139 Financial Instruments: Recognition and Measurement financial assets may only be designated as at fair value through profit or loss when doing so results in more relevant information because either:

- it eliminates or significantly reduces an accounting mismatch that would arise from measuring assets or liabilities (or recognising the gains and losses on them) on different bases; or
- the instrument forms part of a group of financial assets and/or financial liabilities that are managed on a fair value basis in accordance with a documented risk management or investment strategy and information about the group is provided internally on that basis to the entity's key management personnel.

For insurers the first reason for designation is the most often cited because of the requirement to manage their assets backing insurance liabilities on a fair value basis under AASB 1023.

Note that this does not affect the treatment of those financial assets that are classified as held for trading (i.e. acquired principally for the purpose of selling or repurchasing in the near term, or are part of a portfolio for which there is evidence of recent short-term profit taking) as these are automatically designated as fair value through profit and loss.

Deferral of acquisition costs and liability adequacy test for unearned premium

AASB 1023 requires that acquisition costs, including commission and brokerage paid, incurred in obtaining and recording insurance policies shall be deferred and recognised as an asset if it is "… probable that they will give rise to premium revenue that will be recognised in the income statement in subsequent reporting periods".

AASB 1023 also requires the application of a LAT to the unearned premium liability. If the present value of the expected future cash flows relating to future claims arising from the current contracts plus an additional risk margin exceed the unearned premium liability less related intangible assets and related deferred acquisition costs, then the entire deficiency shall be recognised, first by writing down any intangible assets and then DAC. If additional liability is required it is recognised as an unexpired risk liability.

General insurers are permitted to use a probability of adequacy that is different to that to be used for outstanding claims, provided that the reasons for using a different rate are disclosed. The LAT shall be performed at the level of a portfolio of contracts that are subject to broadly similar risks and are managed together as a single portfolio.

Inwards reinsurance

AASB 1023 requires that inwards reinsurance business should be accounted for in line with the general principles established for direct business. Essentially, the standard requires companies underwriting inwards reinsurance to take responsible steps to estimate and bring to account "unclosed premiums" and to recognise such premiums as earned, having regard to the spread of risk of underlying policies ceded under inwards reinsurance treaties. On the claims side, the standard requires inwards reinsurance business to be accounted for in a similar manner to direct business.

Outstanding claims should have regard to IBNRs and future claims development, and also be discounted to their net present value. The standard allows reinsurers some latitude. It requires compliance only when the information received is reasonably reliable.

Non-insurance contracts

Contracts that are regulated under the Insurance Act that fail to meet the definition of insurance risk described above are referred to as non-insurance contracts. Financial assets and liabilities arising from such contracts are to be treated according to AASB 139.

Similarly to assets backing insurance liabilities described above, the financial assets and liabilities arising from non-insurance contracts are required by AASB 1023 to take the fair value option under AASB 139, where this is permitted.

Portfolio transfers within a group

Where the responsibility in relation to claims on transferred insurance business remains with the transferring insurer, the transfer shall be treated as reinsurance. As such, the acquiring insurer agrees to meet the claims. However, the contractual responsibility of the original insurer remains.

Disclosure requirements

AASB 1023 incorporates extensive additional disclosures in respect of accounting policies, sensitivities to key assumptions, risk exposures and risk management. The key disclosure requirements are summarised below.

The income statement should include:

- The underwriting result (net premium less net claims and underwriting expenses).
- Net claims incurred (showing gross undiscounted, reinsurance recoveries undiscounted, the effect of discounting and a split of risks borne in the current period and reassessment of old risks).
- Any deficiency arising from LAT (showing write down of DAC, write down of intangibles and additional unexpired risk provision recognised).

Balance sheet disclosures should include:

- Outstanding claims liability (quantifying central estimate and risk margin).
- Risk margin (including the percentage applied, probability of adequacy it achieves and process used to determine it).
- Process used for determining assets backing insurance liabilities.
- Non-insurance contracts (nature of contracts and assets, liabilities, income, expense and cash flows arising from them).
- Segmental information (per AASB 114 Segmental Reporting, geographical split based on location of the insured risks).

Other disclosures include:

- Accounting policies.
- Assets, liabilities, income, expense and cash flows arising from insurance contracts.
- Gains and losses recognised on buying reinsurance.

Key assumptions (quantification and process used to determine them):

- Effect of changes in assumptions (including quantification of impact of each material assumption change).
- Reconciliations of changes in insurance liabilities and related items.
- Risk management objectives and policies for mitigating risk.
- Description of insurance risk pre and post mitigation via reinsurance.
- Sensitivity of profit and equity to changes in variables in respect of insurance risks.
- Concentrations of insurance risk.
- Claims development (showing development of claims estimates, goes back to date of loss of any material claim that still has uncertainty over the amount and timing of the cash flow, not greater than 10 years).
- Terms and conditions of material insurance contracts.
- Information in respect of interest rate risk and credit risk.
- Exposures to interest rate risk or market risk under embedded derivatives.

Interaction with regulatory reporting

Additionally, GPS 110 Capital Adequacy for General Insurers requires the following to be disclosed in respect of capital adequacy in the financial statements:

a. The amount of eligible Tier 1 Capital, with separate disclosure of each of the components of capital specified in GPS 112;
b. The aggregate amount of any deductions from Tier 1 Capital;
c. The amount of eligible Tier 2 Capital, with separate disclosure of each of the components of capital specified in GPS 112;
d. The aggregate amount of any deductions from Tier 2 Capital;
e. The total capital base of the insurer derived from the items (a) to (d) above;
f. The minimum capital requirements (MCR) of the insurer; and
g. The capital adequacy multiple of the insurer (item (e) divided by item (f)).

APRA yearly statutory accounts

The yearly statutory accounts, which must be audited, are required for periods ending 30 June 2010 and prior to be prepared on a different basis than the financial statements prepared in accordance with the Corporations Act and Australian accounting standards. The key differences are outlined in the following table:

Table 1.9 – Key differences in treatment between financial and prudential reporting

Item	AASB 1023 treatment	APRA treatment	Adjustment required
Premiums (including unclosed business)	Earned over the life of the policy based on the pattern of risk and LAT, providing for premium deficiency	Recognised as income at policy attachment date	Write back movement in unearned premiums
Acquisition costs (including fire brigade charges)	Costs are deferred and amortised over the period of benefit (i.e. premium earning)	Recognised on an as-incurred basis	Write back movement in DAC
Reinsurance expense	Recognised on a basis consistent with the pattern of reinsurance	Recognised as an expense at policy attachment date	Write back movement in deferred reinsurance
Claims	Includes estimating expected claims (IBNR) on earned premiums	Includes estimating expected claims on written premiums	Increase liability for outstanding claims by expected losses on unexpired period of policies (premium liabilities). Adjust for differences in assumptions on discount rate and level of risk margins
Recoveries (reinsurance and other)	Includes estimating expected recoveries on outstanding claims	Includes estimating expected recoveries on outstanding claims and premium liabilities	Increase asset for expected recoveries consistent with change in liability for outstanding claims and premium liabilities
Tax	Liability method	Liability method	The adjustments above must be tax effected

APRA released a discussion paper on 3 December 2009 titled “Proposed changes to the general insurance prudential reporting”. The aim of the proposed changes to the general insurance reporting arrangements is to align reporting requirements with the Australian Accounting Standards from 1 July 2010 and to obtain information which is more effective for assessing the financial performance of general insurers. The main changes proposed were to the treatment of unearned premium, deferred acquisitions costs and reinsurance expenses to be in line with AASB accounting treatment. While this will ensure the APRA balance sheet and income statement are aligned with those under AASB 1023, there will be no capital charge impact of these changes on these balances as they are not used in the capital calculation. APRA also proposes that bound but not incepted (BBNI) policies will not be reported under the proposed changes.

APRA prudential standards stipulate that for prudential reporting purposes, an insurer must:

- discount insurance liabilities using Commonwealth Government bond rates; and
- include a prudential margin so as to achieve 75 per cent probable adequacy of insurance liabilities and not less than half the coefficient of variation.

For some insurers, this may result in differing treatments for prudential and financial reporting purposes. In this case, the standards indicate that disclosure of the differing treatments should be included in the published financial statements.

The two accounting frameworks are reconciled within the audited APRA yearly statutory accounts forms. The yearly statutory accounts forms and their instructions can be found on the APRA website **www.apra.gov.au**

Other financial reporting with the APRA yearly statutory accounts

In addition to the yearly statutory accounts, the general insurer must also provide APRA with:

- A financial information declaration (FID);
- The Appointed Auditor’s opinion on the annual statutory accounts;
- The appointed actuary’s Insurance Liability Valuation Report (ILVR);
- The appointed actuary’s financial condition report (FCR); and
- Quarterly statistical and financial returns.

The general insurer must also arrange for an independent peer review of the appointed actuary’s ILVR.

An overview of these additional reporting requirements is discussed in the following pages.

Financial information declaration

The FID must state that:

- The financial information lodged with APRA has been prepared in accordance with the Insurance Act, regulations, prudential standards, the Collection of Data Act 2001, accounting standards and other mandatory professional reporting requirements in Australia, to the extent that the accounting standards and professional reporting requirements do not contain any requirements contrary to the aforementioned legislative and prudential requirements;
- The information provided to the Appointed Auditor and appointed actuary for the purpose of enabling them to undertake their roles and responsibilities is accurate and complete, consistent with the accounting records of the insurer, and a true representation of the transactions for the year and the financial position of the insurer; and
- The financial information lodged with APRA is accurate and complete, consistent with the accounting records, and represents a true and fair view of the transactions for the year and the financial position.

This declaration is to be signed by the chief executive officer (CEO) and the chief financial officer (CFO), or local equivalents for a branch operation, and is due within four months of the financial year-end.

Any qualifications must include a description of the cause and circumstances of the qualification, and the steps taken, or proposed to be taken, to remedy the problem.

Appointed Auditor's opinion

The Appointed Auditor must prepare a certificate, addressed to the board of the general insurer, in respect of the insurer's yearly statutory accounts.

The certificate must specify whether, in the Appointed Auditor's opinion, the yearly statutory accounts of the general insurer present a true and fair view of the results of the operations for the year and financial position at year-end, in accordance with:

- The provisions of the Insurance Act and prudential standards, the Collection of Data Act and reporting standards; and
- To the extent that they do not contain any requirements that conflict with the aforementioned, Australian accounting standards and other mandatory professional reporting requirements in Australia.

In preparing the certificate, the Appointed Auditor must have regard to relevant professional standards and guidance notes issued by the Auditing and Assurance Standards Board (AUASB), to the extent that they are not inconsistent with the requirements of the prudential standard.

Appointed Actuary's insurance liability valuation report

GPS 310 Audit and Actuarial Reporting and Valuation specifies the contents and the requirements of the ILVR. These are summarised as follows:

- The report must be addressed to the board of the insurer and provide the appointed actuary's advice in respect of the value of the insurer's insurance liabilities, determined in accordance with GPS 310;
- The report must, in respect of each class of business underwritten by the insurer (or in abbreviated details for classes that are immaterial), provide:
  - The value of the insurance liabilities;
  - The assumptions used in the valuation process and the justifications of these assumptions;
  - The availability and appropriateness of the data;
  - Significant aspects of recent experience;
  - The methodologies used to model the central estimates of outstanding claims liabilities and premium liabilities;
  - An indication of the uncertainty in the central estimate, including statistics such as the standard deviation;
  - The results of the sensitivity analyses undertaken;
  - A description of the probability distributions and parameters, or approaches adopted to estimate uncertainty; and
  - Risk margins that relate to the inherent uncertainty in the central estimate values for outstanding claims liabilities and premium liabilities; and
- The report must provide sufficient information in relation to the assumptions and methods used for the valuation liabilities so that another actuary reading the report can obtain a sound understanding of the valuation process and results, limitations and key risks in the insurance portfolio; and
- The report must be prepared by the appointed actuary and be subject to an independent peer review.

When an insurer does not adopt the value of the insurance liabilities recommended by the appointed actuary, the insurer must notify APRA in writing, and should include within its published annual financial statements:

- The reasons for not accepting the appointed actuary's advice, or for not determining the insurance liabilities in a manner consistent with GPS 310; and
- Details of the alternative assumptions and methodologies used for determining the value of the insurance liabilities.

Appointed Actuary's financial condition report

Under GPS 310, the appointed actuary must prepare an annual FCR. This report must be filed with APRA at the same time or before lodgement of the yearly statutory accounts.

The FCR must be addressed to be the Board of the insurer and provide the appointed actuary's objective assessment of the overall financial condition of the insurer. APRA requires that in preparing an FCR, an appointed actuary must have regard to relevant professional standards issued by the IAA, to the extent that they are not inconsistent with the requirements of GPS 310. The relevant professional standard for this purpose is General Insurance Standard 305 Financial Condition Reports for General Insurance.

In accordance with GPS 310 and professional standard 305, the FCR must include or show consideration for the following:

- Statements by the appointed actuary, setting out who commissioned the actuarial reporting, the scope and purpose of the FCR, the specified terms of reference and any limitations or restrictions placed upon the actuary;
- Information requirements, including identification of the information upon which the appointed actuary placed material reliance in preparing the FCR, the limitations of the FCR as a result of material data discrepancies, and any other data reliances and limitations;
- Business overview;
- Assessment of the insurer's recent experience and profitability, including at least the experience during the year ending on the valuation date;
- Summary of the key results of the ILVR (prepared in accordance with GPS 310);
- Assessment of the adequacy of past estimates for insurance liabilities (may include references to the current or past ILVRs);
- Assessment of the asset and liability management, including the insurer's investment strategy;
- Assessment of pricing, including adequacy of premiums;
- Assessment of the suitability and adequacy of reinsurance arrangements;
- Assessment of the suitability and adequacy of the risk management framework;
- Assessment of capital management and capital adequacy.

The appointed actuary is required to consider the future implications and outlooks of the above matters. If the implications are adverse, the appointed actuary must propose recommendations to address the issues.

As a general rule, an FCR must be completed in respect of each insurer. An insurance group may submit to APRA an FCR in respect of the insurance group where the appointed actuary completing the FCR is the appointed actuary for each insurer included in the FCR or it is practical to produce a single over-arching FCR. If the single FCR does not adequately address each of the above issues for any single insurer, APRA may require one or more insurers in the group to prepare and submit to APRA a new FCR.

Foreign insurers must prepare an FCR in respect of their Australian branch operation.

Independent peer review

Under GPS 310, the general insurer must arrange for an independent peer review of the appointed actuary's ILVR. This peer review must provide an assessment of the reasonableness of the appointed actuary's investigations and reports including the results contained within.

Copies of the report must be provided to the appointed actuary, the Appointed Auditor, the board and the management of the insurer before the yearly lodgement of statutory accounts. The review report is not required to be provided to APRA, but must be made available to APRA upon request.

IAA Professional Standard 100 External Peer Review for General Insurance and Life Insurance details the responsibilities of the reviewing actuary and the reviewing requirements.

Items to be reviewed by the external peer reviewer include:

- Scope – Consideration of the appropriateness of the scope of the primary actuary's specified valuation and of the actuarial advice provided in relation to it;
- Data – Consideration of the sources of data, whether appropriate and sufficient data inputs have been used, and that the quality of these have been checked by the primary actuary or the personnel employed to support the primary actuary;
- Valuation methods – Consideration as to whether the methods chosen are suitable in the circumstances and within the range of reasonable current practice, and whether their application has been appropriate;
- Assumptions – Consideration as to whether assumptions are consistent with experience investigations, industry trends and reasonable judgement;
- Controls – Consideration as to whether appropriate quality assurance reviews and controls are in place;
- Analysis of specified valuation results – Consideration as to whether results have been developed following a reasonable sequence of steps; that there is consistency within the results; and that changes in the results from one year to the next have been adequately explained;

- Specified valuation results – Consideration as to whether results have been clearly stated, that they are supported by the experience and any reasonableness tests undertaken have been identified in the primary actuary's report. Consideration must also be given as to whether the reliances and limitations of the primary actuary have been clearly stated; and
- Standards – The reviewing actuary must consider whether the work complies with applicable legislation, including regulations and subordinate legislation, relevant professional standards and takes regard of guidance notes with appropriate disclosures.

National Claims and Policies Database

The National Claims and Policies Database requires insurers to submit claims and policies at three different levels of aggregation and analysis. Classes covered by this database include public and product liability and professional indemnity. This database, managed by APRA, supplements databases on CTP and workers compensation in several States and aims to provide transparency in the industry. The data may also reduce the volatility through the insurance cycle, as insurers will have access to more information to assess the risks more precisely.

Key dates

Financial Sector (Collection of Data) Act

Lodgement of returns

- Quarterly forms (GRF 110.0 – 310.3*)
  Within 20 business days of the end of each quarter.

  * These forms may be subject to review as part of the work performed by the Appointed Auditor under GS 004 Audit Implications of Prudential Reporting Requirements for General Insurers.

- Annual forms and report (GRF 110.0 – 450.0), [only GRF 110.0 – 320.0 are audited] including directors' certification in respect of the Risk Management Strategy (RMS) or Reinsurance Management Strategy (REMS), FID, appointed actuary's ILVR and FCR, Appointed Auditor's certificate on the Annual statutory accounts and APRA prudential compliance review report
  Within four months of the year-end.
- Business plan
  Annually (when appointed by the Board) and when material changes are made.
- Changes in reinsurance and risk management strategies
  Within 10 days of board approval. The revised REMS must be appointed by APRA.
- Changes to details in original application for licence, including appointment of senior staff, appointed actuary and Appointed Auditor
  Must be approved by APRA prior to the change taking effect.
- National Claims and Policies Database data
  (GRF 800.1 – 800.3 and LOLRF 800.1 – 800.3)
  Within two months from the end of the half year.

1.8 Taxation

General developments

The Government has continued with ambitious plans for significant tax reform. The comprehensive review of Australia's tax system, otherwise known as the Henry Review has been completed and the final report released to the public on 2 May 2010 together with the Government's response. Despite the 138 recommendations in the Henry Report, the Government has only made a handful of announcements, although there may be further announcements in the May budget.

The Government proposes to reduce the company income tax rate from 30 per cent to 29 per cent for the 2013-2014 income year and to 28 per cent from the 2014-2015 income year and introduce certain changes to the superannuation system including a staged increase in the Superannuation Guarantee payment from 9 per cent to 12 per cent. These initiatives are to a large extent funded by the Resource Super Profits Tax of 40 per cent.

One of the insurance specific recommendations in the Henry Report is the abolition of specific taxes on insurance products, including stamp duties and fire service levies, which is consistent with the recommendations in the "Australia as a Financial Centre: Building on our Strengths" report released by the Australian Financial Centre Forum. The Government has not ruled out this recommendation, although any changes will need agreement from the State Governments.

Some other key tax developments during the year are listed below.

- A rewrite of the existing general insurance provisions within Schedule 2J of the Income Tax Assessment Act 1936 has been proposed, by repealing the existing provisions and reproducing its effect in new Division 321 of the Income Tax Assessment Act 1997. Treasury has confirmed that the policy intentions of the existing provisions will remain the same in the proposed legislation.
- The new Taxation of Financial Arrangements (TOFA) measures which provide a comprehensive regime for the tax treatment of gains and losses arising from financial arrangements have been legislated. The TOFA measures will apply to eligible taxpayers for the income year beginning on or after 1 July 2010 unless the taxpayer chooses to have the rules apply for income years beginning on or after 1 July 2009 (i.e. the "early adopt" election). Taxpayers have a choice as to how TOFA will apply to their financial arrangements.
- New tax consolidation measures were introduced into Parliament on 10 February 2010 to refine the existing rules. Some of the relevant changes proposed include modification of certain cost setting rules for general insurance companies joining or leaving a consolidated group and clarification of the income tax treatment of rights to future income
- The Federal Government has proposed a reform of Australia's foreign source income anti-tax deferral (attribution) rules. The proposal includes a rewrite of the Controlled Foreign Companies (CFC) rules and the repeal of the Foreign Investment Fund (FIF) rules. The FIF rules will be replaced with a specific, narrowly defined anti-avoidance rule that applies to offshore accumulation or roll-up funds.
- The new International Dealings Schedule - Financial Services 2010 (the IDS-FS 2010) was released by the Australian Taxation Office ("ATO"). The IDS-FS 2010 is the ATO's newly proposed tax return schedule for large (> $250m turnover) financial services taxpayers to replace the Schedule 25A and Thin Capitalisation Schedule and provide additional information in relation to financial arrangements. For the 2010 income year the IDS-FS is optional. However, the IDS-FS will be mandatory for affected taxpayers for the 2011 year.
- During 2009 (subsequent to the release of last year's "Insurance Facts and Figures Publication"), the Australian Government announced its support for 41 of 46 recommendations that were made by the Board of Taxation in relation to its review of the Administration of the GST System. Generally these changes are aimed at reducing the administrative burden of complying with the GST legislation and represent the most significant package of GST reform in 10 years.

While many supported recommendations were identified as applying from 1 July 2010, the legislative process has only started for some of the recommendations with either Exposure Drafts or Bills being introduced and debated in Parliament during 2010. We expect some but not all of the current proposed changes to be passed by parliament prior to 1 July 2010 with the effective date of the changes ranging from 1 July 2000 to 1 July 2010 (that is, some changes are likely to apply retrospectively). Many of the changes have general application to business taxpayers and it is important for each organisation to consider the impact of each of the proposed or finalised changes.

Taxation of general insurers

In Australia, general insurance companies are assessed under Division 321 of the Income Tax Assessment Act (ITAA) 1936. Tax is payable on the profits of a general insurer at the corporate tax rate, currently 30 per cent.

Premium income

Division 321 of the ITAA legislates the manner in which premium income is earned by an insurer for taxation purposes.

An insurance premium has a number of components. The gross premium, including components referable to fire brigade charges, stamp duty and other statutory charges must be included as assessable income. Insurers must recognise premium income from the date of attachment of risk. As a result, unclosed business will be brought to account in calculating tax liability.

Subject to the following comments on unearned premium reserve, all premiums received or receivable in that year are included in assessable income.

Unearned premium reserve

Where part of the premium relates to risk in a future year, an unearned premium reserve (UPR) is established. When the UPR is greater at year-end than it was at the beginning, a deduction is allowed for the increase. Where it decreases over the year, the decrease is included in assessable income.

The legislation prescribes the way UPR is to be calculated. In particular, expenses relating to the issuing of policies, as well as reinsurance, reduce the amount of the UPR.

The Commercial Union Australia Mortgage Insurance Corporation (CUAMIC) case in 1996 considered the tax implications of a change in the methodology adopted in calculating the UPR. It was held that the full reduction in UPR in the year was assessable, even though part of the reduction related to a change in methodology. The legislation reinforces this decision by bringing to account the movement of the UPR from one year to the next, which will automatically account for changes in the earning pattern of the premiums.

Liability adequacy testing

Under the accounting standards, an insurer is required to assess at each reporting date whether its UPR is adequate, by considering current estimates of future cash flows under its insurance contracts. If the assessment shows that the carrying amount of its UPR is inadequate, the entire deficiency shall be recognised in profit or loss by first writing off related intangibles and deferred acquisition costs and then recognising an unexpired risk liability. This process is known as Liability Adequacy Testing of “LAT”.

For tax purposes, the LAT adjustment is not deductible and generates a temporary difference.

Apportionable issue costs (acquisition costs)

Costs incurred in obtaining and recording premiums are allowable deductions in the year of income in which they are incurred. These costs include commissions and brokerage fees, processing costs, risk assessment fees, fire brigade charges, stamp duty and other government charges and levies (excluding GST).

The benefit of an immediate deduction for apportionable issue costs incurred during a year of income is effectively restricted, as these costs are taken into account in the determination of the unearned premium reserve. This is achieved by determining the UPR based on premiums net of apportionable issue costs.

Prepayments

The prepayment legislation would normally apply to apportionable issue costs and reinsurance expense. However, as the methodology for calculating the unearned premium reserve includes a reduction component for these expenses, the legislation excludes these expenses from the prepayment rules.

Treaty non-proportional reinsurance, which is not taken into account in determining the UPR, remains subject to the prepayment rules.

Outstanding claims

A deduction is allowed for any increase in the outstanding claims reserve during the year, while decreases in the outstanding claims reserve are assessable. In addition, claims paid during the year are deductible. This effectively mandates a balance sheet approach for determining the claims expense for the year, and with the exception of indirect claims settlement costs, should align with the current accounting treatment of claims.

This means that a deduction is allowed for the estimated cost of settling reported claims and claims incurred but not reported (IBNR) during the year of income. The deduction is based on the costs of claims incurred and paid during the year of income, an estimate of costs to be paid in respect of claims incurred during the year and a revision of previously estimated costs of claims incurred in prior years. These estimates must be soundly based but may take prudential margins into account.

The following factors may be taken into account in determining the quantum of the allowable deduction for outstanding claims and IBNR provisions:

- Direct policy costs;
- Claims investigation and assessment costs;
- Direct claims settlement expenses;
- Estimated increased costs of litigation and other factors, such as superimposed inflation; and
- Recoverables, including reinsurances, excesses and salvage and subrogation.

These factors allow for the effects of inflation. However, only the present value (i.e. the value after discounting for future investment income) of costs associated with long-term claims is an allowable deduction. A deduction is not allowed for estimated indirect claims settlement costs (e.g. future claims department costs), until those expenses are paid.

Profits or losses on realisation of investments

The purchase and sale of investments are regarded as part of the income-producing activities of a general insurer. As a consequence, profits or losses on the sale of investments are generally considered to be of a revenue nature. Profits will be assessable as ordinary income, while losses will be allowable deductions. However, a profit or loss arising on the sale of a capital asset that is not part of the insurance business may be treated as a capital gain or loss. It is generally accepted that a building used as a head office or permanent place of business by an insurer is a capital asset.

Unrealised profits and losses on investments are not currently brought to account as assessable income or allowable deductions for tax purposes. However, this may change where a general insurer makes certain elections under the TOFA regime.

Reinsurance

Generally, a premium paid for reinsurance will be an allowable deduction in the year in which the premium is incurred. Because such premiums (other than treaty non- proportional reinsurance premiums) reduce gross premiums in calculating the unearned premium reserve, the benefit of the deduction allowed in any year is effectively limited to the proportion of risk covered by the premium that has expired during the year.

Reinsurance recoveries are assessable income and future recoveries must be taken into account in determining outstanding claims reserves (unless the reinsurance is with a non-resident and a section 148(2) election has not been made).

Reinsurance with non-residents

Where a general insurer reinsures the whole or part of any risk with a non-resident, a deduction will not be allowed in the first instance in respect of those premiums.

These reinsurance premiums will not reduce gross premiums in calculating the unearned premium reserve and reinsurance recoveries will not be assessable.

However, an insurer may elect that this principle does not apply in determining its taxable income, in which case the insurer becomes liable to furnish returns and to pay tax at the relevant rate (30 per cent) on 10 per cent of the gross premiums paid or credited to these non-resident reinsurers during the year. Where the election has been made, these reinsurance premiums should be included in the calculation of UPR, and recoveries under those reinsurance policies included in the calculation of the outstanding claims reserve (OCR).

Financial reinsurance

The ATO considers (in TR96/2) that financial insurance and financial reinsurance arrangements should be treated as the provision and repayment of loans. In determining whether an arrangement constitutes financial insurance or reinsurance, reference is made to two criteria:

- The degree of insurance risk assumed; and
- The possibility of the insurer/reinsurer incurring a significant loss under the arrangement.

An insurer needs to prove both of these to support a claim for a deduction of a reinsurance premium.

Goods and Services Tax

Under the Australian GST legislation, some classes of insurance are treated differently, leading to different implications for insurers and insured parties.

The provision of general insurance is, in most cases, a “taxable supply”. Insurers are required to account for GST of one-eleventh of the premium income collected (excluding stamp duty). In most cases, they are also entitled to claim input tax credits for the GST included in the price of expenses they incur that relate to making supplies of general insurance (with certain exclusions which apply to all businesses).

It should be noted that the GST classification of general insurance will be different if a supply is made in relation to a risk located outside of Australia, in which case the supply of these policies may be GST-free (known as “zero rated supplies” in other jurisdictions). Insurance that is provided as part of certain transport services will lose its character as insurance and will take on the GST character of the other services supplied. For example, insurance provided as part of exporting goods will also be GST-free.

Insurers are not required to account for GST on premium income on GST-free policies, but they are still entitled to recover input tax credits on the expenses incurred in making supplies of GST-free insurance where the expenses do not relate to settling a claim. No entitlement to input tax credits will arise for expenses incurred in settling a claim under an insurance policy which is GST-free.

Where an insurance policy may be treated as either GST-free, taxable or input taxed, the GST-free treatment will prevail.

The GST legislation contains complex provisions in respect of general insurance businesses. The effect of the main provisions is summarised below.

- GST, where applicable, is chargeable on the stamp duty-exclusive amount of the premium. As GST forms part of the "price" of a supply, it constitutes one-eleventh of the price paid for the premium (based on the prevailing GST rate of 10 per cent). Stamp duty will be calculated on the GST-inclusive amount of the premium.
- At or before the time a claim on the policy is made, the insured must notify the insurer as to the extent of the input tax credit they are entitled to claim on the policy. Failure to do so could adversely affect the GST position for both the insurer and the insured.
- An insurer will not have to account for GST on supplies made in the course of settling a claim if it has received notification from the insured entity of its entitlement to claim input tax credits on the premium paid for the insurance. Furthermore, it can generally claim input tax credits when acquiring goods and services that are to be supplied in settlement of a claim, provided the policy was not initially a GST-free supply.
- Where the insured was not entitled to claim an input tax credit in respect of the premium, the insurer is entitled to make a decreasing adjustment mechanism (DAM) in respect of any settlement amount (in the form of cash and/or goods or services) paid out under that policy.
- Where the insured was entitled to claim a full input tax credit for GST included in the premium, there is no entitlement to a DAM for the insurer when they make a settlement under the policy.
- If the insured is entitled to partial input tax credits on the premium, the insurer is entitled to a partial DAM.

The receipt of an excess payment can trigger a GST liability as an increasing adjustment for the insurer. The actual liability is based on a specific formula contained in the GST law.

Special rules also exist for a range of common insurance scenarios such as, excesses, insurance settlements and subrogated recoveries. In most cases, the rules and the practical impact on business systems and processes can be complicated. For example:

- Excesses – the GST implications differ depending on whether an excess is paid to the insurer directly, received by a service provider as agent for the insurer, or paid to the service provider directly (where no agency role exists).
- Insurers must differentiate between costs incurred in 'settling' a claim and costs incurred in 'managing' a claim as the special rules that give rise a DAM (mentioned above) only apply to costs incurred in settling a claim.
- Insurance recoveries – whether or not GST implication arise in relation to recoveries received by an insurer depends upon on a number of factors including whether the recovery is a subrogated recovery or not, the recovery relates to salvage proceeds and whether or not a DAM entitlement has arisen on the claim payments made.

Further, there are special GST rules dealing with the various state and territory-based compulsory third party (CTP) insurance schemes. New GST laws were introduced in 2003 to address the statutory and working differences between CTP and general insurance businesses. These laws are complicated and generally require careful consideration.

Investment activities

Investment activities are input taxed in many cases as they are classified as financial supplies for GST purposes.

The effect of this is that, while GST will not be payable on the supplies made, not all of the GST incurred as part of the price paid for expenses associated with investment activities will be recoverable unless one of the following exceptions applies:

- The expense relates directly to the purchase or sale of securities or other investments in an overseas market.
- The expenses incurred by the insurer for the purpose of making input taxed financial supplies do not exceed the "financial acquisitions threshold" (which is a "de minimus" test to ensure that entities that do not usually make financial supplies are not denied input tax credits on making financial supplies that are not a significant part of their principal commercial activities).
- The financial supply is a borrowing and the borrowing relates to supplies which are not input taxed.

Where the above exceptions apply, the insurer retains the entitlement to fully recover the GST incurred on related costs. However, where the exceptions do not apply, the insurer will have to use an appropriate apportionment methodology to determine the extent to which it is entitled to recover GST incurred on general costs.

It should be noted that where acquisitions made by an insurer for the purpose of its investment activities are "reduced credit acquisitions", the insurer is entitled to claim a reduced input tax credit equal to 75 percent of the GST included in the price of the expense.

Stamp duty

General Insurance Supervisory Levy Imposition Act 1998

Financial Institutions Supervisory Levies Collection Act 1998

Stamp duty is generally chargeable on the amount of the premium paid in relation to an insurance policy (including any fire service levy where applicable). The amount of GST or reimbursement for GST is generally included in the amount on which duty is calculated. The rates of general insurance duty vary in each state and territory and in some states, by class of insurance.

Generally, the liability for duty on general insurance policies falls on the general insurer.

Table 1.10 – Stamp duty rates – General insurance products

As at March 2010	Class	Rate
NSW	Type A Insurance other than Type B or Type C insurance	9%
	Type B Insurance for motor vehicles, aviation, disability, occupational health and hospital	5%
	Type C Insurance for livestock, crops	2.5%
VIC, WA, ACT, NT	All	10%
QLD	Class 1 Insurance other than Class 2 insurance or CTP insurance	7.5%
	Class 2 Insurance such as professional indemnity, motor vehicle (not CTP insurance), personal injury from air travel, first home mortgage, life insurance rider	5%
	CTP Insurance	$0.10
	Accident Insurance	5%
SA	All	11%
TAS	All	8 %

The lodgement of returns and payment of duty needs to occur:

- New South Wales, Victoria, Australian Capital Territory, Tasmania, Western Australia and the Northern Territory – within 21 days after the end of each month.
- South Australia – within 15 days after the end of each month. Annual licence to be applied for by 31 January of each year.
- Queensland – within 14 days after the end of each month or such other period as the Commissioner may determine.

Other levies and taxes

Fire Services Levy (FSL)

Fire service levies are imposed on various classes of general insurance in New South Wales, Victoria and Tasmania to fund the cost of providing fire and emergency services. The levies vary in each state with different rates applying to various classes of insurance. Policies which include coverage for risks prior to this date must include a proportional contribution to the levy.

The lodgement and payment requirements for FSLs are outlined in the following table:

Table 1.11 FSL lodgement and payment requirements

Lodgement of returns	Payment of charges	
NSW – Fire Brigades and Rural Fire Brigade	In September each year (audited)	Fire Brigade and Rural Fire Brigade quarterly advance payments due by 1 July, 1 October, 1 January and 1 April. Advance payments to be adjusted based on returns lodged in September in the following financial year.
VIC – Metropolitan and Country Fire Brigades	Before 15 August each year	Metropolitan & Country quarterly advance payments and country due by 1 July, 1 October, 1 January and 1 April. Advance payments to be adjusted based on returns lodged by 15 August in the following year.
TAS	Within 14 days after the end of each month	Payment made with monthly return.

Insurance Protection Tax (NSW)

The Insurance Protection Tax Act (NSW) 2001, which came into effect on 1 July 2001, imposes a tax on the total annual amount of general insurance premiums received by insurers in New South Wales.

The tax was introduced to establish a fund to assist builders' warranty and compulsory third-party policyholders affected by the collapse of HIH Insurance Limited. The tax for the year commencing 1 July 2001 and for each subsequent year is $65 million. The tax for subsequent years may be reduced by determination of the New South Wales Governor on the recommendation of the New South Wales Treasurer. The tax is apportioned among general insurers according to their share of the total premium pool for the relevant year.

Where insurance is undertaken with a non-registered insurer and duty is payable by the insured person, an ad valorem duty of one per cent is imposed on dutiable premiums.

Lodgement and payment deadlines:

- Lodgement of returns by 15 August of each year.
- Notices of assessment issued by 1 September of each year.
- Quarterly payments due by 15 September, 15 December, 15 March and 15 June of each year.

General Insurance Levy

General Insurance Supervisory Levy Imposition Act 1998

Financial Institutions Supervisory Levies Collection Act 1998

This annual levy is based on a percentage of the value of assets of a general insurance company at a specified date. The unrestricted and restricted levy percentage, the specified date, and the minimum and maximum restricted levy amount for each financial year are determined by the Federal Treasurer (2009/2010: unrestricted levy of 0.006796 per cent of assets; restricted levy of 0.02185 per cent of assets; minimum restricted levy: $4,700; maximum restricted levy: $810,000).

Life Insurance 2

Introduction
Tony Cook

It is arguable the life insurance industry in Australia has emerged from the recent financial storm in a stronger position than when it went in:

- while some balance sheets took pain, none failed, enhancing the industry's reputation for strength, prudence and security;
- while profitability remains subdued for those companies where the portfolio contains a high proportion of investment business, FUM growth is returning and risk product volumes continue their seemingly unstoppable growth;
- while regulatory change confronts and challenges the industry. it also brings with it opportunities for agile companies to innovate and to improve their offerings and competitive position; and
- while investment may have been subdued, some companies grabbed the opportunity presented by challenging times to acquire other businesses or to innovate to meet emerging customer needs.

The industry is often its own worst critic when it comes to innovation and embracing change. However it is right to acknowledge how well it has taken advantage of the opportunities presented by these unprecedented times. This is seen best in the:

- innovation of new guaranteed income stream products to meet the needs of an aging population with adversion to market and longevity exposure;
- innovation of new technologies designed to help reach more potential insurance customers more cost effectively than ever before;
- innovation of new distribution channels and growth of the group insurance market to better reach previously untapped markets; and
- rapid emergence of merger and acquisition activity following the onset of the crises.

At the same time there is no room for complacency. There remain the challenges of developing solutions to reach the underinsured population, of improving retention, and of influencing and responding to the emerging regulatory changes. This last challenge arises in no small part from a real or perceived failure of the regulatory protections and industry structures to meet customer needs under the stress of the recent crises.

Arguably all three challenges share a common issue. Does the industry understand its current and potential customers well enough and does it know how to engage them effectively? Failure on this front will inhibit its ability to solve the underinsurance and retention problems and will inhibit its ability to influence and respond to regulatory change from the high ground. Meeting customer needs will ultimately deliver long term success for the industry, which is a better outcome than looking to protect short term industry interests.

The customer has always been king. Success will go to those companies who can embrace this most effectively.

2.1 Statistics

Top 15 life insurers

		Ranking Measure:						Performance:	
		Net insurance premium revenue						Investment revenue	
	Entity	Year end	Current $m	Current Rank	Prior $m	Prior Rank	% Change	Current	Prior
1	AMP Life	12/09	969	1	913	1	6%	6,835	-12,863
2	The Colonial Mutual Life Assurance Society (CBA)	06/09	955	2	804	2	19%	-1,009	-617
3	ING Life (ANZ)[1]	12/09	875	3	777	3	13%	3,681	-6,283
4	National Mutual Life Association (AXA)	12/09	847	4	552	5	53%	1,412	3,161
5	MLC (NAB)[2]	09/09	812	5	749	4	8%	908	-9,175
6	TOWER Australia	09/09	529	6	486	6	9%	80	-313
7	American International Assurance Company Australia	11/09	514	7	368	9	40%	69	-27
8	Suncorp life companies[3]	06/09	460	8	179	15	157%	-724	575
9	Swiss Re Life & Health Australia	12/09	423	9	420	7	1%	42	29
10	RGA Reinsurance Company of Australia	12/09	420	10	386	8	9%	20	58
11	Westpac Life[4]	09/09	316	11	258	12	22%	292	-1,785
12	MetLife Insurance	12/09	289	12	264	11	9%	29	10
13	Munich Reinsurance Company of Australasia	12/09	264	13	200	13	32%	33	73
14	Hannover Life Re of Australasia	12/09	207	14	313	10	-34%	24	89
15	Norwich Union Life Australia[5]	09/09	155	15	186	14	-17%	520	-818

Performance:		Financial Position:									
Result after tax		Net policy liabilities		Solvency coverage		Financial assets held at FV		Net assets		Total assets	
Current $m	Prior $m	Current $m	Prior $m	Current	Prior	Current $m	Prior $m	Current $m	Prior $m	Current $m	Prior $m
521	461	65,575	60,760	1.8	1.6	65,865	60,956	2,743	2,565	70,868	76,802
202	80	14,256	16,706	2.1	2.2	15,340	17,757	1,394	1,093	16,106	18,345
231	194	28,827	24,073	2.3	1.8	25,186	21,419	1,965	1,835	31,484	26,695
164	-95	12,608	12,095	1.9	1.2	12,853	12,293	1,345	981	15,647	16,589
184	392	46,899	49,346	1.6	1.7	47,952	50,367	2,016	2,502	48,875	52,639
81	76	1,960	2,128	2.5	2.5	2,285	2,518	572	492	3,067	3,171
43	13	551	460	1.7	1.4	815	674	273	231	1,174	906
109	68	4,998	4,066	2.3	2.7	6,873	5,805	1,207	286	7,728	6,062
87	-40	704	730	3.0	1.7	1,038	933	302	227	1,133	1,074
47	67	302	260	2.4	2.5	611	524	302	258	1,087	705
134	204	10,332	10,555	2.7	2.1	10,994	11,159	789	720	11,452	11,609
59	35	116	103	5.4	5.9	380	414	338	378	644	663
4	28	263	246	1.8	1.4	596	565	161	148	942	873
33	39	595	592	2.8	3.6	766	713	225	192	978	966
69	39	3,779	3,561	5.18	2.98	4,557	4,035	610	541	4,970	4,658

Source: Published annual financial statements or APRA annual returns for Australian life insurance operations.

Notes: Policy liabilities are net of all reinsurance recoveries and also include life investment policy liabilities.

Investment revenue includes unrealised gains/losses and are net of investment management expenses.

A weighted average based on net assets is used to estimate overall solvency ratio where there are more than one entity within the group.

1 ING Life was acquired by ANZ Banking Corporation on 30 November 2009.

2 The National Australia Bank acquired Norwich Union Life on 1 October 2009. As the insurer was acquired post year end, Norwich Union continues to be shown separately in this table.

3 Suncorp life companies comprise of Suncorp Life & Health and Asteron Life. Suncorp acquired the Promina group in March 2007. As it had an 18 month period to 30 June 2008, information for Asteron Life was not included in the prior year table.

4 Westpac acquired St George Life on 1 December 2008. Comparative figures are for Westpac only.

5 Norwich Union changed its balance date to 30 September 2009 to align with that of National Australia Bank. Consequently the figures provided for Norwich in the current period are for 9 months.

2.2
Key developments

APRA regulatory changes

Remuneration review

On 30 November 2009, APRA released its prudential requirements on remuneration for life insurance companies. The revised prudential standard LPS 510 and the associated prudential practice guide PPG 551 came into effect on 1 April 2010. APRA requires that a Board Remuneration Committee, with appropriate composition and charter, be established, and a suitable Remuneration Policy be in place. (See section 2.6 for further comments on APRA remuneration requirements.)

Enhancements to prudential framework for life companies

On 4 March 2010, APRA released final prudential standards on enhancements to the prudential framework for life insurance companies.

Legislation was passed in 2009 that gave APRA power to regulate non-operating holding companies (NOHCs) of life insurance companies, including the power to determine prudential standards for life NOHCs. APRA will apply to these NOHCs the same governance and fit and proper standards that currently apply to NOHCs of authorised deposit-taking institutions (ADIs) and general insurers.

APRA also made some limited amendments to the audit and actuarial requirements for life companies. These amendments clarify APRA's requirements and align them more closely with those for ADIs and general insurers.

As a result of these enhancements, the following prudential standards were revised and will take effect from 1 July 2010:

- Prudential Standard LPS 510 Governance (LPS 510);
- Prudential Standard LPS 520 Fit and Proper (LPS 520);
- Prudential Standard LPS 310 Audit and Related Matters (LPS 310); and
- Prudential Standard LPS 320 Actuarial and Related Matters (LPS 320).

See section 2.6 for further comments on these revised standards.

Release of life insurance data

On 6 November 2009, APRA issued a discussion paper for consultation with the life insurance industry on what life insurance data could be released publicly by APRA. As part of this consultation, APRA has also released two proposed new statistical publications, a Half Yearly Life Insurance Bulletin and an Annual Friendly Society Bulletin.

The proposed new life industry publication would supplement APRA's current Quarterly Life Insurance Performance Statistics, while the proposed Annual Friendly Society Bulletin would be APRA's first publication of friendly society data.

These two new publications would provide an overview of both sectors of the life insurance industry based on annual returns received over a 12-month period. Data will be provided both at an aggregate level and for individual life insurers and friendly societies.

Capital review

In May 2009, APRA began a project to review the capital standards for life insurance. The intention is not to rebuild the standards from first principles but rather to adjust the current standards. The objectives of this project are to:

- Improve the risk sensitivity and appropriateness of the standards;
- Improve the alignments of the standards between industries; and
- Consider the standards in light of international developments.

Key areas identified for review include:

- Asset concentration;
- Diversification;
- Investments in subsidiaries;
- Liquidity risk;
- Operational risk;
- Quality of capital (tier 1 / tier 2, etc);
- Risk free rates;
- Life catastrophe risk;
- Resilience reserve;
- Internal models;
- Risk products capital requirements;
- Surrender values;

APRA has engaged the industry as part of this review and intends to release a public discussion paper in mid 2010.

Regulatory review

Ripoll Inquiry into financial products and services in Australia (the Ripoll review)

On 25 February 2009, the Parliamentary Joint Committee on Corporations and Financial Services resolved to inquire on the issues associated with recent financial product and services provider collapses, such as Storm Financial, Opes Prime and other similar collapses.

The report was released on 24 November 2009. It considered in depth a number of themes, issues and debates for the financial services sector – in particular the financial planning industry, and concluded with eleven major recommendations for regulatory reform. These recommendations will now be considered by the government, along with recommendations from the forthcoming Cooper review, to shape the future landscape of advice.

Refer to Chapter 6 for more details on the Ripoll Inquiry.

The Super System Review (the Cooper review)

In May 2009, the Australian Government announced a comprehensive review of Australia's superannuation system: the Super System Review. The review focused on the governance, efficiency, structure and operation of Australia's superannuation system. It aims to achieve an outcome that is in the best interests of members and which maximises retirement incomes for Australia.

The review was carried out in three phases:

- **Phase One:** Governance;
- **Phase Two:** Operation and efficiency; and
- **Phase Three:** Structure.

Each phase commenced with the release of an issue paper calling for submissions and is followed by the release of a preliminary report. The final report will be delivered to the Government by 30 June 2010.

The preliminary report for Phase One was released on 14th December 2009. The key recommendation from this report is to introduce a new member-oriented model – a choice architecture model – which classifies members into three main types: universal, choice and self-managed.

The proposed model allows for the application of different governance models including regulation and member protection to each individual member segment.

It will enable the precise allocation of costs to members, and movement towards segments offering increasing choice can only arise where member needs are better met, and members are well informed of the nature of the risks involved.

The preliminary report for Phase Two was released on 22nd March 2010. The Review Panel proposed a package of measures, collectively called "SuperStream", to enhance the current superannuation "back office" operation and efficiency. "SuperStream" includes:

- improving the quality of data when members enter the system using industry-wide standards;
- better use of technology, including 'straight-through processing' (i.e. without human intervention);
- e-commerce solutions to replace paper;
- extending the use of the tax file number as a primary identifier throughout the system;
- easier consolidation of multiple member accounts; and
- eliminating redundant processes, leading to simpler rollovers and consolidations.

The public submission for Phase Three review was closed on 19 February 2010 and the preliminary report is expected to be released in May 2010.

Product rationalisation of life insurance products and Management Investment Schemes

On 14 December 2009, the Treasury released a Proposals Paper for public consultation, which sets out a proposed product rationalisation framework for life insurance products and Managed Investment Schemes. This Proposals Paper follows on from an Issues Paper on product rationalisation published in June 2007.

The main objectives of the proposed framework include:

- Beneficiaries receive an appropriate level of protection of their interests.
- Beneficiaries receive financial products with at least equivalent rights and benefits, or compensations in cases where losses are suffered.
- Neither beneficiaries nor providers suffer adverse tax consequences.
- Product rationalisation transfer mechanisms and requirements are efficient, practical and sufficiently flexible.
- Industry is provided with an appropriate level of certainty that product rationalisation transfers are not open to subsequent challenge after completion.
- Regulators are provided with appropriate powers of supervision and intervention.

Public comments on the proposed framework and mechanisms were due on 26 February 2010. The Panel is now assessing the submissions from the public before reporting to the Government. However, at the time of writing, there has been no indication of an estimated start date for the proposed framework.

Australia's future tax system review (the Henry tax review)

The Australia's Future Tax System Review was established by the Rudd Government in 2008 to examine Australia's tax and transfer system and make recommendations to position Australia to deal with the demographic, social, economic and environmental challenges of the 21st century. The final report from the Henry Tax Review together with the government's response was released on 2 May 2010. Refer to Section 2.8 for further details.

Other industry initiatives

Australia insurance industry launch of Lifewise to address underinsurance

The Lifewise campaign was launched by IFSA and Australia's insurance industry in May 2009 to address the growing concerns of underinsurance in Australia's life industry. It aims to encourage Australians to take appropriate steps to protect themselves from financial hardships which can arise from accident, sickness and death. The campaign features a straight-talking website and "how much is enough" insurance needs calculator to educate and help Australians manage their financial risks.

Lifewise is expected to be a three to five year campaign with a range of activity planned for the coming financial year including further research, working closely with all Lifewise supporters and online consumer campaigns.

IFSA Superannuation Member Charter

In November 2009, IFSA members endorsed the IFSA Superannuation Member Charter. The Charter presents a pro-active, self-regulatory and far-reaching industry reform which empowers super fund members to make informed comparisons and to determine how they pay for advice.

Under IFSA's Superannuation Member Charter, commitments have been made in four key areas:

- Increased transparency and control to payments to advisers
  - superannuation members must agree to the amount they pay for the advice they receive and method of payment. Payment may cease where members wish to cease their relationship with that adviser, and members will not be asked to pay for advice they do not receive
- Enhanced competition through more informed choice
  - members will have access to investment options performance information online every quarter and these are calculated in a consistent manner
  - investment performance information will relate to an actual investment option they are able to invest in
- Improved regulation of the superannuation industry
- Partnership approach between industry, regulators and government

The Charter will be implemented by all IFSA members through compliance with IFSA's Standards, which will come into effect on 1 July 2010.

2.3 Regulation and supervision

Australian Prudential Regulation Authority

APRA is the single Commonwealth authority responsible for licensing and prudential regulation for all life insurance companies. APRA is also empowered to appoint an administrator to provide investor or consumer protection in the event of financial difficulties experienced by life insurance companies.

APRA's powers to regulate and collect data from the insurance industry stem principally from the following acts:

- Life Insurance Act 1995 (the Life Act);
- Financial Sector (Collection of Data) Act 2001;
- Financial Sector (Shareholdings) Act 1998;
- Insurance (Acquisitions and Takeovers) Act 1991; and
- Financial Sector (Transfers of Business) Act 1999.

As supervisor of life insurance companies, APRA administers the Life Act. The objective of the Life Act is to "protect policy owners and promote financial systems by encouraging a viable and competitive Australian life insurance industry with financially sound participants and fair trading practices".

APRA supervises life insurance companies authorised under the Life Act with a view to maximising the likelihood that these companies will be able to meet their obligations to policyholders. Prudential requirements for life insurance companies are set out in prudential standards and in prudential rules.

Although APRA is responsible for the prudential regulation of insurers, it is not responsible for product disclosure standards, customer complaints or licensing of financial service providers (including authorised representatives and insurance brokers) as these responsibilities fall to the Australian Securities and Investments Commission (ASIC) under its Australian Financial Services Licence (AFSL) regime. Most insurers require an AFSL, and as such, a dual licensing system exists with overlapping requirements under both ASIC and APRA.

Since its establishment in 1998, APRA has been working to harmonise the regulatory framework of regulated institutions. The aim is to apply similar principles across all prudential regulation and to ensure that similar financial risks are treated in a consistent manner whenever possible.

Regulatory framework

Similar to the general insurance regulatory framework, there is a three-tier regulatory system for life insurers:

- Tier 1 – The Life Act contains the high-level principles necessary for prudential regulation;
- Tier 2 – Prudential standards detail compliance requirements for companies authorised under the Life Act; and
- Tier 3 – Prudential Practice Guides accompany most prudential standards, providing details of how APRA expects them to be interpreted in practice.

The main features of the prudential standards which set out the mandatory elements of the regulatory framework are outlined below.

Table 2.1 – Life insurance prudential standards

Prudential standard	Explanation
PS 3 Prudential Capital Requirement	See section 2.4
LPS 1.04 Valuation of Policy Liabilities	Discussed below
LPS 2.04 Solvency Standard	See section 2.4
LPS 3.04 Capital Adequacy Standard	See section 2.4
LPS 4.02 Minimum Surrender Values and Paid-up Values	Discussed below
LPS 5.02 Cost of Investment Performance Guarantees	Discussed below
LPS 6.03 Management Capital Standard	See section 2.4
LPS 7.02 General Standard	Discussed below
LPS 220 Risk Management	See section 2.5
LPS 230 Reinsurance	See section 2.5
LPS 231 Outsourcing	See section 2.5
LPS 232 Business Continuity Management	See section 2.5
LPS 310 Audit and Related Matters	See section 2.6
LPS 320 Actuarial and Related Matters	See section 2.6
LPS 350 Contract Classification for the Purpose of Regulatory Reporting	Discussed below
LPS 510 Governance	See section 2.6
LPS 520 Fit and Proper	See section 2.6
LPS 900 Consolidation of Prudential Rules No. 15, 18, 22, 27 and 28	Discussed below
LPS 902 Approved Benefit Fund Requirements	Discussed below

Probability and Impact Rating System

APRA's primary objective is to minimise the probability of regulated institutions failing and to ensure a stable, efficient and competitive financial system. APRA uses its Probability and Impact Rating System (PAIRS) to classify regulated financial institutions in two key areas:

- The probability that the institution may be unable to honour its financial promises to beneficiaries – depositors, policyholders and superannuation fund members; and
- The impact on the Australian financial system should the institution fail.

As part of its role as a prudential regulator, APRA uses PAIRS to assess risk and to:

- determine where to focus supervisory effort;
- determine the appropriate supervisory actions to take with each regulated entity;
- define each supervisor's obligation to report on regulated entities to APRA's executive committee, board and, in some circumstances, to the relevant government minister;
- provide a risk diagnostic tool; and
- ensure regulated entities are aware of how APRA determines the nature and intensity of their supervisory relationships.

The PAIRS Supervisory Attention Index rises as the probability of failure and the potential impact of failure increase, ranging from "Low" to "Extreme". These ratings are not publicly available, and are used only to identify potential issues and seek remediation before serious problems develop.

Supervision and compliance

APRA's supervisory objectives are met in two main ways:

- Maintaining a regulatory framework within which insurance companies must operate
- Requiring the submission of financial and other returns, insurer declarations and independent reports, so that APRA can monitor the financial position of the insurer and its ability to meet policyholder claims as they fall due.

In addition to companies' reporting and other obligations, the Life Act grants powers to APRA to monitor and investigate life insurance companies, including the power to appoint a judicial manager. A judicial manager acts in a similar manner to the administrator of a financially troubled company and, in accordance with Section 175 of the Life Act, is appointed by a judge to whom he or she must report the recommended course of action for the insurer.

Valuation of policy liabilities

The prudential standard LPS 1.04 Valuation of Policy Liabilities prescribes a set of principles and associated actuarial methodology for the valuation of policy liabilities for life insurance contracts. The valuation of policy liabilities for life investment contracts is presented to generally comply with the requirements of the relevant accounting standards.

Minimum surrender values and paid-up values

LPS 4.02 – Minimum Surrender Values and Paid-up Values prescribes a set of principles and an actuarial methodology for the calculation of minimum surrender values and paid-up values for the purpose of the solvency standard, and for payment on actual surrender at the policy owner's request.

The objective of this prudential standard is to:

- Protect the interests of surrendering policy owners in the situation of terminating (or making paid-up) life insurance policies prior to their full term, by providing for a minimum amount; and
- Protect the interests of remaining policy owners, by both:
  - ensuring that the costs of termination are being appropriately borne by the surrendering policy owners; and
  - providing a base which is used in the determination of the solvency requirement for a statutory fund.

Cost of investment performance guarantees

LPS 5.02 – Cost of Investment Performance Guarantees prescribes the principles and methodology for calculating the cost of investment performance guarantees if they are provided in association with investment-linked contracts. As prescribed in the Life Act, the cost of investment performance guarantees must not exceed 5% of the policy liabilities of the fund in which the business is written.

General standard

LPS 7.02 – General Standard covers:

- Introduction of the prudential standards 1.04 to 6.03;
- Application of the standards to friendly societies;
- Instruction on how to use the prudential standards;
- History of the development of the prudential standards;
- Dictionary for the terminology used in the prudential standards 1.04 to 6.03; and
- Counterparty grade for investment assets, for the purposes of the solvency and capital adequacy standards.

Contract classification for the purpose of regulatory reporting

The prudential standard LPS 350 – Contract Classification for the Purpose of Regulatory Reporting stipulates the basis on which contracts written by life companies are to be classified for the purpose of regulatory reporting to APRA and for the valuation of contracts in accordance with the prudential standards relating to actuarial matters.

The purposes of LPS 350 are:

- to distinguish between those contracts that meet the definition of a life insurance contract under Australian Accounting Standard AASB 1038 Life Insurance Contracts and those that do not;
- to identify key components of contracts written by life companies (insurance component, financial instrument, service component, discretionary participation feature and embedded derivatives); and
- to stipulate the circumstances in which such components must be unbundled for regulatory reporting purposes and for the valuation of contracts in accordance with Prudential Standard LPS 1.04 – Valuation of Policy Liabilities.

Consolidation of Prudential Rules No. 15, 18, 22, 27 and 28

LPS 900 – Consolidation of Prudential Rules No. 15, 18, 22, 27 and 28 consolidates the following Prudential Rules:

- Prudential Rules No. 15 Consequences of Transfer of Policy Between Statutory Funds (s 55(2)&(3));
- Prudential Rules No. 18 Single Bank Account for Statutory Funds (s 34(4));
- Prudential Rules No. 22 Non-Participating Benefit (s 15(3));
- Prudential Rules No. 27 Starting Amount (s 61(1)); and
- Prudential Rules No. 28 Distribution of Shareholders' Retained Profits (Australian Participating) (s 62(5)).

Approved benefit fund requirements

This prudential standard LPS 902 – Approved Benefit Fund Requirements is designed to ensure that the establishment, structure, and operation of an approved benefit fund by a friendly society are fair and equitable for its members. In particular, it sets out the requirements for:

- the content of approved benefit fund rules;
- the allocation of an approved benefit fund surplus (depending on the classification of the approved benefit fund); and
- the provision of seed capital.

Australian Securities and Investment Commission

ASIC is the single Commonwealth regulator responsible for market integrity and consumer protection functions across the financial system. It is responsible for:

- Corporate regulation, securities and futures markets;
- Market integrity and consumer protection in connection with life and general insurance and superannuation products, including the licensing of financial service providers; and
- Consumer protection functions for the finance sector.

Most insurers require an AFSL, and as such, a dual licensing system exists with overlapping requirements under both ASIC and APRA.

Australian Financial Services Licence

The Corporations Act requires all sellers of insurance products to retail clients, including registered insurers and brokers, to obtain an AFSL.

To obtain a licence, the applicant must meet the obligations under Section 912A and demonstrate that they will provide financial services efficiently, honestly and fairly. Specific provisions under the Corporations Regulations require that financial services licensees have in place the following:

- Documented procedures to monitor, supervise and train representatives;
- "Responsible officers" (senior management responsible for day-to-day business decisions) with minimum standards of knowledge and skills in financial services;
- Adequate resources (financial, technological and human) to provide services covered by the licence. These requirements do not apply to APRA-regulated entities (such as registered insurers), but do apply to any non-APRA-regulated subsidiaries;
- Adequate risk management systems (AS4360, the Australian Standard for Risk Management, acts as a guide to minimum requirements). These requirements do not apply to APRA-regulated entities, but do apply to any non-APRA-regulated subsidiaries;
- Adequate compliance framework (AS3806, the Australian Standard on Compliance Programs, acts as a guide to minimum requirements);
- Internal and external dispute resolution procedures (where dealing with retail clients);
- Adequate compensation requirements (where dealing with retail clients as described in Section 912B). This typically is achieved through membership of a guarantee fund or obtaining professional indemnity insurance cover; and
- Register of representatives, i.e. directors and employees of the insurer and its related bodies corporate, as well as authorised representatives and insurance brokers.

Once ASIC has granted an AFSL pursuant to Section 913B of the Corporations Act, any variations to authorisations and conditions of the licence can be made electronically via the ASIC website.

Insurers that are regulated by APRA are exempted from the financial obligations of an AFSL as their financial position is separately monitored by APRA through quarterly statistical reporting.

Ongoing notification obligations

Licence holders are required to meet ongoing notification obligations, which include requirements to notify ASIC about:

- Breaches and events;
- Changes in particulars (form F205 for change of name of corporate entities, form FS20 for all others);
- Authorised representatives (forms FS30, FS31, FS32);
- Financial statements and audit (forms FS70 and FS71); and
- Appointment/removal of auditor (forms FS06, FS07, FS08 and FS09).

Section 989B of the Corporations Act also outlines ongoing financial reporting and audit obligations. A licensee is required to prepare and lodge an audited profit and loss statement and a balance sheet within three months of the end of its financial year.

ASIC has released Class Order 06/68 which grants relief to local branches of foreign licensees from preparing and lodging accounts in accordance with Section 989B of the Corporations Act. This relief is only available where the foreign licensee lodges accounts, prepared and audited in accordance with the requirements of its local financial reporting jurisdiction with ASIC once every calendar year.

Ownership restrictions

The Financial Sector (Shareholdings) Act limits shareholdings to 15 per cent of an insurer, unless otherwise approved by the Federal Treasurer. The Insurance (Acquisitions and Takeovers) Act complements this legislation by requiring government approval for offers to buy more than 15 per cent of an insurer.

2.4 Solvency and capital adequacy

Overview

APRA prudential standards establish a two-tier capital requirement for the statutory funds of life companies.

- Tier 1 (Solvency Requirement) requires a minimum capital requirement to ensure the solvency of the company. More specifically, to ensure that under a range of adverse circumstances, the company would be expected to be in a position to meet obligations to policyholders and other creditors in the context of a fund closed to new business, and which is either operating in a run-off situation or is to be transferred to another insurer.
- Tier 2 (Capital Adequacy Requirement) is intended to secure the financial strength of the company to ensure that the obligations to, and reasonable expectations of, policyholders and creditors are able to be met under a range of adverse circumstances in the context of a viable ongoing operation.

The key elements of the prudential standards that prescribe these capital requirements are outlined below.

Solvency

LPS 2.04 Solvency Standard broadly comprises the following components:

- Solvency liability – A calculation of the value of the guaranteed policy liabilities on the basis of assumptions that are generally more conservative than best estimate assumptions;
- Other liabilities – The value of the liabilities of the statutory fund to other creditors but excluding subordinated debt arrangements;
- Expense reserve – To provide for the loss of contribution from non-commission acquisition charges, which occurs upon closing a statutory fund to new business;
- Resilience reserve – To allow for adverse movements in investment markets and obligor defaults to the extent they will not be matched by corresponding movements in the liabilities; and
- Inadmissible assets reserve – To cover risks associated with holdings in associated financial entities and concentrated asset exposures.

Capital adequacy

LPS 3.04 Capital Adequacy Standard broadly comprises:

- Capital adequacy liability – A calculation of the value of liabilities on the basis of assumptions that are generally more conservative than the solvency liability assumptions;
- Other liabilities – The value of the liabilities of the statutory fund to other creditors but excluding subordinated debt arrangements;
- Resilience reserve – Similar to the solvency requirements, except movements are more adverse;
- Inadmissible assets reserve – As per the solvency requirements, except it does not apply to otherwise sound assets that depend on the continuation of the business; and
- New business reserve – To provide for a fund to continue meeting its solvency requirement assuming the planned level of new business over the next three years.

Management capital

LPS6.03 Management Capital Standard prescribes the minimum capital requirement to be held outside the statutory funds to ensure that under adverse circumstances the company would be able to meet its trading commitments and adequately service its policyholders.

Prudential capital requirement

APRA PS 3 Prudential Capital Requirement complements LPS 6.03. The standard indicates that the minimum capital value is $10 million for life insurers (nil for friendly societies). This capital must be maintained as excess assets and at least 50 per cent must be in the form of eligible assets.

According to APRA, a life insurance company will need to independently comply with the requirements of the Prudential Standard PS 3 and the Prudential Standard LPS 6.03. However, the two requirements are not additive. PS 3 will, generally, result in capital over and above that needed to comply with LPS 6.03 only to the extent that:

- the amount of capital established by LPS 6.03 is less than that prescribed by PS 3; and
- the type of capital used in satisfying LPS 6.03 does not comply with the prescribed form of capital required by PS 3.

Subject to approval from APRA, statutory funds must not be invested in related companies other than subsidiaries. The following assets are inadmissible for solvency purposes:

- An asset with a value that is dependent upon the continuation of the business;
- Holdings in an associated entity which is an institution itself subject to legislated minimum capital requirements; and
- Assets which breach asset concentration thresholds.

Investment policy

There are no absolute restrictions on investments that may be held by life insurance companies subject to some capital requirements for certain assets as discussed previously in this section.

Under Section 1017E of the FSR Act, which applied from 11 March 2002, where monies received cannot be applied to the issue of a product within one business day of receipt (i.e. unmatched cash), then the monies must be held in a trust account.

2.5 Management of risk and reinsurance

Risk Management

The prudential standard – LPS220 Risk Management aims to ensure that a life company maintains a risk management framework and strategy that is appropriate to the nature and scale of its operations. A life company's systems, processes, structures, policies and people involved in identifying, assessing, mitigating and monitoring risks are referred to as a life company's risk management framework.

The key requirements of LPS 220 include:

- maintaining a risk management framework that identifies, assesses, monitors, reports on and mitigates all material risks faced by the company;
- having a written 3 year business plan approved by the board;
- maintaining a risk management strategy which outlines the company's risk appetite and its strategy for managing risk;
- having its risk management framework subject to review by persons independent to the operation of the company; and
- supplying APRA with an annual declaration on risk management approved by the board.

Risk management framework

The risk management framework must include:

- a Risk Management Strategy (RMS);
- risk management policies, controls and procedures which identify, assess, monitor report on and mitigate all material financial and non-financial risks;
- a written business plan (which must be reviewed annually);
- clearly defined managerial responsibilities and controls for the framework; and
- a review process to ensure the framework remains effective.

The review process must be conducted in an effective and comprehensive manner by operationally independent, appropriately trained and competent persons. Satisfactory internal audit procedures and/or external audit arrangements must be implemented to ensure compliance with, and the effectiveness of, the framework.

APRA has also released a prudential practice guide – LPG 200 Risk Management, to assist life companies in complying with those requirements under LPS 220, and more generally, to outline prudent practices in relation to risk management frameworks.

Risk Management Strategy

The RMS must include:

- details of the insurer's approach to risk management;
- policies and procedures to be adopted in dealing with various risk management matters;
- a description of the relationships within the risk management framework between the Board, Board committees and senior management;
- managerial roles and responsibilities for the framework;
- a description of the approach adopted in ensuring relevant staff have an awareness of the framework and instilling an appropriate risk culture across the company; and
- a description by which the framework is reviewed including coverage and timing of these reviews.

Risk Management Declaration

The Board of each life company must also provide APRA with a declaration on risk management for each financial year. This declaration involves stating, to the best of the Board's knowledge and belief, having made the appropriate enquiries, that:

- there are systems in place to ensure compliance with the Life Act, the Regulations, prudential standards, actuarial standards, the Prudential Rules, reporting standards, the Financial Sector (Collection of Data) Act 2001, authorisation conditions, directions and any other requirements imposed by APRA;
- the processes and systems surrounding the production of financial information are effective;
- an RMS is in place which has been developed in accordance with the requirements of LPS 220; and
- the systems that are in place for managing and monitoring risks, and the risk management framework, are appropriate to the company, having regard to such factors as the size, business mix and complexity of its operations.

Outsourcing

Prudential Standard – LPS 231 Outsourcing and Prudential Practice Guide – PPG 231 Outsourcing aim to ensure that all outsourcing arrangements involving material business activities entered into by a life company are subject to appropriate due diligence, approval and on-going monitoring.

The key requirements of LPS 231 include:

- having a policy relating to outsourcing of material business activity;
- having sufficient monitoring processes in place to manage the outsourcing of material business activities;
- having a legally binding agreement in place for all material business activities with third parties, unless otherwise agreed by APRA;
- consulting with APRA prior to entering into agreements to outsource material business activities to service providers who conduct their activities outside Australia; and
- notifying APRA after entering into agreements to outsource material business activities.

Business continuity management

The prudential standard LPS 232 – Business Continuity Management aims to ensure that each life company implements a whole of business approach to business continuity management, appropriate to the nature and scale of its operation.

The key requirements of LPS 232 include:

- developing and maintaining a business continuity management policy;
- conducting a business impact analysis;
- maintaining a business continuity plan and testing it at least annually; and
- notifying APRA of any major disruptions to business operation

Reinsurance

The prudential standard LPS 230 – Reinsurance aims to ensure that reinsurance arrangements of a life companies are subject to minimum standards of independent oversight. It addresses the regular reporting of reinsurance arrangements to APRA, and APRA's oversight of financial reinsurance contracts.

The key requirements of LPS 230 are:

- a life company must give APRA a report on its reinsurance arrangements for a financial year within 3 months after the end of each financial year; and
- a life company must not enter into reinsurance arrangements of a certain type unless approval has been granted by APRA. These are primarily contracts that contain elements of financial reinsurance. Such contracts and details surrounding the application for approval are outlined in attachment B of LPS 230.

The reinsurance report must set out the particulars of each reinsurance contract or group of reinsurance contracts in force between the company and a reinsurer during the financial year.

The report must also set out the opinion of the company's appointed actuary on:

- whether the company's reinsurance arrangements during the financial year and the way in which it administered those arrangements were adequate and effective; and
- whether the company's reinsurance arrangements during the financial year have been accounted for in accordance with the prudential standards in force under section 230A of the Life Insurance Act.

Reinsurance management framework

Prudential Standard LPS 220 Risk Management requires a life company to have in place a risk management framework, including risk management policies, controls and procedures which identify, assess, monitor, report on and mitigate all material risks likely to be faced by the life company. This risk management framework must also address risks arising out of reinsurance arrangements.

Prudential Practice Guide LPG 240 Life Insurance Risk and Life Reinsurance Management provides guidance to assist life companies in complying with the requirements of LPS 220 in relation to insurance risk and reinsurance management. LPG 240 also outlines prudent practices in relation to good life insurance risk and reinsurance management.

2.6 Governance and assurance

Audit and actuarial requirements

APRA has made enhancement to the prudential framework for life companies. The existing prudential standard – LPS 310 Audit and Actuarial Requirements was amended and restructured into two separate standard LPS 310 Audit and Related Requirements and LPS 320 Actuarial and Related Requirements. The amendments clarified APRA's audit and actuarial requirements and aligned them more closely with those for ADIs and general insurers.

The key requirements of LPS 310 include:

- a life company must make arrangements to enable its Auditor to undertake his or her role and responsibilities;
- the Auditor must audit certain returns of the life company to APRA and provide a report to the Board of the life company;
- the Auditor must review other aspects of the life company's operations on an annual basis and provide a report to the Board of the life company;
- the Auditor may also be required to undertake other functions, such as a special purpose review; and
- a life company must submit to APRA all reports required to be prepared by its Auditor under the standard.

The key requirements of LPS 320 include:

- a life company must make arrangements to enable its Appointed Actuary to undertake his or her role and responsibilities;
- the Appointed Actuary must provide an assessment of the overall financial condition of the life company and advise on the valuation of its policy liabilities on an annual basis. In particular, the Appointed Actuary must prepare a Financial Condition Report and provide this report to the company;
- a life company must submit the Financial Condition Report to APRA;
- the Appointed Actuary may also be required to provide advice to the life company on certain life policies; and
- the Appointed Actuary may be required to conduct a special purpose review and provide a report to APRA and the life company.

Both LPS 310 and LPS 320 aim to ensure that the Board and the senior management of a life company are provided with impartial advice in relation to the life company's operations, financial condition and internal controls. This advice is designed to assist the Board and senior management in carrying out their responsibility for the sound and prudent management of the life company.

Governance

In LPS 510 – Governance, APRA sets out the minimum foundations for good governance of regulated institutions (comprising life companies and registered NOHCs). It aims to ensure that regulated institutions are managed in a sound and prudent manner by a competent Board of directors, which is capable of making reasonable and impartial business judgements in the best interests of the regulated institution and which gives due consideration to the impact of its decisions on policyholders.

The key requirements of this standard include:

- specific requirements with respect to Board size and composition;
- requiring the chairperson of the Board to be an independent director;
- requiring that a Board Audit Committee be established;
- requiring regulated institutions to have a dedicated internal audit function;
- certain provisions dealing with independence requirements for auditors consistent with those in the Corporations Act 2001;
- requiring the Board to have a Remuneration policy that aligns remuneration and risk management;
- requiring that a Board Remuneration Committee must be established; and
- requiring the Board to have a policy on Board renewal and procedures for assessing Board performance.

In November 2009, APRA released its prudential requirements on remuneration for life insurance companies. The requirements were incorporated into the existing prudential standard LPS 510 and came into effect on 1 April 2010.

APRA's key requirements on remuneration include:

- A regulated institution (including an eligible foreign life insurance companies, i.e. EFLIC) must establish and maintain a written Remuneration Policy.
- The Remuneration Policy must outline the remuneration objectives and the structure of the remuneration arrangements, including but not limited to the performance-based remuneration components.
- The Remuneration Policy must be approved by the Board, or for an EFLIC, by the Compliance Committee with delegated authority from the Board.

- The Remuneration Policy must form part of a regulated institution's risk management framework required under Prudential Standard LPS 220 Risk Management.
- The Remuneration Policy must be provided to APRA on request.
- A regulated institution (other than an EFLIC) must, unless otherwise approved in writing by APRA, have a Board Remuneration Committee that complies with the requirements of LPS 510.
- The Board Remuneration Committee must conduct regular review of, and making recommendations to the Board on, the Remuneration Policy; make annual recommendations to the Board on the remuneration of the CEO, direct reports of the CEO, other persons whose activities affect the financial soundness of the regulated institution, other person specified by APRA and any other categories of persons covered by the Remuneration Policy.
- The members of the Board Remuneration Committee must be available to meet with APRA on request.

Fit and proper

In LPS 520 – Fit and Proper, APRA sets out minimum requirements for the regulated institutions (comprising life companies and registered NOHCs) in determining the fitness and propriety of individuals to hold positions of responsibility.

The key requirements of this standard are that:

- a regulated institution must have and implement a written fit and proper policy that meets the requirements of the standard;
- the fitness and propriety of a responsible person must generally be assessed prior to initial appointment and then re-assessment annually (or as close to annually as practicable);
- a regulated institution must take all prudent steps to ensure that a person is not appointed to, or does not continue to hold, a responsible person position for which they are not fit and proper;
- additional requirements must be met for certain auditors and actuaries; and
- information must be provided to APRA regarding responsible persons and the regulated institution's assessment of their fitness and propriety.

2.7 Financial reporting

Accounting Standards

AASB 1038 Life Insurance Contracts prescribes the accounting treatment for life insurance contracts. It also mandates the use of certain options available in other accounting standards. AASB 1038 applies to life insurance companies and friendly societies that issue life insurance contracts (life insurers).

There have been no changes relating to AASB 1038 during the year, however there are a number of developments within the General Reporting Framework which will affect insurance companies. A summary of these changes is provided within Chapter 5 (Financial Reporting Update).

The following table outlines the key accounting standards for life insurers and their applications:

AASB 4 Insurance Contracts (Last updated April 2009) AASB 1038 Life Insurance Contracts (Last updated October 2009)	Prescribes the accounting methods to be used for reporting on: • life insurance contracts; • certain aspects of life investment contracts; • assets backing life insurance liabilities or life investment contract liabilities; and • disclosures about life insurance contracts and certain aspects of life investment contracts.
AASB 7 Financial Instruments: Disclosures (Last updated February 2010) AASB 132 Financial Instruments: Presentation (Last updated October 2009) AASB 139 Financial Instruments: Recognition and Measurement (Last updated December 2009)	Applies to the financial instrument component of life investment contracts Prescribes the accounting methods to be used in recognising, measuring, presenting and disclosing financial assets and financial liabilities.
AASB 118 Revenue (Last updated May 2009)	Applies to the service element of life investment contracts

Life insurance contracts

An insurance contract is defined as a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

Under AASB 1038, a life insurance contract is an insurance contract, or a financial instrument with a discretionary participation feature, regulated under the Life Insurance Act 1995 (Life Act), and similar contracts issued by entities operating outside Australia.

Key accounting principles of life insurance contracts:

Principle	Requirement
Basis for valuing policy liabilities	Policy liabilities are calculated as the present value of the best estimate of expected future net cash flows, plus future profit margins
Basis for valuing investments backing life insurance contract liabilities	Investments are valued at fair value through profit or loss where permitted
Basis for valuing controlled entities	Controlled entities are valued in accordance with AASB 127 Consolidated and Separate Financial Statements, at cost or fair value
Deferral of acquisition costs (DACs)	All acquisition costs are deferred and amortised over the period of expected benefit. DACs are to be deducted from policy liabilities
Recognition of embedded value	Not recognised

Life investment contracts

A life investment contract is a contract which is regulated under the Life Act but which does not meet the above definition of a life insurance contract.

AASB 1038 addresses key accounting issues by requiring:

- profits to be recognised appropriately over the life of an insurance contract in line with the services provided;
- calculation of best estimate policy liabilities; and
- application of fair value principles.

Key accounting principles of life investment contracts:

Principle	Requirement
Basis for valuing policy liabilities	Valued at fair value in accordance with AASB 139. In practice, this will likely be on an accumulation basis, but may be adjusted to take account of demand deposit features
Basis for valuing investments backing life investment contract liabilities	Investments are valued at fair value through profit or loss where permitted
Deferral of acquisition costs (DACs)	Only those costs which are incremental and directly attributable to securing the life investment contract can be deferred. DACs are recognised as a separate asset and are tested for impairment at each balance date
Recognition of embedded value	Not recognised

AASB 1038 Applications

The key applications of AASB 1038 to life insurance financial reporting are summarised below.

Profit recognition – Life insurance contracts

Planned profit margins and life insurance contract liabilities (referred to as policy liabilities) are calculated separately for each 'related product group' using best estimate assumptions at each reporting date. Profit margins are released over the financial year during which services are provided and revenues relating to those services are received. The balance of the planned profits is deferred by including the amount in the value of policy liabilities.

AASB 1038 requires the use of the prospective method (projection basis) to value policy liabilities (including planned profit margins and other components) at each reporting date unless, using the retrospective method (accumulation basis), the results are not materially different. To ensure planned margins are recognised during the financial year in which the relevant services are provided, policy liabilities include a component relating to those margins.

This methodology, which is commonly known as the "margin-on-services" method, results in reported shareholders' profits comprising:

- The release of planned profit margins on policies in force at the beginning of the year;
- The release of planned profit margins on new business written during the year;
- The impact of differences between assumed and actual experience during the year including mortality, disability, expenses, lapses, inflation, taxation, reinsurance and investment returns;
- Loss recognition (or reversal of past recognised losses) as appropriate; and
- Investment earnings on shareholders' capital and retained profits.

Changes in the assumptions underlying the policy liabilities are spread over future years during which the services to policyholders are rendered, except those for related products groups on which future losses are expected. The effect of a change to assumed discount rates caused by changes in investment market conditions or where calculation errors occur results in a revenue or expense being recognised in the current financial year.

The income statement includes all premium and policy-related revenue, investment revenues, fair value gains and losses, all claims (including surrenders), and all expenses and taxes, whether they relate to policyholders or shareholders. The change in the value of policy liabilities (including the change of unvested policyholder benefits and discretionary additions/bonuses vested in policyholders during the financial year) is shown as an expense before arriving at the shareholder profit.

Valuation of life insurance policy liabilities

Under AASB 1038 the best estimate liability is calculated as the present value of expected future benefit payments, plus expenses, less future receipts. The following factors are considered to be material to the calculations:

- Investment earnings;
- Inflation;
- Taxation;
- Expenses;
- Mortality and morbidity reinsurance; and
- Policy discontinuance.

The best estimate liability will normally be determined using projection methods, and the value of future profits calculated as the present value of future profit margins.

A profit margin is determined using a profit carrier, which is a financially measurable indicator of either the expected cost of the services provided to the policyholder or the expected income relating to the services.

Profit carriers are selected and profit margins determined at policy commencement to enable an appropriate emergence of profit over the term of the benefits or services provided. The selection of a profit carrier is critical in determining the timing of profits released. More than one profit carrier may be selected for a product, although the practical implications of selecting multiple carriers should be considered relative to the materiality of the results. Typical profit carriers are identified below:

Product	Profit carrier
Yearly renewable term	Premiums or claims
Level premium term	Claims
Group life	Premiums or claims
Disability income	Claims
Immediate annuities	Annuity payments
Traditional non-participating	Death claims
Traditional participating	Value of bonuses

Profits or losses may emerge on acquisition depending on whether establishment fees are more or less than the related expenses. Losses may also emerge if expected future income is not considered adequate to cover acquisition expenses.

Changes in assumptions which directly affect profit in the year in which they occur are:

- Changes in the discount rate due to a change in market conditions; and
- Changes that lead to capitalised losses or reversal of previous capitalised losses.

All other changes in best estimate assumptions result in the profit margin being recalculated. This results in future profits calculated using the revised best estimate assumptions re-spread in accordance with the profit carrier. When expected future losses are identified at a reporting date, these are recognised as an immediate loss at that date.

A record of cumulative losses is kept for each related product group and profit margins are maintained at zero until cumulative losses are fully reversed.

Revenue recognition – Life investment contracts

Revenue from investment contracts arises either from explicit fees charged to investment contract holders or from the earning of the management services elements (MSE) inherent in the valuation of the investment contract liability.

Explicit fees are measured as the fair value of the consideration received or receivable and are earned in the income statement as the services are provided to the contract holder. This would normally be on a straight line basis over the life of the investment contract but other earning patterns may be more appropriate if they better reflect the provision of services.

A MSE arises when the sum of consideration received or receivable exceeds the fair value of the investment contract liability upon initial recognition. This deferred revenue is recognised as a liability on the balance sheet and earned as the management services are provided, as per the explicit fees above.

Incremental costs that are directly attributable to the acquisition of an investment contract are recognised as an asset if: they can be identified separately; measured reliably; and if it is probable that they will be recovered.

An incremental cost is one that would not have been incurred if the life insurer had not acquired the life investment contract. The asset represents the insurer's contractual right to benefit from providing ongoing services, and is amortised as the insurer recognises the related revenue.

Valuation of investment contract liabilities

Investment contract liabilities are valued at fair value in accordance with AASB 139. As there is generally no active market for investment contract liabilities, these should be valued using an appropriate valuation technique which would normally involve a discounted future cash flow analysis.

For investment contracts with a demand feature, or surrender value, AASB 139 stipulates that the fair value of the liability cannot be less than the current surrender value.

Accounting for investments

AASB 1038 requires life insurers to measure all assets backing life insurance and life investment contracts at fair value through profit or loss as at the reporting date where this option is available. Changes in the fair value must be recognised in the income statement as either income or expenses in the financial year in which the changes occur. Where there are choices available in other standards for the measurement of assets, AASB 1038 requires the following to be applied, to those assets determined as backing life insurance and life investment contracts.

Type of asset	Measurement basis
Financial assets	Fair value through profit or loss in accordance with AASB 139
Investment property	Fair value using the fair value model under AASB 140 Investment Property
Property, plant and equipment (including owner- occupied property)	Revaluation model under AASB 116 Property, Plant and Equipment, being fair value less any subsequent accumulated depreciation and subsequent accumulated impairment losses (revaluation movements through equity)

Statutory Funds

AASB 1038 requires life insurers to recognise in its financial report all of the assets, liabilities, and expenses of each statutory fund. It recognises that the interests of policyholders and shareholders are intertwined and form the basis of a single entity. Where the parent entity controls the life insurance subsidiary, the parent in turn controls the assets and liabilities of the statutory funds and the policyholders' interests.

Benefit funds of friendly societies are treated in the same way as life insurance company statutory funds.

Acquired life insurance contracts

When purchasing a life insurance company or a portfolio of life insurance contracts, a life insurer must value the insurance assets and insurance liabilities assumed at fair value. They are permitted, but not required, to split the fair value into two components:

(i) A liability measured in accordance with the insurer's accounting policies for life insurance contracts; and

(ii) An intangible asset, representing the difference between the fair value of the insurance contracts acquired and the liability recognised in (i).

The intangible asset is exempt from the recognition and measurement requirements of both AASB 138 Intangible Assets and AASB 136 Impairment of Assets. It is not exempt from the disclosure requirements. The subsequent measurement has to be consistent with the measurement of the related liability, i.e. it will be amortised over the life of the liabilities, consistent with the profit recognition on those contracts.

Disclosure requirements

AASB 1038 requires specific life insurance contract disclosures. The key requirements are summarised below.

1. A life insurance company is required to disclose "information that identifies and explains the amounts in its financial report arising from life insurance contracts", including:
   - Accounting policies for life insurance contracts and related assets, liabilities income and expenses;
   - Assets, liabilities income, expense and cash flows arising from life insurance contracts;
   - The process used to determine the assumptions that have the greatest effect on life insurance balances, including, where practicable, quantified disclosure of those assumptions;
   - The effect of changes in assumptions used to measure life insurance assets and life insurance liabilities, showing separately the effect of each change that has a material effect on the financial report; and
   - Reconciliations of changes in life insurance liabilities and reinsurance assets.
2. A life insurer must disclose the process they have adopted to determine which assets back their life insurance or life investment contract liabilities.
3. The following split of expenses must be disclosed by life insurers:
   - Outwards reinsurance expense;
   - Operating expenses:
   - Claims expense;
   - Policy acquisition expenses, separated into material components including commission;
   - Policy maintenance expenses; and
   - Investment management expenses

   The basis for the apportionment of operating expenses must also be disclosed between:
   - Life insurance contract acquisition;
   - Life insurance contract maintenance;
   - Investment management expenses;
   - Life investment contract acquisition;
   - Life investment contract maintenance; and
   - Other expenses.

4. The following disclosures should be made in respect of amount, timing and uncertainty of cash flows from life insurance contracts:
   - Objectives in managing risk and policies for mitigating risk;
   - Contract terms and conditions which have a material effect on the amount, timing and uncertainty of cash flows;
   - Information about insurance risk (before and after risk mitigation by reinsurance), including:
     a. The sensitivity of profit and equity to changes in variables (for material effects);
     b. Insurance risk concentration;
     c. Interest rate risk and credit risk disclosures, detailing:
        (i) Exposure to interest rate risk by class of asset and liability, including details of contractual repricing or maturity dates and effective interest rates, where applicable; and
        (ii) Exposure to credit risk for each class of financial asset or other credit exposure, including the maximum credit risk exposure and significant concentrations of insurance risk.

Annual and quarterly reporting

Corporations Act reporting

In general, a public company must file its annual shareholder accounts (financial statements) with ASIC within four months of year-end (within three months for disclosing entities or registered schemes). Small proprietary companies are normally exempted. The financial statements prepared under the Corporations Act 2001 must be independently audited by an Australian registered auditor.

APRA reporting

Life insurance companies and friendly societies are required to submit quarterly non-audited returns (LRF 100.0 – LRF 340.2) and annual returns (LRF 100.0 – LRF 430.0, only LRF 100.0, LRF 120.0 – LRF 340.2 are audited) to APRA under the Financial Sector (Collection of Data) Act 2001. The returns should be submitted using the online 'Direct to APRA' (D2A) software, or on paper where this is not possible. The quarterly returns are due 20 business days after the end of the reporting period. The annual returns are due four months after year-end.

The reporting requirements for the returns are broadly consistent with the requirements for financial statements under the accounting standards issued by AASB. The major differences are outlined in LPS 350 Contract Classification for the Purpose of Regulatory Reporting to APRA.

In addition, a life insurer which holds an AFSL is required to submit the forms FS 70 (completed by the insurer) and FS 71 (completed by the appointed auditor) annually to ASIC.

Other reports due to APRA

1. Annual Auditors Report

   All annual audited returns must be submitted in conjunction with the annual auditor's report, as required under Prudential Standard LPS 310 Audit and Actuarial Requirements.

2. Financial Condition Report

   LPS 310 requires life companies and friendly societies to give to APRA a copy of a financial condition report prepared by the appointed actuary within 3 months after the end of the period as at which the report is made.

3. Reinsurance Report

   LPS 230 Reinsurance requires each life company to give APRA a reinsurance report relating to the financial year of the company within 3 months after each financial year.

4. Risk Management Declaration

   LPS 220 Risk Management requires the Board to provide APRA with a Risk Management Declaration relating to each financial year of the life company. The Risk Management Declaration must be signed by two directors and submitted to APRA on, or before, the due date of the annual returns.

Key dates

Annual

Audited financial statements under Corporations Act 2001
Within three months of balance date for a disclosing entity or registered scheme and within four months of balance date for anyone else.

APRA Annual Returns LRF 100.0 – LRF 430.0
(only LRF 100.0, LRF 120.0 – LRF 340.2 are audited)
Within four months of balance date

Financial Condition Report
Within three months of elected balance date

Reinsurance Report
Within three months of balance date

Risk management declaration
On or before the due date of annual returns

Quarterly

APRA Quarterly Returns LRS 100 – 340.2
Within 20 business days of quarter-end

2.8 Taxation

General developments

The Government has continued with ambitious plans for significant tax reform. The comprehensive review of Australia's tax system, otherwise known as the Henry Review has been completed and the final report released to the public on 2 May 2010 together with the Government's response. Despite the 138 recommendations in the Henry Report, the Government has only made a handful of announcements, although there may be further announcements in the May budget.

The Government proposes to reduce the company income tax rate from 30 per cent to 29 per cent for the 2013-2014 income year and to 28 per cent from the 2014-2015 income year and introduce certain changes to the superannuation system including a staged increase in the Superannuation Guarantee payment from 9 per cent to 12 per cent. The superannuation changes will increase the amount of funds held within superannuation, and this should have a flow on benefits for life insurers. These initiatives are to a large extent funded by the Resource Super Profits Tax of 40 per cent.

The Henry Report also contains the following recommendations which will impact the life insurance industry:

- The abolition of specific taxes on insurance products, including stamp duties and fire service levies, which is consistent with the recommendations in the "Australia as a Financial Centre: Building on our Strengths" report released by the Australian Financial Centre Forum. The Government has not ruled out this recommendation, although any changes will need agreement from the State Governments.
- Government support for the development of a longevity insurance market within the private sector, for example by issuing long-term securities and by releasing data needed to create and maintain a longevity index. The further development of the longevity insurance market could help reduce the risk that self funded retirees will exhaust their superannuation balances and need to turn to Government pensions. This would of course only work if the products were seen as attractive by retirees or were compulsory. The report recommends against making the purchase of these products compulsory.
- No restrictions on people wanting to purchase longevity products from a prudentially regulated entity. While the global financial crisis has seen the development of some longevity products outside of insurance, this recommendation has the potential to broaden the types of entities offering such products, providing further competition to life insurers.

Some other key tax developments during the year are listed below.

- The new Taxation of Financial Arrangements (TOFA) measures which provide a comprehensive regime for the tax treatment of gains and losses arising from financial arrangements have been legislated. The TOFA measures will apply to eligible taxpayers for the income year beginning on or after 1 July 2010 unless the taxpayer chooses to have the rules apply for income years beginning on or after 1 July 2009 (i.e. the "early adopt" election). Taxpayers have a choice as to how TOFA will apply to their financial arrangements.
- New tax consolidation measures were introduced into Parliament on 10 February 2010 to refine the existing rules. Some of the relevant changes proposed include clarification of the treatment of intra-group transactions of a consolidated group that have a life insurance company member and clarification of the income tax treatment of rights to future income.
- The Federal Government has proposed a reform of Australia's foreign source income anti-tax deferral (attribution) rules. The proposal includes a rewrite of the Controlled Foreign Companies (CFC) rules and the repeal of the Foreign Investment Fund (FIF) rules. The FIF rules will be replaced with a specific, narrowly defined anti-avoidance rule that applies to offshore accumulation or roll-up funds.
- The new International Dealings Schedule - Financial Services 2010 (the IDS-FS 2010) was released by the ATO. The IDS-FS 2010 is the ATO's newly proposed tax return schedule for large (> $250m turnover) financial services taxpayers to replace the Schedule 25A and Thin Capitalisation Schedule and provide additional information in relation to financial arrangements. For the 2010 income year the IDS-FS is optional. However, the IDS-FS will be mandatory for affected taxpayers for the 2011 year.
- On 14 December 2009, Treasury released a Proposals Paper as the next step in consultation with stakeholders on product rationalisation for managed investment trusts and life insurance companies. It is proposed that some form of tax rollover relief would be provided to legitimate rationalisations.
- Legislation was enacted which allows tax rollover relief for the merging of superannuation funds. The relief also includes transfers to and from pooled superannuation trusts and life insurance companies.
- The Queensland Government has introduced amendments to the insurance duty provisions to expand the definition of insurer to ensure that stamp duty is payable on life insurance riders issued by life companies. The amendments were introduced to remove the potential restriction on the Queensland Revenue Office imposing duty on general insurance policies that were issued by life insurance companies. These amendments have effect from 14 January 2010.
- During 2009 (subsequent to the release of last year's "Insurance Facts and Figures Publication"), the Australian Government announced its support for 41 of 46 recommendations that were made by the Board of Taxation in relation to its review of the Administration of the GST System. Generally these changes are aimed at reducing the administrative burden of complying with the GST legislation and represent the most significant package of GST reform in 10 years.

While many supported recommendations were identified as applying from 1 July 2010, the legislative process has only started for some of the recommendations with either Exposure Drafts or Bills being introduced and debated in Parliament during 2010. We expect some but not all of the current proposed changes to be passed by parliament prior to 1 July 2010 with the effective date of the changes ranging from 1 July 2000 to 1 July 2010 (that is, some changes are likely to apply retrospectively). Many of the changes have general application to business taxpayers and it is important for each organisation to consider the impact of each of the proposed or finalised changes.

Taxation of life insurers

The rules governing how life companies are taxed are contained in Division 320 of the Income Tax Assessment Act 1997 (ITAA97). Broadly, these rules seek to tax most underwriting profits and fee income at the normal corporate rate, whereas investment income is taxed at varying rates – generally being for income from assets backing superannuation policies, zero percent for income from assets backing pension portfolio amounts, 15% for assets backing superannuation amounts in accumulation phase and 30% for other investment income.

Classes of income

The income of a life insurance company is effectively divided into three classes: the Ordinary Class, the Complying Superannuation Class or First Home Saver Account (FHSA) Class (both being taxable) and a Segregated Exempt Assets (SEA) Class. The complying superannuation/FHSA class, formerly known as the Virtual Pooled Superannuation Trust (VPST) class, is established for the company's complying superannuation policies.

Life insurance companies must establish a segregated asset pool for their immediate annuity policy liabilities, which is the SEA Class. All other classes of policies and any shareholder capital will form part of the Ordinary Class.

The classification of income and gains among the various classes of income (assessable and exempt) is not determined by reference to statutory funds and the mix of policy liabilities (in the case of mixed statutory funds). Rather, the life insurance company must segregate its assets by allocating these as supporting certain (tax) classes of policies it has issued.

Life insurance companies pay tax on income derived in the Ordinary Class at the rate of 30 per cent and are ordinarily taxed at a rate of 15 per cent on income derived from complying superannuation/FHSA assets. Any income derived from the SEA Class is exempt from tax.

A life insurance company remains a single entity for taxation purposes. However, the effect of the rules outlined above is that for taxation purposes, the company is effectively divided into three pools, with each segment representing a particular class of business.

A life insurance company can also form part of a tax consolidated group, in which case the head company will be deemed to be a life insurance company.

Assessable income

The assessable income of a life insurer includes fee income and underwriting profits of a life insurer as well as its investment income and realised gains on the disposal of assets.

Assessable income also specifically includes life insurance premiums "paid" to the company, reinsurance amounts received, refunds of reinsurance paid under a contract of reinsurance and amounts received under a profit-sharing arrangement under a contract of reinsurance. In an Interpretative Decision, the ATO states that premium income should be recognised on an accruals basis.

Amounts representing a decrease in the value of the net risk components of risk policy liabilities and taxable contributions transferred from complying super funds or approved deposit funds (ADFs) are also included in assessable income.

Specified rollover amounts, fees and charges imposed in respect of life insurance policies but not otherwise included in assessable income and taxable contributions made to retirement savings accounts provided by that company also form part of the life company's assessable income.

Furthermore, most transfers of assets from one class to another will have a tax consequence. It is therefore necessary to carefully review and record each transfer to ensure its appropriate tax treatment.

Disposal of investments

Whether a profit or gain realised on the disposal or transfer of an investment is liable to tax (and the rate of tax) depends on the class of income to which it relates.

Gains and losses realised on certain complying superannuation/FHSA assets are determined by reference to the general capital gains tax provisions (which is consistent with the treatment of disposals of investments by superannuation funds).

The legislation also provides that a "deemed disposal" will arise where there is a transfer between the asset pools of an asset other than money. For tax purposes, an assessable gain may arise for the "transferor" asset pool.

A different rule, being a deferral mechanism, applies where an asset transfer results in a loss for tax purposes.

Similar to the tax treatment for general insurers, investments in the Ordinary Class are usually held on revenue rather than on capital account. Accordingly, profits on the disposal of such investments would be included in assessable income as ordinary income. However, this treatment may be modified under the TOFA rules.

Profits and losses on the disposal of investments held in the SEA Class are not taxable or deductible.

Each year, a life company is required to carry out a valuation of its complying superannuation/FHSA liabilities and SEA liabilities. Where the valuation of the corresponding asset pool exceeds the respective value of these liabilities (plus a reasonable provision for tax), the company must transfer the excess out of that asset pool. Where the valuation indicates a shortfall, the company may transfer assets into the pool. Such transfers will have the taxation consequences outlined above.

Management fee income

Where a life insurance company imposes fees and charges on policies included in the asset pools representing the complying superannuation/FHSA and SEA classes, it is required to transfer an amount equal to those fees and charges out of these pools. This will give rise to an assessable amount in the Ordinary Class, as well as a deduction in the complying superannuation/FHSA Class, but no deduction in the SEA Class.

This requirement ensures that any fees and charges imposed by the life insurance company are taxed at the prevailing corporate tax rate.

Investment income

A life insurer is required to separately calculate the investment income from each of its asset pools. This means adequate accounting records must be maintained to separately identify each of these pools, which will differ from the normal statutory fund basis of asset allocation.

Allowable deductions

The current tax provisions are based on the principle that a deduction is allowed for expenses of a revenue nature to the extent they are incurred in gaining or producing assessable income.

A life insurance company is allowed certain specific deductions. These include certain components of life insurance premiums (see below), the risk component of claims paid under life insurance policies, the increase in the value of risk policy liabilities, certain reinsurance premiums and amounts transferred to the SEA Class.

Premiums are fully deductible if they are transferred to the SEA Class, or if they are for policies providing participating or discretionary benefits. Part of the premium may be deductible if they are transferred to the complying superannuation/FHSA Class.

The deductible component of premiums in respect of ordinary non-participating investment policies would normally be determined by an actuary.

In relation to risk-only policies, such as term insurance policies, deductions will be allowed for increases in the value of those policy liabilities over the financial year (conversely, decreases will be assessable). An actuary would generally assist in calculating these assessable and deductible amounts.

Allocation and utilisation of losses

A life insurance company remains a single entity for tax purposes but in effect will be divided into three separate taxpayers, each representing a separate class of business. The idea of notional separate taxpayers for each class of business limits the way in which tax losses and capital losses can be used by a life company.

Capital losses from complying superannuation/FHSA assets can be applied only to reduce capital gains from complying superannuation/FHSA assets or carried forward to be used in a later year against capital gains derived in the complying superannuation/FHSA Class. Similarly, capital losses from Ordinary Class assets can be applied only to reduce capital gains from Ordinary Class assets or carried forward to be used in a later year against future capital gains generated by that class.

Ordinary Class revenue losses can only be applied against Ordinary Class assessable income. Similarly, complying superannuation/FHSA revenue losses can only be applied against complying superannuation/FHSA assessable income.

No assessable gains or deductible losses (including capital gains and losses) will arise from the SEA pool.

Certain types of income, including SEA income and income from the disposal of units in a pooled superannuation trust, are classified as “non-assessable non-exempt income”. As a result, tax losses incurred by a life insurance company will not be wasted against these non-assessable non-exempt income amounts before being offset against assessable income.

Imputation credits

A life insurance company is entitled to franking credits in its franking account for the payment of tax on income and/or the receipt of franked dividends attributable to Ordinary Class business. This means that no franking credits are recorded in a life insurance company’s franking account for tax paid on income from assets held in the complying superannuation/FHSA Class and SEA Class or franked dividends received from assets held in those classes. In this way, the imputation rules for life insurers are consistent with other non-life corporate taxpayers.

A life insurance company is generally entitled to a tax offset for imputation credits attached to dividends received from assets held in the Ordinary Class and complying superannuation/FHSA Class. Excess imputation credits are refundable to the complying superannuation/FHSA Class. As the SEA Class does not generate taxable income, any imputation credits generated by the assets in this class are also refundable.

There are special rules for life insurance companies which enable the offset of a franking deficit tax liability against the income tax liability attributable to shareholders business in the Ordinary Class. These rules complement the normal franking deficit provisions which apply to all companies.

Reinsurance with non-residents

Where a life insurance company reinsures all or part of any risk associated with disability policies with a non-resident, a deduction will not be allowed in respect of those premiums and an amount will not be assessable in respect of any recoveries.

The company's net risk liabilities include so much of the risk component as is reinsured with the non-resident reinsurer.

However, a life insurance company may elect that this principle does not apply in determining its taxable income, in which case the insurer becomes liable to furnish returns and to pay tax at the relevant rate (30 per cent) on 10 per cent of the gross premiums paid or credited to these non-resident reinsurers during the year. Where the election has been made, the company's net risk liabilities do not include the risk component which is reinsured with the non-resident reinsurer.

Goods and Services Tax

Under the Australian GST legislation, some classes of insurance are treated differently, leading to different implications for insurers and insured parties.

The provision of life insurance is usually an "input taxed" supply (known as "exempt supplies" in other jurisdictions), as the supply of an interest in certain life insurance businesses is defined to be a "financial supply" which, in turn, is input taxed for GST purposes. As a result, while life insurers are not required to account for GST on premium income derived from life insurance businesses, they are usually denied full input tax credits on the expenses incurred in making supplies of life insurance.

However, life insurers may be entitled to recover a reduced input tax credit on certain specified expenses. These are known as "reduced credit acquisitions" and are specifically listed in the GST Regulations. The current rate of reduced input tax credits is set at 75 per cent of the GST included in the price of particular expenses.

It should be noted that the GST classification of life insurance will be different if the supply is made in relation to a risk located outside of Australia, in which case the supply of these policies may be GST-free. Such a scenario will also result in a need to closely examine the expenses related to the life insurance operation to determine the extent to which input tax credits are available. It is common for life insurance entities to develop and apply a GST apportionment methodology in order to calculate their entitlement to input tax credits incurred.

Also note that the meaning of life insurance from a GST perspective is linked to certain provisions of the Life Insurance Act 1995. The GST regulations also stipulate that a supply that is incidental to another financial supply will itself be input taxed, subject to certain criteria being met. Certain products can be declared by APRA to be life insurance, and others will qualify as life insurance due to being related businesses (e.g. certain disability insurance).

In summary, as noted above, the consequence of input taxed classification is that input tax credits are not available for expenditure incurred in connection with making input taxed supplies of life insurance. This means that life insurance companies will not be entitled to recover all the GST included in the price paid for acquisitions of goods and services from suppliers, which has a consequential direct impact on their net costs and profitability. However, the GST law also contains provisions which allow financial supply providers to claim reduced input tax credits on certain acquisitions.

Investment activities

Investment activities are, like life insurance businesses, input taxed in many cases, as they are classified as financial supplies for GST purposes.

The effect of this is that, while GST will not be payable on the supplies made, not all of the GST incurred as part of the price paid for expenses associated with investment activities will be recoverable unless one of the following exceptions applies:

- The expense relates directly to the purchase or sale of securities or other investments in an overseas market.
- The expenses incurred by the insurer for the purpose of making input taxed financial supplies do not exceed the "financial acquisitions threshold" (which is a "de minimus" test to ensure that entities that do not usually make financial supplies are not denied input tax credits on making financial supplies that are not a significant part of their principal commercial activities).
- The financial supply is a borrowing and the borrowing relates to supplies which are not input taxed.

Where the above exceptions apply, the insurer retains the entitlement to fully recover the GST incurred on related costs. However, where the exceptions do not apply, the insurer will have to use an appropriate apportionment methodology to determine the extent to which it is entitled to recover GST incurred on general costs.

It should be noted that where acquisitions made by an insurer for the purpose of its investment activities are "reduced credit acquisitions", the insurer is entitled to claim a reduced input tax credit equal to 75 percent of the GST included in the price of the expense.

Stamp duty

Stamp duty on life insurance (other than term life) is generally calculated on the sum insured. The rates of duty vary in each state and territory. Generally, temporary or term life insurance is subject to duty at the rate of 5 per cent of the first year's premium.

Western Australia no longer imposes stamp duty on life insurance policies entered into after 1 July 2004. Policies entered into prior to this date continue to be subject to life insurance duty at the same rate as New South Wales, Queensland, Tasmania, Australian Capital Territory and Northern Territory. However, life insurance riders which are categorised as a separate policy of general insurance will continue to be subject to duty at general insurance rates in Western Australia.

Stamp duty rates – life insurance products

As at March 2010	Life insurance	Term or temporary insurance
NSW, QLD, TAS, ACT, NT	0.10% of sum insured	5% of first year's premium
VIC	0.12% of sum insured	5% of first year's premium
SA	1.5% of premium	1.5% of premium
WA	No duty payable	No duty payable

The lodgement of returns and payment of duty needs to occur:

- New South Wales, Australian Capital Territory, Tasmania and Northern Territory – within 21 days after the end of each month.
- Victoria – within 14 days after the end of each month.
- South Australia – annual licence to be applied for by 31 January of each year. Payment upon application.
- Queensland – within 14 days after the end of each month (or such other period as the Commissioner may determine).

Life insurance riders

A life insurance rider is dutiable in all states and territories. In New South Wales and the Australian Capital Territory, the amount of duty payable on a life insurance rider is five per cent of the first year's premium paid for the rider. In Queensland, a life insurance rider is treated as Class 2 general insurance and duty at the rate of five per cent of the premium (to the extent that the premium paid for the rider is payable).

In Victoria, Western Australia, Tasmania and the Northern Territory, a life insurance rider will be subject to the applicable life insurance rate unless the rider is characterised as a separate policy of general insurance, in which case duty is payable at the general insurance rate applying in the relevant jurisdiction (see table below).

As at March 2010	Class	Rate
VIC, WA, NT	Life Insurance Rider	10% of premium
TAS	Life Insurance Rider	8 % of premium

Some states, such as South Australia, have adopted the view that life insurance riders should be characterised as general insurance. However, the correct interpretation of policies and riders will depend on the terms of the specific insurance contracts. Some states have issued revenue rulings dealing with life insurance riders. These rulings should be considered when determining the current rate of duty payable on life insurance riders.

Life insurance levy

Life Insurance Supervisory Levy Imposition Act 1998

Financial Institutions Supervisory Levies Collection Act 1998

This annual levy is based on a percentage of the value of assets of a life insurance company at a specified date. The unrestricted and restricted levy percentage, the specified date, and the minimum and maximum restricted levy amount for each financial year are determined by the Federal Treasurer (2009/2010: unrestricted levy of 0.001823 per cent of assets; restricted levy of 0.00920 per cent of assets; minimum restricted levy: $470; maximum restricted levy: $910,000).

Health Insurance 3

Introduction

Andrew McPhail

The private health insurance industry continues to face a changing environment post the Global Financial Crisis. While there have been a number of challenges and threats to the operating environment of private health insurers, a number of opportunities have also materialised over the last 12 months.

A number of private health insurers have seized the opportunity to expand their service offerings to their members by expanding into the chronic disease and all encompassing total health management arenas. This expansion has taken many forms including acquiring existing businesses, establishing new businesses and through strategic partnerships. Private health insurers are offering these services as a point of differentiation within the market to attract new and retain existing members with a holistic approach to healthcare for the member.

The main threat to the Australian private health insurance industry is the effect of possible changes in government policy around health care and health delivery. The industry has responded well to previous legislative changes, e.g. the increases to the Medicare Levy Surcharges that commenced in 2009. Most private health insurers did not experience the lapses in membership speculated at the time and have either maintained or increased their membership levels. The industry is closely monitoring the ongoing government debate surrounding the means testing of the private health insurance rebate which has been presented to the Houses of Government twice and defeated on both occasions.

The dynamics of the industry will again be tested as the government, the industry and the community debate the recommendations arising from the National Health and Hospitals Reform Commission's (NHHRC) review into the future of the Australian Health system. The key recommendations affecting private health insurers include:

- The Healthy Australia Accord, which would see Australia move to one overarching health system including primary health care, basic dental, public hospital and aged care funded by the Commonwealth
- Denticare, a proposed national insurance scheme for basic dental care; and
- Medicare Select, a proposed model to open the health system to greater consumer choice and competition with the ultimate aim of achieving high quality and efficient delivery of health care services. Under Medicare Select all Australians would belong to a Government-operated plan, unless they elected to move to another operated by a not-for-profit or private enterprise operator.

In addition to the NHHRC recommendations the Federal government has proposed a new hospital health care funding model which has received in-principle agreement from the majority of States. This new funding model involves the Federal government becoming the primary funding provider for infrastructure and service delivery in exchange for 30% of the States' GST allocation. This legislation is yet to be presented to Parliament for debate.

3.1 Statistics

Top 15 private health insurers

		Ranking Measure:					Performance:					
		Contributions					Membership		Other revenue		Result after tax	
	Entity	Current $m	Current Rank	Prior $m	Prior Rank	% Change	Current '000	Prior '000	Current $m	Prior $m	Current $m	Prior $m
1	Medibank Private Ltd (incl. AHMG)[1]	3,959	1	3,724	1	6%	1,703	1,654	-26	-8	104	197
2	BUPA Australia Health Pty Ltd (incl. MBF)[2]	3,781	2	3,533	3	7%	1,473	1,435	115	23	174	105
3	HCF (incl. MUA)[3]	1,421	3	1,306	4	9%	557	546	-3	36	27	66
4	HBF	854	4	793	5	8%	413	391	-129	-56	-115	-6
5	NIB	829	5	758	6	9%	384	365	19	9	43	25
6	Australian Unity Health Ltd	459	6	455	7	1%	180	184	-4	5	14	30
7	Teachers Federation Health	265	7	242	9	9%	94	90	4	9	10	-9
8	Defence Health Ltd	201	8	180	11	11%	80	75	-3	-4	6	1
9	GMHBA Ltd	191	9	165	12	16%	86	78	3	-3	8	1
10	CBHS Health Fund Ltd	180	10	162	13	11%	67	62	3	4	9	4
11	Westfund Ltd	90	11	83	14	9%	41	39	1	-	3	5
12	Health Partners	87	12	81	15	8%	35	33	-1	5	-2	6
13	Latrobe Health Services Inc	78	13	69	-	14%	35	31	7	8	11	11
14	Queensland Teachers' Union Health Fund Ltd	75	14	71	-	5%	22	21	1	0	3	6
15	Healthguard Health Benefits Fund	72	15	69	-	5%	27	27	-12	-3	-7	1

Financial Position:								Ratios:					
Outstanding claims		Investment securities		Net assets		Total assets		Solvency		Benefits		Net margin	
Current $m	Prior $m	Current $m	Prior $m	Current $m	Prior $m	Current $m	Prior $m	Current %	Prior %	Current %	Prior %	Current %	Prior %
476	428	1,779	2,102	1,642	1,546	2,714	2,607	2.45	3.97	86%	83%	3.3%	5.5%
489	433	1,287	752	1,024	1,725	1,841	2,696	3.29	2.18	85%	84%	2.6%	2.9%
119	123	473	746	641	623	1,001	968	2.11	4.00	86%	86%	2.2%	2.6%
75	74	484	643	396	511	674	761	2.77	3.10	88%	83%	1.7%	6.3%
56	62	164	155	205	269	380	459	2.79	3.63	83%	83%	4.8%	2.9%
41	34	91	122	98	94	268	260	2.21	2.15	84%	79%	8.0%	11.9%
29	33	153	147	118	107	183	176	6.95	4.10	88%	98%	2.3%	-7.4%
24	19	147	114	114	108	166	152	8.88	5.72	89%	91%	4.5%	2.5%
15	12	130	117	91	83	153	140	6.64	5.08	88%	88%	2.5%	2.4%
16	14	93	87	75	67	107	101	8.55	9.84	90%	92%	3.1%	0.3%
7	7	77	74	65	63	87	83	8.10	9.28	86%	82%	1.8%	5.9%
6	4	46	46	49	50	65	64	5.86	6.58	93%	90%	-2.3%	1.8%
7	6	99	89	94	83	113	101	10.26	9.52	85%	84%	5.0%	5.1%
6	5	35	33	56	50	70	63	6.45	7.23	86%	82%	2.9%	8.7%
8	9	50	61	43	49	63	70	5.57	5.33	82%	83%	7.8%	6.7%

Source: The statistics are in respect of registered health benefit organisations as reported in the PHIAC annual statistics as at 30 June 2009 and 30 June 2008.

Notes: Membership is based on the number of policies in force.

Other revenue comprises mainly of investment income.

Benefits ratio is benefits paid as a proportion of contributions.

Where there are more than one entity within the group, a weighted average based on net assets is used to estimate the overall solvency ratio, and a weighted average based on contributions is used to estimate overall net margin.

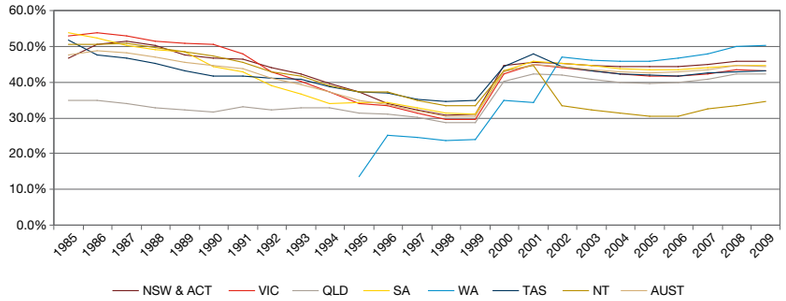
1 Medibank Private acquired Australian Health Management Group on 15 January 2009.

2 BUPA acquired MBF on 16 June 2008.

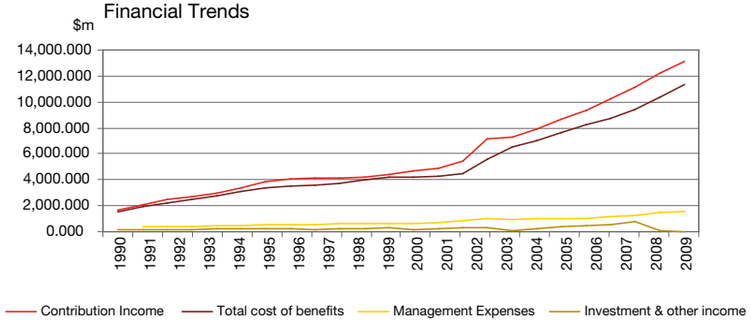
3 HCF acquired Manchester Unity Australia on 24 December 2008.

Health insurance

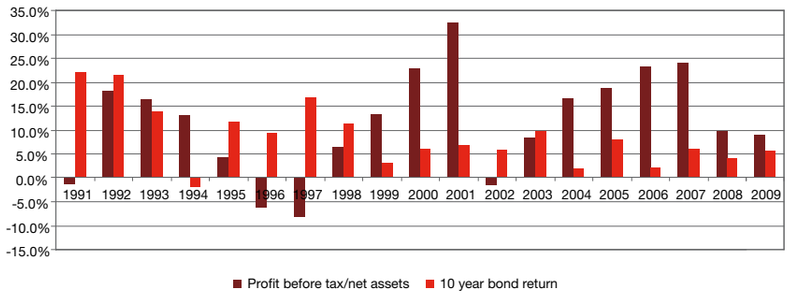
Health Insurance Coverage by State



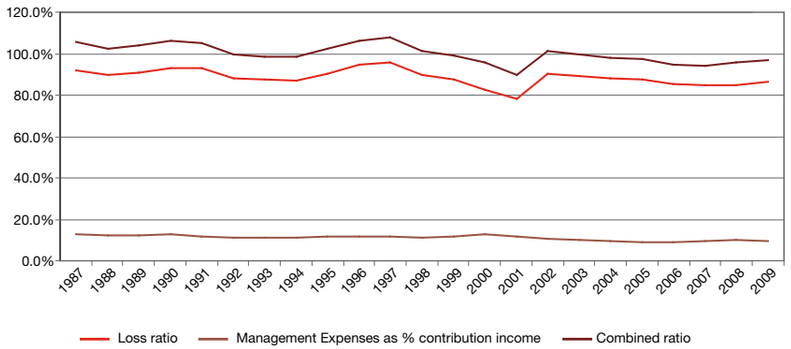
Financial Trends



Comparison of Profitability (%) – Year ended 30 June



Loss and expense ratios – Year ended 30 June



Source: PHIAC, Operators of the registered health benefit organisations, 2008-09

3.2

Key developments

Industry movements

During the year the industry has seen minimal movement amongst its key players. Unlike 2008/09 which saw significant consolidation in the industry there has been no change in the number of registered private health insurers since the merger of Druids Friendly Society Ltd with GMHBA on 1 October 2009. This merger decreased the number of private health insurers operating in Australia from 38 to 37.

Although there was minimal movement in terms of consolidation, the last 18 months has seen an important change in the industry with the emergency of the 'for-profit' model. This change has occurred rapidly and following the Medibank Private Limited (Medibank) conversion to 'for-profit' status sees 71% of the market share (10 open access funds) adopting this model (30 June 2009 42%).

The application by Medibank to become a 'for-profit' health insurer was approved by the Board of Private Health Insurance Administration Council, on 2 July 2009. Medibank became 'for-profit' with effect from 1 October 2009.

Rate and threshold increases

Private health insurance premiums increased by an average of 5.78% on 1 April 2010 (6.02% in April 2009, 4.99% in 2008). Annual rate increases are subject to review and approval by the Minister for Health and Ageing. The date for lodging applications for the 2011 premium will be in the fourth quarter of 2010.

For the 2009/10 taxation year the Medicare Levy Surcharge threshold for singles is $73,000 (2008/09 $70,000) and for couples and families, the threshold is $146,000 (2008/09 $140,000).

Proposals to means test the rebate

In the 2009/10 Budget, the Government proposed to means test the private health insurance rebate. On the 9 September 2009 the Senate voted against the Fairer Private Health Insurance Incentives Bill 2009 and then the proposals were voted against for a second time on the 9 March 2010. The Government is currently considering its options regard means testing.

Prudential standards

The implementation of the Private Health Insurance Act 2007 gave the Private Health Insurance Administration Council (PHIAC) a wider range of powers to devise mandatory prudential standards. Work on a range of prudential standards has now commenced and the first to be issued was a new governance standard which commenced on 1 January 2010. PHIAC's objectives in relation to governance are to ensure that insurers are managed in a sound and prudent manner by a competent board of directors which is capable of making reasonable and impartial business judgements in the best interest of the insurer and which gives due consideration to the impact of its decisions on policyholders.

National Health and Hospital Reform Commission report

A proposed national health reform agenda has been set out in the final report of the National Health and Hospital Reform Commission released in July 2009. In total the report contained 123 recommendations including options for reforming the structure of the Australian health system. One of the most far-reaching suggestions is to replace the current Medicare system with a new Medicare Select scheme. This proposal would involve all Australians becoming enrolled in a government funded health care plan, but with the option of moving to an individual (private) 'plan'. There is a two year consultation period in respect of the recommendations, subject to the outcome of the Federal Government's proposed health care funding model with the States.

3.3

Regulation and supervision

Private Health Insurance Administration Council

The private health insurance industry is regulated by the Australian Government Department of Health and Ageing (DoHA) in conjunction with its private health insurance portfolio agency the Private Health Insurance Administration Council (PHIAC). The DoHA sets down private health insurance policy in addition to fulfilling other functions such as managing the annual rate review process.

PHIAC is an independent statutory authority which was established as a body corporate under section 82B of the National Health Act 1953. The Private Health Insurance Act 2007, (the Act), came into effect from 1 April 2007. PHIAC operates by force of section 264-1 of the Act.

Section 264-5 of the Act sets out PHIAC's broad objectives which are to:

- foster an efficient and competitive health insurance industry;
- protect the interests of consumers; and
- ensure the prudential safety of individual private health insurers.

PHIAC's main functions are the monitoring and regulation of the private health insurance industry and the provision of private health insurance related information to the Government and other stakeholders.

As at 31 December 2009 PHIAC was supervising 37 private health insurers, which provide private hospital treatment insurance coverage for 45 per cent of the Australian population.

PHIAC administers the Private Health Insurance Risk Equalisation Trust Fund on behalf of the Australian Government, collects and publishes industry statistics and monitors the solvency and capital adequacy of private health insurers. All health insurance funds must provide PHIAC with returns prepared in accordance with the guidelines set out in PHIAC circulars. The guidelines state that the accounts and returns should comply with Australian Accounting Standards.

PHIAC and APRA have signed a memorandum of understanding (MOU) setting out a framework for co-operation in areas of common interest. The MOU recognises the importance of close co-ordination and co-operation between the two organisations. In particular, it provides for exchange of relevant information and liaison on issues of joint interest.

New PHIAC reporting requirements

At the start of 2009 PHIAC introduced a new return, the PHIAC M return, it was required to be completed by private health insurers from February 2009 on a monthly basis until further notice. The return provided statistical data relating to movements in claims and membership numbers. It was introduced as a precautionary measure in response to the current economic crisis and was designed to provide PHIAC with current data in relation to two leading indicators of potential prudential risk in the private health insurance industry. On the 15 December 2009 PHIAC announced that with immediate effect it had decided to discontinue the PHIAC M collection.

PHIAC has introduced a reporting extension in relation to ACT data reported within the PHIAC 1 returns commencing with the December 2009 quarterly return. Previously the NSW return contained data for NSW and ACT, now an additional return is required for the ACT data.

Authorised private health insurers are now subject to a Governance Standard which is detailed under Schedule 1 of the Private Health Insurance (Insurer Obligations) Rules 2009. The Governance Standard commenced 1 January 2010. The Standard is an industry wide standard which has been developed following much industry consultation and assessment. The standard is aimed at aligning the approach to governance in the private health insurance industry with that of the general insurance industry and is designed to ensure that practices across the industry are reflective of domestically and internationally accepted practices.

The standards will be reviewed after 24 months of operation and again after five years, to ensure they continue to reflect good practice and remain relevant and effective.

Authorisation

The health insurance regulatory environment witnessed a period of activity following on from the enactment of the Private Health Insurance Act 2007 (the Act). All existing private health insurers were required to re-register in line with the Act so as to maintain their registration status after 1 July 2008.

An organisation may not carry on a health insurance business unless it is registered under Part 4-3 of the Act.

The Private Health Insurance Legislation Amendment Act 2008 (the Amendment Act) commenced on 25 June 2008. The Amendment Act introduced the requirement that future applicants for registration as a private health insurer must be a company within the meaning of the Corporations Act 2001, whereas previously applicants could be a company or a registered body within the meaning of the Corporations Act 2001. In conjunction with this requirement, all existing private health insurers that are registered bodies were required to become companies within the meaning of the Corporations Act 2001 before 1 January 2010.

PHIAC has the power, on application, to register companies as private health insurers. PHIAC will take into account the ability of the applicant to comply with the obligations imposed by the Act. Registration is granted by PHIAC subject to terms and conditions as it sees fit.

Appointed Actuaries

All private health insurers are required to have an actuary appointed by the insurer. Under section 160-30 of the Act the appointed actuary is obliged to report both to the insurer and PHIAC. Schedule 2 of the Private Health Insurance (Insurers Obligations) Rules 2009 specifies the duties of the appointed actuary and defines the notifiable circumstances of which private health insurers are obliged to keep the appointed actuary informed.

Supervision and Compliance

In addition to monitoring the financial and statistical reports from private health insurers, PHIAC's functions are:

- to administer the Risk Equalisation Trust Fund;
- to administer the registration of private health insurers;
- to oversee information collection, compliance, enforcement, public information, agency cooperation; and
- to advise the Minister about the financial operations and affairs of private health insurers.

PHIAC supervisory objectives are met in the following ways:

- reviewing compliance with solvency and capital adequacy standards;
- examining from time to time the financial affairs of the private health insurers;
- reviewing the value of assets and liabilities of each health benefit fund by carrying out independent actuarial assessments;
- the collection and review of audited financial and other returns so that PHIAC can monitor the financial position of individual private health insurers and its ability to meet their outstanding claims as they fall due; and
- the collection of signed statements and declarations from the private health insurers and their approved auditors that provide PHIAC with assurance that systems and procedures to meet regulatory requirements are in place, are adequate and have been independently tested.

Medicare Levy Surcharge

The Medicare Levy Surcharge is levied on Australian taxpayers who do not have private hospital cover and who earn above a certain income. The surcharge aims to encourage individuals to take out private hospital cover, and where possible, to use the private system to reduce the demand on the public system. The surcharge is calculated at the rate of 1% of taxable income when taxable income exceeds set thresholds. The thresholds are subject to an annual adjustment to reflect the changes in average earnings. For the 2009/10 taxation year the Medicare Levy Surcharge threshold for singles is $73,000 (2008/09 $70,000) and for couples and families, the threshold is $146,000 (2008/09 $140,000).

3.4 Solvency and capital adequacy

Authorised health insurers are subject to solvency and capital adequacy tests under Schedule 2 and 3 of the Private Health Insurance (Health Benefits Fund Administration) Rules 2007. These tests were legislated under Divisions 140 and 143 of the Act.

Revised standards for capital adequacy and solvency were issued as part of the Private Health Insurance (Health Benefits Fund Administration) Rules 2007 and reflect changes in the legislative environment through the introduction of the Private Health Insurance Act 2007. PHIAC is currently undertaking a review process of the standards. Implementation of the revised standards which incorporate changes arising from the review is anticipated at this stage to take effect early 2010.

The standards place rigorous reporting requirement on funds. They need to demonstrate the soundness of their financial position, considering both their existing balance sheet position and the profitability of future business.

The Act specifies a two-tier capital requirement for health benefits funds, with each tier considering the capital requirements of a different set of circumstances.

The Solvency Standard is a short-term test that prescribes the minimum capital requirements of a health benefits fund to ensure that under a wide range of circumstances it would be in a position to meet its obligations to members and creditors.

The solvency standard is essentially based on a “run-off” view of the fund. The health benefits fund must demonstrate that it can reliably meet its accrued liabilities and obligations in the event of a wind-up. It should be noted that there is a difference between meeting the solvency standard and being solvent in terms of the Corporations Act 2001. A fund meeting the solvency standard is required to hold reserves to meet its obligations to members and staff, such that it should be in a position to avoid insolvency as defined under the Corporations Act 2001.

The Capital Adequacy Standard is a medium-term test that prescribes the capital requirement of a health benefits fund to ensure that its obligations to, and reasonable expectations of, contributors and creditors can be met under a range of adverse circumstances. The capital adequacy requirement is thus based on an ongoing view that requires a fund to show that it has sufficient capital to implement its business plans, accept new business, absorb short-term adverse events from time to time and remain solvent.

The solvency and capital adequacy standards are based on the concepts of liability risk, asset risk and other risks.

3.5 Management of risk and reinsurance

Liability risk

The liability risk can be considered as the amount required to meet existing liabilities (solvency and capital adequacy standard) plus an amount to meet the liability associated with continuing to write business (capital adequacy standard). The amount required to meet existing liabilities is set as the sum of the:

- Net claims liability;
- Risk equalisation accrued liability; and
- Other liabilities.

The net claims liability is outstanding claims net of risk equalisation on outstanding claims and the liability in respect of unexpired risk (determined as the premiums paid in advance multiplied by a specified loss ratio). Each item includes a margin and includes associated claims handling expenses. The margin is prescribed at 10 per cent for the solvency calculation, while the capital adequacy margin is determined by the board of directors of each private health insurer (subject to a prescribed minimum of 12.5 per cent) based on a qualitative risk assessment of the health insurer’s membership base and the volatility of claims. For both the solvency and capital adequacy standards, the net claims liability should not be less than the liability reported in the entity’s financial statements.

The risk equalisation accrued liability is the amount due/payable from the risk equalisation trust fund in the coming period in respect of members covered and benefits paid from prior periods. The liability is thus the risk equalisation levy for members covered in the preceding quarter, less benefit payments that can be recovered from the risk equalisation trust fund. A margin is added to the risk equalisation levy (currently 10 per cent).

The capital adequacy standard is also concerned with the additional capital required to continue to cover members’ future benefits (referred to as the renewal options reserve) and to fund business plans (referred to as the business funding reserve).

The renewal options reserve takes into account the risks and potential costs associated with providing members with the right to renew membership. The reserve is based on a best-estimate projection of the net earned contribution income less incurred payments and costs, with suitable conservative margins added to the cash outflows in the projection.

The business funding reserve is intended to ensure capital adequacy over the projected period. It requires an insurer to hold sufficient reserves to meet the demands of any planned increase in membership and of other business development strategies.

Asset risk

The asset risk is the risk to the value of assets supporting the liabilities. Asset risk can be considered in two parts:

- Inadmissible assets; and
- Resilience reserve.

Inadmissible assets include assets in associated entities and risks from asset contagion, asset concentration and general asset credit or liquidity.

The factors considered in calculating the inadmissible asset reserve are as follows:

- A reserve must be maintained if the value of a business' assets in a run-off situation is less than the value of the assets in an ongoing situation;
- If the health insurer has investments in an associate or subsidiary that is prudentially regulated, a reserve must be maintained that represents the prudentially regulated capital within the value of the associate or subsidiary in the financial statements of the health insurer; and
- A reserve is required to be held against the adverse impact of concentration of investments in a particular asset with a particular counterparty or related party.

The capital adequacy standard prescribes certain limits and weightings depending on the asset type. The resilience reserve is based on an assessment of the health insurer's ability to sustain shocks that are likely to result in adverse movements in the value of its assets relative to its liabilities. The reserve is calculated with reference to the admissible assets of the health insurer and by applying a calculated diversification factor (based on each health insurer's asset exposure) to a prescribed movement in returns per investment class.

The resilience reserve is intended to provide protection against adverse movement in the value of assets. The reserve considers the fall in value of assets by the investment sector under adverse conditions, assuming greater adversity in the capital adequacy test. An offset is allowed for diversification of assets.

Other risks

In addition, the standards require an allowance for management capital and, in the solvency test, for an expense reserve. The management capital reserve is designed to ensure that private health insurers maintain a minimum dollar level of capital. In practice, this test applies only to small private health insurers. The expense reserve, in the run-off test, allows for unavoidable expenses expected to be incurred as a health insurer adjusts to a run-off status. The solvency standard calculates the expense reserve as 40 per cent of total non-claim expenses.

Investment Policy

There is no restriction on investments that may be held by health insurer's. However, in calculating the solvency requirement and the capital adequacy requirement under the respective standards, the level of capital required varies with the risk profile of the investment portfolio. This is addressed through the calculation of an inadmissible assets reserve and a resilience reserve.

Community rating principle and risk equalisation

Private health insurers do not typically carry reinsurance. However, private health insurers participate in the risk equalisation arrangements administered by the Private Health Insurance Administration Council (PHIAC).

The principle of community rating prevents private health insurers from discriminating between people on the basis of their health status, age, race, sex, sexuality, the frequency that a person needs treatment, or claims history. The risk equalisation arrangements scheme supports the principle of community rating as it averages the cost of hospital treatment across the industry. The scheme transfers money from private health insurers with younger healthier members with lower average benefits payments to those private health insurers with older and less healthy membership profiles and which therefore have higher average benefits payments. This redistributes the burden of high cost claims across the industry to avoid the financial strain of the costs being borne by individual private health insurers.

The redistribution is calculated based on the average benefit paid by Australian private health insurers (per State) to customers in their aged-based pool (over 55 years old) and the high costs claimants pool (claims exceeding $50,000 each). The arrangements operate by private health insurers paying / receiving a levy into / from the Health Benefits Risk Equalisation Trust Fund. Private health insurers prepare and submit membership and benefit data to PHIAC on a quarterly basis through the PHIAC 1 returns. Effectively, a health insurer that paid more risk equalised benefits than the state average will have an amount receivable from the Risk Equalisation Trust Fund, whereas a health insurer that paid less will have an amount payable to Risk Equalisation Trust Fund.

3.6 Financial reporting

Private health insurers are required to prepare financial statements that comply with Australian Accounting Standards, in particular AASB 1023 General Insurance Contracts. The key principles and disclosure requirements of AASB 1023 are set out in the General Insurance section of this publication.

The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) are planning to issue an exposure draft in mid-2010 that will propose potentially significant changes to the accounting for insurance contracts. Whilst the IASB has tentatively agreed to an approach that will look familiar to the Australian general insurance industry, there are some key issues that could have wide ranging impacts. Refer to Financial Reporting Update section for further details.

In order to ensure a consistent approach to interpreting the requirements of AASB 1023, the Australian Health Insurance Association (AHIA) has developed guidance notes to assist private health insurers in applying AASB 1023.

Discussion of the key requirements of AASB 1023 can be found in Chapter 1 of this publication. Supplementing this, the key issues addressed by the AHIA guidance notes are summarised below.

Assessment of insurance risk

AASB 1023 applies to "general insurance contracts" defined as a contract under which one party (the insurer) accepts significant insurance risk from another party. Private health insurers may issue contracts that do not transfer "significant insurance risk" within the meaning of AASB 1023. For example, the benefits under certain products may be restricted to the extent that claims payments are not variable enough for the PHI to have demonstrated the transfer of significant risk.

If no significant insurance risk is transferred, AASB 1023 will not apply and private health insurers would instead apply AASB 139 Financial Instruments: Recognition and Measurement to the contract to the extent that the contract gives rise to financial assets or financial liabilities. To the extent that the contract is a service contract, revenues and expenses under the contract should be treated under AASB 118 Revenue.

Premium revenue

Under AASB 1023, premium revenue is recognised from the date on which the insurer accepts insurance risk ("attachment date") over the period of the contract in accordance with the pattern of the incidence of risk expected.

Unlike most other forms of insurance contract, a health insurance contract does not typically stipulate a fixed period of cover as contracts typically require payment in advance and include an option for the policyholder to renew. In practice, private health insurers recognise premiums from the date cash is received over the period covered by the payment. It should be noted that private health insurers are legally obliged to continue cover (but not pay benefits for the period in arrears) for 63 days if a policyholder's premiums are in arrears. Private health insurers will therefore need to consider past experience to determine whether it is appropriate to accrue for premiums in arrears.

With regard to the liability adequacy test (LAT) required by AASB 1023 the unearned element of premiums in arrears and the expected claims relating to that business should be considered.

Measurement of outstanding claims

Matters of particular importance to private health insurers are set out below.

Central estimates

A central estimate of claims incurred is the mean of all possible values of outstanding claims liabilities as at the reporting date. The central estimate, therefore, has a 50 per cent probability of adequacy (i.e. there is a 50 per cent chance that the central estimate will be adequate to meet all future claims payments).

Risk margin

AASB 1023 requires that the outstanding claims liability includes a risk margin to reflect the inherent uncertainty in the central estimate of the present value of the expected future payments. It does not specifically prescribe a fixed risk margin or probability of adequacy. The risk margin for a given level of probability of adequacy will be specific to each insurer, taking into account the variability of claims processing, the availability of claims data and the features of the claims being provided for at the reporting date.

Regulatory valuations

The solvency requirements for private health insurers are set by PHIAC and are set out in schedule 2 of the Private Health Insurance (Health Benefits Fund Administrations) Rules 2007. Under this standard the starting point for valuing liabilities is the value shown in the financial statements. This valuation is then adjusted for "solvency risks" being the risks relating to assumptions used valuing liabilities.

Discounting

AASB 1023 requires the liability for outstanding claims to be discounted to reflect the time value of money. As health insurance claims are generally settled within one year, private health insurers may be able to demonstrate that no discounting of claims is required as the difference between the future and present value of claims payments is not material.

Deferred acquisition costs

When acquisition costs meet certain criteria they must be deferred, recognised as assets and amortised systematically. Private health insurers need to establish procedures to identify relevant costs to be deferred.

Unearned premium

Typically private health insurers have referred to the unearned premium liability as "contributions in advance". These are determined in accordance with AASB 1023.

Liability adequacy test

AASB 1023 requires a liability adequacy test to be performed by the PHI at the level of a portfolio of contracts that are subject to broadly similar risks and are managed together as a single portfolio. The AHIA guidance note suggests that private health insurers should dissect portfolios into at least two classes of business: hospital and ancillary. A private health insurer may determine further disaggregation of portfolios depending on its particular portfolio of products. The liability adequacy test typically incorporates an analysis based on the unearned premiums at reporting date and the constructive obligation in relation to projected premiums up to the subsequent 1 April rate review.

Annual accounts

Audited annual Corporations Act financial statements must be lodged with ASIC in line with the requirements of the Corporations Act, i.e. within three months for a disclosing entity and four months for a non-disclosing entity. Private health insurers are required to lodge annual audited financial statements with PHIAC by 30 September each year (approximately).

Other returns

All private health insurers must provide a number of other returns under various legislative requirements.

PHIAC 1 Returns – Quarterly state and territory-based returns must be prepared for all states under the Private Health Insurance Act 2007. The returns must be prepared in accordance with the guidelines established in PHIAC circulars. Each quarterly return is audited by the health insurer's external auditor at the end of the financial year.

PHIAC 2 Returns – This is the main reporting requirement under the solvency and capital adequacy standards. Quarterly unaudited returns are lodged with PHIAC and the annual return is audited by the health insurer's external auditor. The annual return includes an unaudited certification by directors in relation to the capital adequacy margin, loss ratio and risk management procedures.

PHIAC 3 Returns – These quarterly returns contain prostheses reports and are not required to be audited.

PHIAC 4 Returns – Specialty gap cover data is required to be provided quarterly to PHIAC. The totals reported on this quarterly PHIAC 4 medical gap report should be consistent with data reported in the quarterly PHIAC 1 return. The returns are not required to be audited.

Rebate Returns – Private health insurers are required to lodge a monthly application for the rebate with Medicare Australia in line with the requirements of section 26-10 of the Private Health Insurance Act 2007 in order to receive the rebate.

Second Tier Benefits Returns – The Private Health Insurance (Benefits Requirements) Rules 2008 (No 2) were registered in February 2009. Under schedule 5 of these requirements, if a health facility is accredited with a Commonwealth provider number and it does not have Hospital Purchaser Provider Agreements (HPPA) or a similar agreement with a particular health insurer, it may approach the health insurer for its second tier benefits rates. The private health insurers are required to calculate 85 per cent of the average HPPA rates, effective at 1 August, for procedures that are included in the majority of their HPPAs. The audited second tier benefits return must be lodged with both the Department of Health and Ageing and PHIAC by 30 September each year.

Key dates

Private Health Insurance Administration Council

Lodgement of returns

- Unaudited quarterly PHIAC 1 and 2 returns
  Within four weeks after the end of the quarter to which it relates.
- Annual audited quarterly PHIAC 1 returns
  All four quarters returns within 3 months of the end of the financial year or such time as approved by the Commissioner.
- Annual audited PHIAC 2 return and a statement by the directors in relation to the capital adequacy margin, loss ratio and risk management procedures
  Within 3 months of the end of the financial year or such time as approved by the Commissioner.
- Quarterly unaudited PHIAC 3 prostheses returns
  Within 28 days of the quarter end.
- Quarterly unaudited PHIAC 4 medical gap returns
  Within 28 days of the quarter end.
- Annual audited financial statements of health insurer
  By 30 September each year (approximately).
- Annual audited financial statements of the legal entity of which the health insurer is part, if these are available to members
  By 30 September each year (approximately).
- Unaudited financial condition report
  By 30 September each year (approximately).

Risk Equalisation Trust Fund

- Letters advising of the distributions to/from the fund are sent out quarterly following the processing of PHIAC 1 returns
  Approximately eight weeks from each quarter end.

Annual levy

- Annual levy is based on health insurer membership numbers
  Payment is due quarterly, within two weeks of the request for payment.

Medicare Australia

Lodgement of returns

- Audited annual statement of 30% rebate receipts
  Within three weeks from the end of the year (approximately).

Federal Department of Health and Ageing

Lodgement of returns

- Audited Second-Tier Benefits Rates
  By 30 September each year (where applicable).

3.7 Taxation

General developments

The Government has continued with ambitious plans for significant tax reform. The comprehensive review of Australia's tax system, otherwise known as the Henry Review has been completed and the final report released to the public on 2 May 2010 together with the Government's response. Despite the 138 recommendations in the Henry Report, the Government has only made a handful of announcements, although there may be further announcements in the May budget.

The Government proposes to reduce the company income tax rate from 30 per cent to 29 per cent for the 2013-2014 income year and to 28 per cent from the 2014-2015 income year and introduce certain changes to the superannuation system including a staged increase in the Superannuation Guarantee payment from 9 per cent to 12 per cent. These initiatives are to a large extent funded by the Resource Super Profits Tax of 40 per cent.

One of the insurance specific recommendations in the Henry Report is the abolition of specific taxes on insurance products, including stamp duties and fire service levies, which is consistent with the recommendations in the "Australia as a Financial Centre: Building on our Strengths" report released by the Australian Financial Centre Forum. The Government has not ruled out this recommendation, although any changes will need agreement from the State Governments.

Some other key tax developments during the year are listed below.

- The new Taxation of Financial Arrangements (TOFA) measures which provide a comprehensive regime for the tax treatment of gains and losses arising from financial arrangements have been legislated. The TOFA measures will apply to eligible taxpayers for the income year beginning on or after 1 July 2010 unless the taxpayer chooses to have the rules apply for income years beginning on or after 1 July 2009 (i.e. the "early adopt" election). Taxpayers have a choice as to how TOFA will apply to their financial arrangements.
- New tax consolidation measures were introduced into Parliament on 10 February 2010. One of the significant changes proposed is clarification of the income tax treatment of rights to future income.
- The Federal Government has proposed a reform of Australia's foreign source income anti-tax deferral (attribution) rules. The proposal includes a rewrite of the Controlled Foreign Companies (CFC) rules and the repeal of the Foreign Investment Fund (FIF) rules. The FIF rules will be replaced with a specific, narrowly defined anti-avoidance rule that applies to offshore accumulation or roll-up funds.
- The new International Dealings Schedule - Financial Services 2010 (the IDS-FS 2010) was released by the ATO. The IDS-FS 2010 is the ATO's newly proposed tax return schedule for large (> $250m turnover) financial services taxpayers to replace the Schedule 25A and Thin Capitalisation Schedule and provide additional information in relation to financial arrangements. For the 2010 income year the IDS-FS is optional. However, the IDS-FS will be mandatory for affected taxpayers for the 2011 year.
- During 2009 (subsequent to the release of last year's "Insurance Facts and Figures Publication"), the Australian Government announced its support for 41 of 46 recommendations that were made by the Board of Taxation in relation to its review of the Administration of the GST System. Generally these changes are aimed at reducing the administrative burden of complying with the GST legislation and represent the most significant package of GST reform in 10 years.

While many supported recommendations were identified as applying from 1 July 2010, the legislative process has only started for some of the recommendations with either Exposure Drafts or Bills being introduced and debated in Parliament during 2010. We expect some but not all of the current proposed changes to be passed by parliament prior to 1 July 2010 with the effective date of the changes ranging from 1 July 2000 to 1 July 2010 (that is, some changes are likely to apply retrospectively). Many of the changes have general application to business taxpayers and it is important for each organisation to consider the impact of each of the proposed or finalised changes.

Taxation of health insurers

An organisation which is a registered health benefits organisation for the purposes of the Private Health Insurance Act 2007, and which is not in business for the purposes of profit or gain for its individual members, is exempt from income tax. The fact that a health fund may offer rebates and/or discounts to members has not been construed as the distribution of profits or gains to members. Accordingly, the scope of this exemption will depend generally on the type of activities carried out by the organisation insofar as they do not disqualify it from registration under the Act. Registered health benefit organisations that operate for the purposes of profit or gain are taxed like normal corporates. Although Division 321 of the Income Tax Assessment Act 1936 (taxation of general insurers) does not apply to health insurers, taxable health insurers generally apply broadly equivalent principles to Division 321.

Goods and Services Tax

Under the Australian GST legislation, some classes of insurance are treated differently, leading to different implications for insurers and insured parties.

In relation to Health Insurance, special provisions result in most forms of health insurance to be treated as GST free (known as "zero-rated supplies" in other jurisdictions). This means that health insurers are not required to account for GST on premium income derived from their businesses. In addition, special rules relate to the expenses incurred by GST-free Health Insurers such that they are only entitled to recover input tax credits on the expenses incurred running the business and managing claims. No entitlement to input tax credits will arise for expenses incurred in settling a claim under an insurance policy which is GST-free.

Where an insurance policy may be treated as either GST-free, taxable or input taxed, the GST-free treatment will prevail.

In relation to the investment activities of an insurance entity, it is important to consider if the Financial Acqusitions Threshold test in the GST law applies and if so whether or not the threshold has been exceeded by the insurer due to the quantum of expenses incurred in relation to their investing activities.

Investment activities

Investment activities are input taxed in many cases as they are classified as financial supplies for GST purposes.

The effect of this is that, while GST will not be payable on the supplies made, not all of the GST incurred as part of the price paid for expenses associated with investment activities will be recoverable unless one of the following exceptions applies:

- The expense relates directly to the purchase or sale of securities or other investments in an overseas market.
- The expenses incurred by the insurer for the purpose of making input taxed financial supplies do not exceed the "financial acquisitions threshold" (which is a "de minimus" test to ensure that entities that do not usually make financial supplies are not denied input tax credits on making financial supplies that are not a significant part of their principal commercial activities).
- The financial supply is a borrowing and the borrowing relates to supplies which are not input taxed.

Where the above exceptions apply, the insurer retains the entitlement to fully recover the GST incurred on related costs. However, where the exceptions do not apply, the insurer will have to use an appropriate apportionment methodology to determine the extent to which it is entitled to recover GST incurred on general costs.

It should be noted that where acquisitions made by an insurer for the purpose of its investment activities are "reduced credit acquisitions", the insurer is entitled to claim a reduced input tax credit equal to 75 percent of the GST included in the price of the expense.

Stamp duty

Health insurance policies are exempt from stamp duty in all Australian states and territories provided the policies are issued by an organisation registered under Chapter 4 of the Private Health Insurance Act 2007 or a "private health insurer" (as defined in the Private Health Insurance Act 2007 (Commonwealth) Schedule 1 for the Western Australian duty legislation).

Insurance Brokers 4

Introduction

Billy Bennett

Insurance brokers play a vital role for both the policyholder and the insurer in the purchase of insurance and risk products. In Australia, insurance brokers are responsible for placing around half of the total insurance business every year. However, in recent years, due to various technological and competitive pressures, the offerings of the broker have expanded into various other services such as risk management, claims management, loss control, and due diligence audits. Arguably to maintain their competitive edge, the role of the broker has moved from a mere proponent of insurance to that of a value-added business partner for insurers and the insured.

The insurance broking industry has continued its trend of consolidation, this being an inherent part of the competitive environment in the broking industry due to demanding and often costly market conditions. This has made it difficult for the smaller broking firms to maintain infrastructure such as technology, systems and talented human resources that are essential to maintain competitive advantage and meet regulatory and operational commitments.

In the wake of the global financial crisis, albeit less severe in Australia than the rest of the world, insurance brokers are dealing with pressure on fees and commissions due to cost pressure of the clients they serve.

Further, the industry is also challenged with socio-economic factors – the shift in consumer behaviour being a key dynamic. The trend towards consumers increasingly using the internet for research and the purchase of insurance; and the impact of telemarketing and contact centres set up directly by insurers have taken its toll on the insurance broker. The brokers who recognise the opportunities to leverage from changing customer needs will be the winners as we head into the second decade of the 21st century.

4.1 Key developments

Market trends

The weak economic environment has led to some hardening of general insurance prices for personal lines. Increasing claims costs are eroding insurer's reserves and have resulted in increased prices to maintain capital positions. However, commercial lines have not seen the same level of increase in rates and as a result insurance brokers have not seen any significant change in revenues.

Business volumes remain depressed as the contraction in business activity reduced demand for commercial insurance lines and weak consumer confidence has led to slightly reduced demand for personal insurance lines.

APRA data collection requirements

On 14 December 2009, Corporations Amendment Regulations 2009 (No. 11) was passed requiring intermediaries who are AFS licensees and who deal with an APRA licensed general insurer, Lloyd's underwriter, or an unauthorised foreign insurer, to submit certain data to APRA. The data is in a prescribed form, Form 701, and is to be submitted in respect of premiums invoiced for from 1 May 2010.

4.2 Regulation and supervision

Australian Securities and Investment Commission

ASIC is the single Commonwealth regulator responsible for market integrity and consumer protection functions across the financial system. Its responsibilities include:

- Enforcement and effective administration of the Corporations Act;
- Ensuring market integrity and consumer protection in connection with life and general insurance and superannuation products, including the licensing of financial service providers; and
- Protection of retail investors and consumers in the financial services sector.

The Corporations Act requires brokers to either hold an Australian Financial Services Licence (AFSL) or become an authorised representative of a separate licensee. Except under limited circumstances, no person or company may carry on an insurance broking business or act as an agent of a foreign insurer unless they hold an AFSL under the Corporations Act or become a representative of a separate licensee.

Australian Financial Services Licence

The Corporations Act requires all sellers of insurance products to retail clients, including registered insurers and brokers, to obtain an AFSL.

To obtain a licence, the applicant must meet the obligations under Section 912A and demonstrate that they will provide financial services efficiently, honestly and fairly. The general obligations relate to the insurance brokers' responsibilities in the areas of compliance, internal systems, people and resources. Specific provisions under the Corporations Act require that financial services licensees have in place the following:

- Arrangements for managing conflicts of interest;
- Compliance with conditions on the licence and with financial services laws;
- Adequate resources (financial, technological and human) to provide services covered by the licence. These requirements do not apply to APRA-regulated entities (such as registered insurers), but do apply to any non-APRA-regulated subsidiaries;

- Adequate risk management systems. These requirements do not apply to APRA-regulated entities, but do apply to any non-APRA-regulated subsidiaries;
- Adequate compliance framework (AS3806, the Australian Standard on Compliance Programs, acts as a guide to minimum requirements);
- Internal and external dispute resolution procedures (where dealing with retail clients); and
- To ensure that the competencies of representatives to provide the financial services (as specified on the licence) are maintained and that the representatives are adequately trained to provide those financial services.

Once ASIC has granted an AFSL pursuant to Section 913B of the Corporations Act, any variations to authorisations and conditions of the licence can be made electronically via the ASIC website. Financial and reporting obligations under the AFSL may vary depending on the licensee's circumstances and whether additional requirements are imposed by ASIC.

Renewal of registration

Holders of an AFSL are subject to ongoing financial requirements which are described in ASIC RG 166.

These requirements include:

- **Positive net assets and solvency** – All AFSL holders must be solvent at all times and have a continuous obligation to monitor their solvency.
- **Rolling three-month cash projections** – There are a number of methods available for performing the projections, the most common are:
  - **Option 1** – Reasonable estimate projection plus cash contingency requires licensees to have access to cash to meet any shortfalls in the projected period; or
  - **Option 2** – Contingency-based projection requires licensees to demonstrate that sufficient cash is available to meet commercial contingencies that could impact cash flow.

ASIC has provided additional options for subsidiary entities in consolidated groups to meet their cash needs projections by using the cash flows of their parent entity. This alternative can only be adopted where the subsidiary is able to demonstrate that it has an enforceable commitment from its parent entity to meet its liabilities or reasonably expects that it can draw upon the cash resources of other members of the consolidated group to meet its obligations. Licensees should refer to ASIC Information Release IR 03-44 for further information on this option.

All AFSL holders must have systems to manage risk which includes risk to financial resources. The risk management framework required will depend on the nature, scale and complexity of the business.

Licence holders are required to meet ongoing notification obligations, which include requirements to notify ASIC about:

- Breaches and events;
- Changes in particulars (form F205 for change of name of corporate entities, form FS20 for all others);
- Authorised representatives (forms FS30, FS31, FS32);
- Financial statements and audit (forms FS70 and FS71); and
- Appointment/removal of auditor (forms FS06, FS07, FS08 and FS09).

Section 989B of the Corporations Act also outlines ongoing financial reporting and audit obligations. A licensee is required to prepare and lodge an audited profit and loss statement and a balance sheet within four months of the end of its financial year for non-disclosing entities and within three months of the end of its financial year for disclosing entities.

ASIC has released Class Order 06/68 which grants relief to local branches of foreign licensees from preparing and lodging accounts in accordance with Section 989B of the Corporations Act. This relief is only available where the foreign licensee lodges accounts, prepared and audited in accordance with the requirements of its local financial reporting jurisdiction with ASIC once every calendar year.

Other regulations and related matters

Since 2008, under the Corporations Act, insurance brokers and authorised representatives are prohibited from dealing in general insurance products unless they are from an authorised insurer, a Lloyd's underwriter or if an exemption applied. This is applicable for all insurance brokers holding an AFSL – requirements for which are monitored by ASIC. Under the new regulation, insurance brokers are required to maintain records of business placed with direct offshore foreign insurers (DOFIs) and report their dealings on a regular basis to ASIC.

Insurance brokers are subject to the Anti-Money Laundering and Counter-Terrorism Financing Act (AML/CTF Act). Under the AML/CTF Act, the impact on insurance brokers (if providing a 'designated service'), is meeting their statutory obligations in relation to customer verification, customer due diligence and compliance reporting requirements. For insurance brokers the Act does not consider the advising and placement of general and life insurance as a designated service. Brokers that provide premium funding services and brokers that hold an AFSL and are involved in a client receiving a 'designated service' may be affected.

The Life Insurance Code of Practice governs relationships between life insurance companies, intermediaries and consumers. The Code sets minimum standards for sales practices and the employment of life insurance intermediaries, oversight by life insurance companies and life brokers of the conduct of their staff and agents, and dispute resolution arrangements.

The General Insurance Brokers' Code of Practice which is part of a national self-regulatory scheme, and sets out the responsibilities of participating insurance brokers also requires brokers to establish an internal process for resolving disputes with the insured. Any breach of the Code may give rise to binding orders or sanctions being imposed on the insurance broker. The Insurance Brokers' Compliance Council monitors the Code.

The Insurance Brokers Dispute Facility is a national scheme designed to quickly resolve disputes between insurance brokers and their clients. The facility handles general insurance matters up to $10,000 and life insurance matters up to $50,000. The Insurance Brokers Compliance Council oversees the facility and consists of government, broking and consumer bodies.

In addition to annual financial reporting requirements, under Section 912E of the Corporations Act, ASIC can undertake surveillance checks of AFS licence holders. ASIC has the power to vary licence conditions, as well as issue banning orders that prohibit a person from providing financial services.

4.3 Solvency and capital adequacy

The minimum solvency requirements under the AFSL regime are:

- Positive net assets;
- Sufficient cash resources to cover the next three months' expenses with adequate cover for contingencies; and
- Surplus liquid funds of greater than $50,000 where the licensee holds client assets of more than $100,000.

Further conditions may be set out under the AFSL itself. Compliance with these requirements is tested through audits undertaken by the licensee's auditor both annually and at the request of ASIC.

Investment Policy

Authorised representatives and insurance brokers are required to hold monies in a trust account with an ADI, cash management trust or an ASIC-approved foreign deposit-taking institution. The authorised representative or insurance broker is required to disclose to the insured that they intend to keep any interest earned and must deposit the monies into such an account on the day it is received or on the next business day.

Funds held in a trust account can be invested in a broad range of investments (such as government bonds), but the rules relating to this are complex and should be considered in detail. Typically, any investment requires a written agreement as to the arrangements, which will address issues such as how investment earnings and losses are shared.

Lodgement requirements

As AFSL holders, authorised representatives and insurance brokers are required to lodge forms FS 70 (profit and loss statement and balance sheet) and FS 71 (audit report). Refer to the section below on key dates for timing of lodgement. Note that It is possible to apply to ASIC under Section 989 D (3) for an extension of time for lodging the forms.

For AFSL holders that are not regulated by APRA, the Auditor's are required to review measures for ensuring compliance with all of the financial requirements set out in the licence conditions, including:

- Ability to pay all debts as and when they become due and payable;
- Total assets exceed total liabilities, or adjusted assets exceed adjusted liabilities; at all times
- Sufficient cash resources are available to meet three months' expenses plus adequate cover for contingencies, based on rolling three-month cash flow projections that meet ASIC's requirements;
- Requirement to hold $50,000 of surplus liquid funds for licensees that hold more than $100,000 of client funds; and
- Tiered requirement to hold $50,000 to $10 million of adjusted surplus liquid funds for licensees that have more than $100,000 of liabilities from transacting with clients as a principal.

Furthermore, the management of all licensees will have to demonstrate to the auditor their procedures for ensuring compliance with Part 7.8 of the Corporations Act. This includes requirements in relation to financial records and financial statements, as well as procedures relating to:

- Preventing unconscionable conduct;
- Complying with "anti-hawking" or cold-calling restrictions in relation to financial products; and
- Adequate staff training and identification of breaches.

In addition, Section 990(K) contains "whistle-blowing" provisions that obligate auditors to report to ASIC within seven days if they become aware of a situation that may adversely affect the ability of the licensee to meet its obligations and that may result in a breach of either:

- the conditions of the licence; or
- the requirements pertaining to trust accounts, financial records or financial statements.

4.4 Financial reporting

Annual accounts

Under section 292 of the Corporations Act, public companies, disclosing entities, large proprietary companies and certain small propriety companies (if required by ASIC) are required to lodge annual accounts.

Other returns

Bodies other than ASIC and APRA may also require some form of reporting from Brokers (similar to General Insurers). Brokers may be required to submit the following returns if applicable:

- Fire Brigade Returns for Fire Service Levy (FSL)
- Workers Compensation
- Stamp Duty
- Tax returns such as FBT return, Business Activity Statements (BAS) etc.
- Insurance Protection Tax – NSW government tax to assist builders warranty and compulsory third party policyholders affected by the collapse of HIH.

Key dates

The following are the lodgement requirements for AFS licensees:

- For an AFS licensee that is not a body corporate: within 2 months after the end of its financial year.
- For an AFS licensee that is a body corporate and that is a disclosing entity: within 3 months after the end of its financial year.
- For an AFS licensee that is a body corporate that is not a disclosing entity: within 4 months after the end of its financial year

Lodgement requirements for the other returns vary for periods in review and depending on state of operation. For fire brigade returns, the date of lodgement varies depending upon the state and class of business in which the premiums are earned.

Unaudited stamp duty returns are required to be submitted to the relevant state government on a monthly basis. An annual return is also prepared. Again, the lodgement date differs from state to state. This is the same for Workers' compensation.

Registered insurers must lodge an Insurance Protection Tax return by 15 August each year, which includes details of total premiums received from general insurance for the previous year. A policyholder who takes out insurance with a non-registered insurer must lodge a return within 21 days of the end of the month in which the premium was paid. A payment of tax equal to 1 per cent of the premium must accompany the return. An agent or broker may pay this on behalf of the policyholder.

4.5 Taxation

General developments

The Government has continued with ambitious plans for significant tax reform. The comprehensive review of Australia's tax system, otherwise known as the Henry Review has been completed and the final report released to the public on 2 May 2010 together with the Government's response. Despite the 138 recommendations in the Henry Report, the Government has only made a handful of announcements, although there may be further announcements in the May budget.

The Government proposes to reduce the company income tax rate from 30 per cent to 29 per cent for the 2013-2014 income year and to 28 per cent from the 2014-2015 income year and introduce certain changes to the superannuation system including a staged increase in the Superannuation Guarantee payment from 9 per cent to 12 per cent. These initiatives are to a large extent funded by the Resource Super Profits Tax of 40 per cent.

One of the insurance specific recommendations in the Henry Report is the abolition of specific taxes on insurance products, including stamp duties and fire service levies, which is consistent with the recommendations in the "Australia as a Financial Centre: Building on our Strengths" report released by the Australian Financial Centre Forum. The Government has not ruled out this recommendation although any changes will need agreement from the State Governments.

Some other key tax developments during the year are listed below.

- The new Taxation of Financial Arrangements (TOFA) measures which provide a comprehensive regime for the tax treatment of gains and losses arising from financial arrangements have been legislated. The TOFA measures will apply to eligible taxpayers for the income year beginning on or after 1 July 2010 unless the taxpayer chooses to have the rules apply for income years beginning on or after 1 July 2009 (i.e. the "early adopt" election). Taxpayers have a choice as to how TOFA will apply to their financial arrangements.
- New tax consolidation measures were introduced into Parliament on 10 February 2010. One of the significant changes proposed is clarification of the income tax treatment of rights to future income.

- The Federal Government has proposed a reform of Australia's foreign source income anti-tax deferral (attribution) rules. The proposal includes a rewrite of the Controlled Foreign Companies (CFC) rules and the repeal of the Foreign Investment Fund (FIF) rules. The FIF rules will be replaced with a specific, narrowly defined anti-avoidance rule that applies to offshore accumulation or roll-up funds.
- The new International Dealings Schedule - Financial Services 2010 (the IDS-FS 2010) was released by the ATO. The IDS-FS 2010 is the ATO's newly proposed tax return schedule for large (> $250m turnover) financial services taxpayers to replace the Schedule 25A and Thin Capitalisation Schedule and provide additional information in relation to financial arrangements. For the 2010 Income year the IDS-FS is optional. However, the IDS-FS will be mandatory for affected taxpayers for the 2011 year. For early balancing 31 December substituted accounting period taxpayers, this means that information will be required to be collected and reported in the IDS-FS from 1 January 2010.
- During 2009 (subsequent to the release of last year's "Insurance Facts and Figures Publication"), the Australian Government announced its support for 41 of 46 recommendations that were made by the Board of Taxation in relation to its review of the Administration of the GST System. Generally these changes are aimed at reducing the administrative burden of complying with the GST legislation and represent the most significant package of GST reform in 10 years.

While many supported recommendations were identified as applying from 1 July 2010, the legislative process has only started for some of the recommendations with either Exposure Drafts or Bills being introduced and debated in Parliament during 2010. We expect some but not all of the current proposed changes to be passed by parliament prior to 1 July 2010 with the effective date of the changes ranging from 1 July 2000 to 1 July 2010 (that is, some changes are likely to apply retrospectively). Many of the changes have general application to business taxpayers and it is important for each organisation to consider the impact of each of the proposed or finalised changes.

Taxation of insurance brokers

Tax legislation does not contain specific provisions relating to the taxation of authorised representatives and insurance brokers. One of the important tax issues confronting authorised representatives and insurance brokers is the timing of recognition of commission and brokerage income, as this income is often taxed at a later point in time than it is recognised for accounting purposes. The ATO has issued Taxation Ruling IT2626 to provide guidance on this issue. The terms of the contract or arrangement between the insurer and the authorised representative or insurance broker will be of major importance in determining when commission and brokerage income is derived.

An authorised representative or insurance broker is able to recognise an amount of commission or brokerage as income for tax purposes at different points of time.

Examples include:

- When that amount has become a recoverable debt and the authorised representative or insurance broker is not obliged to take any further steps before becoming entitled to payment.
- When the insurance broker can first withdraw that amount from an insurance broking account.
- When that amount has actually been received from the insurer in those situations where the gross premium has been forwarded by the insured directly to the insurer, provided that the receipt by the authorised representative or insurance broker of that amount had not been deferred unreasonably.
- When that amount has been withheld by the authorised representative or insurance broker from the net premiums passed onto the insurer.

Which of these different scenarios is most relevant in any particular situation will be influenced by the terms of the contract between the authorised representative or insurance broker and the relevant insurer.

The authorised representative or insurance broker will be allowed a deduction in the year in which brokerage and commission is refunded where that amount had previously been included in the assessable income of the authorised representative or insurance broker.

Goods and services tax

Under the Australian GST legislation, some classes of insurance are treated differently, leading to different implications for insurers and insured parties.

Brokerage and fee income earned by insurance brokers will generally be subject to GST, regardless of the type of insurance policy involved, however, some exceptions apply such as brokerage in relation to the arranging of international transport.

We note that changes are currently being proposed to the GST legislation that applies to cross-border transport supplies. In the event these changes are passed by parliament, it is likely that they will apply from 1 July 2010. Based on current drafting, the proposed changes are likely to alter the extent to which international transport activities are GST-free or subject to GST and in turn, this will alter the GST treatment of insurance broker services connected to these international transport activities.

For GST purposes, brokers are treated as agents of the insurer even though they act on behalf of the prospective policyholder. As a result, the general rules regarding agents apply for GST purposes.

It is common place for brokers and insurers to use Recipient Created Tax Invoices (RCTIs) in the process of documenting brokerage due for insurance sales. Particular GST rules exist in relation to RCTIs and in 2009 a new Determination (RCTI 2009/1) was released allowing RCTI agreements to be embedded in RCTIs. This development was aimed at reducing the administration required to comply with the legislative requirements regarding RCTIs.

Stamp duty

Insurance intermediaries (i.e. brokers) are not liable to pay stamp duty on insurance policies, as the liability to pay duty falls on the registered insurer.

Where the insurance is provided by an unregistered insurer (e.g. overseas insurer), the insured is the person who is liable to remit any duty payable in the relevant jurisdictions. However, if the broker has remitted the duty on behalf of the insured, the insured will generally be deemed to have complied with the relevant stamp duty requirements.

Financial Reporting Update

5

Introduction

Rod Balding

The stable platform of financial reporting that we have experienced for the past two years is no more. There are more than 50 financial reporting developments that will affect Australian companies in their 2010 and 2011 financial statements. From listening to our clients, we understand that many companies are unsure how their financial reporting obligations will need to evolve and are concerned about how these changes could affect their bottom line.

The insurance industry is not immune to these financial reporting developments. Although progress to date on the IASB's *Insurance contracts* standard has been less than desirable, the Board is determined to proceed with its proposals before the end of the calendar year. We expect the new standard to have a mandatory application date of 2013, with early adoption permitted.

Notwithstanding the insurance standard, there are a number of other proposed changes arriving in the next 6-12 months that will need to be given due consideration by insurers. In particular, changes to segment reporting, business combination accounting, and disclosures regarding fair value of financial instruments, all have the potential to significantly impact profits and other KPI's.

To help you identify the developments that will have an impact on your business, the following materials are included in this section:

- A summary of the changes that are likely to have a high, medium and low-level impact on insurance companies
- A detailed analysis of those "high" impact issues including insight on what this actually means for the industry.

5.1
New pronouncements

Below is an analysis of the accounting changes that may affect insurers' full year 2010 accounts.

Changes to be implemented by 2010	Who will it affect?	Impact/action needed	Potential level of impact on insurers	Want more information?
Business combinations (Revised) and Consolidated and separate financial statements (Revised)	Companies that: • enter into a business combination; • dispose of a subsidiary and retain an ownership interest; and • buy or sell interests in existing subsidiaries without losing control	A significant number of changes affect companies' earnings at the time of an acquisition and in subsequent years.	High for many companies – not specific to the insurance industry	Download IFRS 3R: Impact on earnings – the crucial Q&A for decision-makers from www.pwc.com/au/ifrs or several articles in the IFRS in brief archive at www.pwc.com/au/ifrsinbrief
Financial instruments: Disclosure	Companies with financial instruments.	Introduces new disclosure requirements for fair value measurement and refines existing disclosures on liquidity risk for financial instruments.	High	Download Fair's fair – More focus on telling the fair value story under the amended AASB 7, which is available from www.pwc.com/au/ifrs
Operating segments	For-profit companies that issue and/or trade equity or debt securities in a public market, or are in the process of doing so. However, the general principal of "how the business is managed" is equally applicable to the liability adequacy test and goodwill allocation and impairment.	Segment reporting will focus on the information that is provided to management and relied upon internally.	High	Download A practical guide to segment reporting from www.pwc.com/au/ifrs
Amendments arising from the first and second annual improvements project	All companies.	Introduces numerous changes. Various impacts. Companies should familiarise themselves with each of the changes.	Medium	Download Impacts of the first and second annual improvements project available from www.pwc.com/au/ifrs
Consolidation*	All companies that prepare consolidated accounts.	The same control criteria and definition will apply to all companies, including special purpose companies. More disclosures will be required about consolidated and nonconsolidated companies.	Medium	Download the 10 March 2009 edition of IFRS in brief from www.pwc.com/au/ifrsinbrief
Cost of an investment in a subsidiary, jointly controlled entity or associate	All companies that receive dividends from a subsidiary, jointly controlled entity, or associate that is carried at cost in the separate financial statements; and some companies that add a new holding company to their group in a group reorganisation.	Dividends are now treated as income, even if they were declared out of pre-acquisition profits. Companies should consider whether the receipt of a dividend from their investments is an impairment trigger under AASB 136 Impairment of Assets. There are also changes to the way that some companies measure an investment in a subsidiary.	Medium	Download the 23 May 2008 edition of IFRS in brief from www.pwc.com/au/ifrsinbrief
Presentation of financial Statements (AASB 101)	All companies with long term employee benefits	Australian companies would measure their long term employee benefit obligations by estimating the discount rate by reference to market yields on high quality corporate bonds.	Medium	Download the 25 August 2009 edition of IFRS in brief: Special edition from www.pwc.com/ifrisnbrifs
Financial instruments (AASB 139 replacement)	All companies that have financial instruments.	Accounting for financial instruments will change significantly in the areas of loan loss provisioning, classification and measurement and hedge accounting.	Medium	Visit www.pwc.com/ifrs for news and developments
IFRS for small and medium-sized companies*	Simplified standards, but only for unlisted companies/SMEs.	Australian companies will follow the guidance issued by the AASB. The AASB is yet to issue guidance.	Medium	Visit www.pwc.com/au/ifrs for news and developments
Provisions (non-financial liabilities)*	All companies, particularly those with environmental obligations or litigation exposures.	New recognition and measurement principles will require extensive re-working of current information.	Medium	Visit www.pwc.com/ifrs for news and developments

Changes to be implemented by 2010	Who will it affect?	Impact/action needed	Potential level of impact on insurers	Want more information?
Share-based payments, specifically vesting conditions and cancellations	Companies with vesting conditions that comprise service conditions and performance conditions.	Features in share-based payment plans must be classified and treated as either vesting or non-vesting conditions.	Medium	Download A practical guide to share-based payments from www.pwc.com/au/ifrs
Accounting for eligible hedged items	Companies that designate options as hedges.	Companies will need to designate hedges with only the intrinsic value of options (not the time value) if they wish to continue hedge accounting. Companies can no longer designate inflation as a hedgeable component of a fixed rate debt.	Low	Visit www.pwc.com/ifrs for news and developments
Agreements for the construction of real estate	Real estate developers that construct all types of real estate, including the development of residential estates, apartments, houses, and other commercial developments. For example, real estate developers that pre sell apartments 'off the plan' or sell the rights to residential house and land packages once they are complete.	Depending on how companies currently account for the associated revenue and expenses, it may delay or bring forward the recognition of revenue. In most cases, companies will recognise the revenue only once the real estate has been transferred to the buyer.	Low	Download the 31 July 2008 edition of IFRS in brief from www.pwc.com/au/ifrsinbrief
Borrowing costs (AASB 123, Revised June 2007)	All companies.	AASB 123 was revised to require borrowing costs on qualifying assets to be capitalised. Little impact in Australia because most companies are already doing this.	Low	Download the July 2008 and September 2008 edition of IFRS News from www.pwc.com/ifrsnews
Concise financial reports	All companies that prepare concise financial reports.	Various terminology changes that achieve consistency with AASB 8 Operating segments.	Low	Visit www.pwc.com/ifrs for news and developments
Customer contributions	Companies that receive contributions from customers either in the form of assets or cash, including but not limited to utilities.	Delays the recognition of revenue from customer contributions for some companies.	Low	Download the 14 April 2009 edition of IFRS in brief from www.pwc.com/au/ifrsinbrief
Discontinued operations*	Companies with discontinued operations.	Changes the definition of a discontinued operation. This may reduce the number of items being recognised as discontinued operations. Requires more disclosure about components of an entity that have been disposed of or are classified as held for sale.	Low	Visit www.pwc.com/ifrs for news and developments
Distribution of non-cash assets to owners	Companies undergoing a reorganisation involving distributions of investments to shareholders.	Asset distributions will be accounted for at fair values, not at book values.	Low	Download the 7 November 2008 edition of IFRS in brief from www.pwc.com/au/ifrsinbrief
Hedges of a net investment in a foreign operation	Companies that hedge the foreign currency risk arising from their net investments in foreign operations and who want to qualify for hedge accounting in accordance with AASB 139 Financial instruments: Recognition and measurement.	Firstly, some companies will need to discontinue hedging relationships where the presentation currency was designated as the hedged risk or, where possible, redesignate the hedge based on functional currency risk. Secondly, hedging instruments may be held by any entity in the group (apart from the subsidiary that is being hedged).	Low	Download the 17 July 2008 edition of IFRS in brief from www.pwc.com/au/ifrsinbrief
Joint ventures*	Principally extractive, pharmaceutical, construction and similar industries.	Introduces a new analysis of joint venture arrangements. Proportionate consolidation may be prohibited.	Low	Visit www.pwc.com/ifrs for news and developments
Puttable financial instruments and obligations arising on liquidation	Companies with limited lives (such as limited life trusts and partnerships); and companies that have units where the unitholder can put their units back to the entity for cash.	Some companies may be able to classify some of their financial instruments which are puttable by the holder back to the entity as equity, rather than as financial liabilities.	Low	Download the March 2008 edition of IFRS News from www.pwc.com/ifrsnews
Related party disclosures*	Certain government-controlled companies.	Lower data collection costs for those companies that do not need to provide disclosures about some transactions.	Low	Visit www.pwc.com/ifrs for news and developments

Changes to be implemented by 2010	Who will it affect?	Impact/action needed	Potential level of impact on insurers	Want more information?
Share-based payments (group cash-settled transactions)	Any group that implements a group share-based payment scheme that is settled in cash.	Clarifies the accounting for a group entity that is a party to a group cash-settled share-based payment arrangement. The entity is required to record an expense in its separate financial statements with a corresponding entry in equity.	Low	Download A practical guide to share-based payments from www.pwc.com/au/ifrs

* Indicates changes that have been proposed by the IASB. Depending on when the final standard is issued, these changes may be delayed to 2011 accounts.

Accounting changes in the pipeline that will affect companies' 2011/12 accounts

Below is an analysis of the accounting changes that are currently on the International Accounting Standards Board's agenda that we expect to affect companies in their 2011 or 2012 accounts.

Changes to be implemented by 2011/12	Who will it affect?	Impact/action needed	Potential level of impact on insurers	Want more information?
Insurance contracts	Insurance companies.	Extensive changes to the measurement of insurance liabilities and income recognition.	High – more information to follow with the release of the pending exposure draft.	Download Get Set for IFRS Insurance Phase II from www.pwc.com/au/ifrs
Income tax	All industries, but more significant in industries with substantial tangible and intangible assets on which tax deductions are available only upon sale of the asset, and companies with major tax uncertainties.	Deferred tax numbers will change. A detailed exercise will be required to capture the tax base of some assets and liabilities.	Medium	Download 19 May 2009 edition of IFRS in brief from www.pwc.com/au/ifrsinbrief
Leases	Companies that have leasing arrangements.	All lease arrangements will be accounted for on the balance sheet. Contingent rentals would be reflected in the asset and liability recognised by the lessee and re-measured each period.	Medium	Download 16 June 2009 edition of IFRS in brief from www.pwc.com/au/ifrsinbrief
Amendments arising from the second and third annual improvements project	All companies.	Introduces numerous changes. Various impacts.	Medium	Visit www.pwc.com/au/ifrs for news and developments
Fair value measurement – amended guidance in many standards and a revised income statement to make it easier for investors to distinguish between the impact of changes in fair value on earnings and the results of key business operations.	All industries, greater impact likely on companies in the financial services sector and businesses with recent acquisitions.	Increased disclosure requirements for companies in the financial services sector that hold non-financial assets (such as investment property) which are measured at fair value. These companies would have to provide disclosures which are consistent with the disclosure requirements for financial assets under AASB 7. Some investment management companies, such as unit trusts, may have greater scope to use the mid price rather than the bid price or offer price where that represents industry practice.	Medium	Download Our view on fair value reporting in today's market from www.pwc.com/au/ifrs or the 29 May 2009 edition of IFRS in brief: Special edition from www.pwc.com/au/ ifrsinbriefse

Changes to be implemented by 2011/12	Who will it affect?	Impact/action needed	Potential level of impact on insurers	Want more information?
Financial statement presentation	All companies.	The information in each of the statements – the balance sheet, cash flow statement, and income statement – would be classified into operating, financing and investing activities. Companies would classify assets and liabilities, and changes in those assets and liabilities, in the same categories in the balance sheet and the income statement. Management would decide how to classify items into these sections and would describe its classification in its disclosure of accounting policies.	Medium	Visit www.pwc.com/ifrs for news and developments
Revenue recognition	All companies.	Extensive changes to the current revenue and construction standards (AASB 118 and AASB 111 respectively). The changes will result in a new, converged and comprehensive IFRS that can be applied consistently regardless of industry.	Medium	Download 20 February 2009 edition of IFRS in brief from www.pwc.com/au/ifrsinbrief
Derecognition	Companies that sell or securitise their receivables or that have complex asset transfers.	Introduces a new IFRS to account for the derecognition of financial instruments.	Low	Download the 2 June 2009 edition of IFRS in brief from www.pwc.com/au/ifrsinbrief
Earnings per share (convertibles amendment to IAS 33)	Companies with contingently convertible share capital.	Restatement of earnings per share numbers.	Low	Visit www.pwc.com/ifrs for news and developments
Emissions trading scheme	Any entity that either acquires or produces carbon pollution permits and that trades in these permits or has to surrender them under an emissions trading scheme.	Companies will need to monitor developments.	Low	Download the 14 August 2008 edition of IFRS in brief from www.pwc.com/au/ifrsinbrief or visit www.pwc.com/au/climatechangee bulletins
Financial instruments with characteristics of equity	Companies that issue complex debt or equity instruments.	Clarifies the appropriate classification of debt and equity financial instruments.	Low	Visit www.pwc.com/ifrs for news and developments
Post-employment benefits (including pensions)	Companies with defined benefit plans.	Immediate recognition of actuarial gains and losses (removal of corridor method). Presentation of changes in the defined benefit obligation and in plan assets may change.	Low	Download Accounting for pensions – what's the benefit? From www.pwc.com/ifrs
Rate regulated activities	Rate regulated companies.	Clarifies the treatment of assets and liabilities arising from rate regulation.	Low	Visit www.pwc.com/ifrs for news and developments

5.2

New segment reporting standard

How insurers will be affected by the new segment reporting standard

What is the issue?

The new segment reporting standard applies to all financial periods being on or after 1 January 2009 including interim reports. Whilst December reporters adopted this in their 2009 Financial Statements, there are still lessons to be learnt for June 2010 reporters and for subsequent second year reporting.

AASB 8 *Operating Segments* aligns segment reporting with the requirements in the US; it replaces AASB 114 *Segment Reporting*.

Who does it affect?

For-profit entities that issue and/or trade equity or debt securities in a public market, or are in the process of doing so.

What are the key changes that insurers should be aware of?

- Entities need to identify their chief operating decision-maker (CODM), which is the person/s responsible for making strategic decisions about the entity's segments. For instance, it may be the CEO, chief operating officer, chief actuary, the senior management team, or the board of directors
- Identifying the correct person/s within the entity is fundamental to the correct identification and measurement of reportable segments.
- More operating segments may be identified. Management will need to consider the practicalities of presenting this information in the financial statements.
- Based on the changes to AASB 136 *Impairment of assets*, some entities will also need to reallocate the goodwill on their balance sheet to a lower level cash generating unit (CGU) or group of CGU's for the purposes of impairment testing. This process can be time-consuming and complex for entities. It may also trigger more impairment of goodwill and increase the volatility of earnings where the recoverable amount of the segment assets (including the goodwill) is below carrying amount.
- As comparatives will require restatement, management are advised to consider the impacts of AASB 8 as early as possible.

What are the practical implications?

Although at first glance, many consider the change to operating segments purely a disclosure issue, there are potentially other issues that insurers will need to consider when first applying the standard. The overall principles of "how the business is managed" are equally applicable to the liability adequacy test and goodwill allocation of all entities, not just those that are required to present segment disclosures.

For example, PwC's experience with the US equivalent standard has shown that:

- Identifying the CODM can be problematic. Judgements about the level of operations that are regularly reviewed by the CODM have been challenging and subject to regulatory scrutiny. The review of products, geographic locations, or businesses with similar risks all need to be considered.
- Entities may experience significant cost increases as a result of ensuring internal processes and systems are sufficiently robust in capturing internal segment information for disclosure in the financial report.
- Applicable insurance groups will need to revisit goodwill impairment because goodwill can no longer be allocated to a CGU or group of CGUs larger than an operating segment. Insurers will need to reassess their CGUs prior to impairment reviews and be aware that the lower level of testing may increase the chance of impairment.
- In practice, many insurers also perform the liability adequacy test (LAT) for the unearned premium liability at the CGU level. With the LAT being performed at a lower level under the revised AASB 8, this could result in additional liabilities being recognised.

5.3

New business combinations rules

How insurers will be affected by the new business combinations rules

What is the issue?

The revised business combination rules make significant changes to the way that entities account for acquisitions and disposals. The revised AASB 3 Business combinations and AASB 127 Consolidated and separate financial statements applies to all financial periods beginning on or after 1 January 2009.

Who does it affect?

All entities that are planning, or have recently completed, an acquisition or disposal.

What are the key changes?

Many of the changes will add to earnings volatility – both in the year of a transaction and for several years afterward.

For example, under the revised standards:

- Gaining or losing control triggers an immediate re-measurement of existing or retained interests to fair value, resulting in an extra gain or loss at the time of the transaction. This isn't permitted under the existing standards.
- Consideration, including contingent consideration, will be recognised at fair value, and in most cases the fair value will be re-measured at every reporting date (including interim periods), resulting in a gain or loss which will affect earnings. Currently, contingent consideration is recognised only if payment is probable, and subsequent adjustments to expected contingent payments affect goodwill.
- Hedge accounting in the books of the acquiree can no longer be 'assumed' to continue at acquisition. Hedge effectiveness must be tested at the acquisition date.
- Acquisition-related transaction costs will be expensed as incurred, so there could be a significant impact on an entity's earnings. Currently, transaction costs form part of consideration and, therefore, goodwill.

What are the practical implications?

Speculation remains high that the recent trend consolidation and M&A activity is set to continue in the insurance industry with a number of financial institutions and large global insurers potentially looking to spin-off their non-core insurance businesses to fund capital shortfalls. Entities operating in this industry should be aware of the changed accounting requirements and their potential effect on deals. In particular:

- In our experience, insurance entities' deferred tax assets with respect to tax losses are often not brought to account at the time of acquisition. The new standard requires any adjustments for deferred taxes made after acquisition date to be taken to the income statement (rather than through goodwill).
- Where entities acquire a controlling interest in a target and any existing interest is re-measured to fair value, significant gains may arise in the income statement. This will often be the case, for example, where entities have a non-controlling interest in an entity and subsequently purchase an additional interest which gives it control. These gains can be material, given the fair value of the assets may have moved quite dramatically from the initial measurement.
- Any commodity, foreign exchange or interest rate hedging activity by an acquiree will need to be re-assessed on acquisition. This has the potential to result in a significant earnings impact if hedge relationships are deemed to have failed.

5.4

New financial instruments disclosure requirements

How insurers will be affected by the new financial instruments disclosure requirements

What is the issue?

The revised financial instruments standard introduces new disclosure requirements for fair value measurements and refines existing disclosures on liquidity risk. The revised AASB 7 Financial instruments: Disclosure applies to all financial periods being on or after 1 January 2009. Whilst December reporters adopted this in their 2009 Financial Statements, there are still lessons to be learnt for June 2010 reporters and for subsequent second year reporting.

Who does it affect?

All entities with financial instruments.

What are the key changes?

- Entities must disclose a table that classifies all financial instruments carried at fair value into three different levels based on how their fair value has been determined.
  - Level 1 is where the fair value has been determined using quoted prices from an active marker (i.e. an ASX listed share).
  - Level 2 is where the fair value has been determined using a valuation model with inputs that can be observed in the marketplace. An example of this is an investment in debt of an entity that has a publicly available credit rating.
  - Level 3 is where the inputs into the valuation rely on management's estimates or judgement. Given the subjectivity around key assumptions and inputs into Level 3 type of assets and liabilities, it is not surprising that this is where the majority of the new disclosure is required and detail needs to be given on how the fair value has been determined.
- In addition to classification of Levels 1, 2 and 3, there is also a requirement to disclose:
  - any change in the basis of determining fair value from one level to another
  - a reconciliation between opening and closing fair value for instruments in Level 3
  - the extent of gains and losses recognised in the P&L out of Level 3.
- The revised standard also requires an entity to disclose a maturity analysis of the financial assets it holds for managing liquidity risk, if that information is necessary to enable users to evaluate the nature and extent of liquidity risk. Many insurers do not currently disclose the maturities of financial assets as historically only financial liabilities were required. Therefore, many insurers will need to change their disclosures as a result of this amendment.

What are the practical implications?

Insurance entities have large, and often diverse, investment portfolios to support their insurance liabilities. Unlike the majority of other industries, the insurance industry has a significant amount of its investment portfolio carried at fair value through profit or loss, and so these changes are extensive and significant for the majority of insurers; particularly for those where investment quotes / prices are obtained from sources outside the organisation ie asset managers and custodians.

PwC's experience to date in helping insurers with these disclosures both globally and in the local market has provided many 'lessons learned', particularly around the investment of time and effort and the necessary changes to systems and processes. In addition, attention is generally given to capturing the necessary information and classifying the financial instruments within the 3 levels, however the focus should be broader and take into consideration the additional disclosure requirements where the financial instruments fall into Level 3. Recent financial conditions have led to a greater need to rely on valuation models when determining fair value, and as such, entities are encouraged to prepare early.

5.5

Status of proposed changes to the accounting for insurance contracts

The IASB and FASB have made significant progress formulating their proposals in the past year, despite the distractions of the global financial crisis and other current projects on their agendas, such as accounting for revenue recognition, leases, and financial and non-financial liabilities.

The Boards' progress has meant that some of the detail of the draft insurance proposals has been tentatively agreed, whilst some issues are still to be resolved. The proposed "current exit value approach" has been refined and the IASB has tentatively agreed that insurance contracts should be measured using the current estimate of the value the insurer would ascribe to fulfilling the present obligation created by the contract. In practical terms, this measurement approach is represented by the following building blocks, which will already be familiar to Australian general insurers:

- An unbiased, probability weighted average of future cash flows
- The time value of money
- Risks adjusted for the effects of uncertainty about the amount and timing of future cash flows
- An amount that eliminates any gain at the inception of the contract

If agreed by the FASB and ultimately endorsed, these changes alone would revolutionise the accounting for Australian life insurers and insurance companies across the globe. Equally significant for insurers are other issues the Boards are currently deliberating on, such as the measurement of risk margins, whether diversification benefits will or will not be allowed, and the treatment of acquisition costs.

The exposure draft for the insurance contracts standard is expected to be released in mid 2010 with an anticipated application date in 2013.

Policyholder Protection

6

Introduction

Carole Ferguson

The Australian government's approach to financial services regulation post the GFC has been relatively measured and in line with that of other jurisdictions such as the UK and USA. It has focused on on the underlying stability of the financial services sector, beginning with the APRA review of remuneration practices and of capital adequacy standards. In December 2009, APRA released a package of proposed changes to prudential standards and prudential practice guides for authorised deposit-taking institutions which are aimed at reflecting enhancements to the Basel II Framework. Insurance companies that are part of banking conglomerates will experience further tightening of prudential controls.

Additionally APRA released in March 2010 a discussion paper on the supervision of conglomerate groups which proposes further tightening of capital requirements for conglomerates generally, irrespective of the ultimate parent.

ASIC too has been granted additional powers as a consequence of government and community concerns post the GFC regarding sales practices generally. The changes are reflective of increased consumer concerns regarding their consumer rights – particularly in the unfair contract and credit spaces.

The outcomes of the Ripoll review (The Future of Financial Advice) were released by the government on 26 April 2010. The proposed changes (see below) are not specifically targeted at risk insurers with limited impact at this stage in that space.

Further regulatory powers to the Australian Consumer and Competition Commission will focus on unfair contract terms (UCT). This legislation is complementary to powers given to ASIC in this space and means that consumers are offered much higher standards of protection generally. Insurers may be impacted by the UCT provisions if they offer additional services to policyholders which fall outside of financial services products.

Consumers have also received further protection through changes to the Privacy Act, These changes will improve enforcement in this space – hence insurers will need to ensure stronger compliance practices in this area.

Not surprisingly risk management and compliance are high on the agenda for the insurance sector as the industry strives to ensure that they are able to meet the new regulatory challenges and consumer expectations whilst balancing the need to ensure profitability for shareholders. Insurers with a strong focus on the ability to leverage from these changes, to simply their offerings, review practices and deliver to consumers products that are "true to label", will be the winners in the post GFC regulatory environment.

6.1 Key developments

The Future of Financial Advice / Ripoll Enquiry:

Bernie Ripoll MP, Chair of the Parliamentary Joint Committee on Corporations and Financial Services, was the chair of an inquiry into the underlying issues associated with certain financial services company collapses such as Storm Financial, Opes Prime and MFS.

The inquiry's recommendations included:

- a change to the Corporations Act to recognise the fiduciary duty by financial planners to put the interests of their clients first;
- government consultation with Australia's financial services industry on the best way to ban commission payments and volume bonuses from product providers to advisers;
- making the cost of financial advice tax deductable for consumers;
- that ASIC work together with the industry to form a professional standards board that advisers would be required to join. The body would establish, monitor and oversee competency and conduct standards;
- that ASIC be resourced to perform risk-based surveillance of the advice provided under an Australian financial services licence; and
- that ASIC's powers be extended to remove individuals and licensees from providing financial services;

The government issued a package of recommendations on 26 April 2010 which provided that from 1 July 2012 there would be:

- a prospective ban on conflicted remuneration structures including commissions and any form of volume based payment. Percentage based fees for geared products would additionally only be chargeable on the ungeared amount;
- the introduction of a statutory fiduciary duty for financial advisers to act in the best interest of their clients and to prefer the client's interests to their own; and
- the introduction of a adviser charging regime requiring an annual requirement for retail clients to opt – in to continued commission payments (including trail commissions).

The changes in relation to remuneration do not currently affect risk insurance. This is because the government is of the view that the difference between insurance and investment products needs to be further considered. The government also wishes to consider affordability and under-insurance in exploring the consumer solutions.

Further consultation will be undertaken by the government about the issues, including a consideration as to whether to ban the payment of commissions for risk and group insurance.

Tort law

Tort law reform remains an ongoing issue for the general insurance industry. Despite the clear benefits that have been delivered by the reforms of 2002, this area is still a contentious one for the industry. Various bills to effect change are now being considered including the Queensland Civil Liability and Other Legislation Amendment Bill (2009).

Bodies such as the Insurance Council argue that tort law reform is critical to the success of the industry and have arguably resulted in public liability insurance being more available and more affordable. In the Insurance Council's view the reforms that began in 2002 have been instrumental in driving down the cost of liability premiums by 27 per cent in the five years to 2008. During the same period the number of policies written across Australia increased by more than 20 per cent.

Group Policy Purchasers

The activities of group insurance purchasing bodies such as employers, clubs or associations may constitute providing financial services under Ch 7 of the Corporations Act 2001 (Corporations Act), and the arrangements these bodies enter into may constitute a managed investment scheme under Ch 5C: see ASIC Regulatory Guide 195.4–RG 195.5.

ASIC has given certain group purchasing bodies relief from the Australian financial services (AFS) licensing and managed investment requirements because they believe the requirements are disproportionately burdensome for them: see RG 195.6–RG 195.9.

The relief is only available to 'eligible' group purchasing bodies and is subject to certain conditions.

Privacy Law

Privacy law reform is high on the government agenda following the release of the Australian Law Reform Commission's report final report, For Your Information: Australian Privacy Law and Practice (ALRC 108). The report was delivered to the Attorney-General on 30 May 2008 and was launched by the then Cabinet Secretary, Senator the Hon John Faulkner, and the Attorney-General, the Hon Robert McClelland MP, on 11 August 2008. The three volume report recommends significant changes to improve Australia's privacy framework.

Given the breadth of the changes the implementation is to be a two staged process. The initial changes include:

- developing a single set of Privacy Principles;
- redrafting and updating the structure of the Privacy Act;
- addressing the impact of new technologies on privacy;
- strengthening and clarifying the Privacy Commissioner's powers and functions;
- introduction of comprehensive credit reporting and enhanced protections for credit reporting information; and
- enhancing and clarifying the protections around the sharing of health information and the ability to use personal information to facilitate research in the public interest.

The Government proposes to release exposure draft legislation implementing the first stage response during 2010.

As indicated above, the Privacy Commissioner will be given additional enforcement powers which will lead to breaches of the new Privacy Act having stronger sanctions.

Stage two of the Government's response will consider the remaining recommendations in the ALRC report, which focus on:

- proposals to clarify or remove certain exemptions from the Privacy Act;
- introducing a statutory cause of action for serious invasion of privacy;
- serious data breach notifications;
- privacy and decision making issues for children and authorised representatives;
- handling of personal information under the *Telecommunications Act 1997*; and
- national harmonisation of privacy laws (partially considered in stage one).

The Government will consider these recommendations once the first stages reforms have been progressed.

National Consumer and Unfair Contracts Legislation

New unfair contract terms provisions of the *Australian Consumer Law (Trade Practices Amendment (Australian Consumer Law) Act 2010*) (ACL) and the *Australian Securities and Investments Commission Act 2001* (ASIC Act) have been enacted to apply from 1 July 2010. The legislation replaces all existing state based consumer contracts legislation.

The unfair contract terms provisions will apply to consumer contracts in a standard form. A contract between businesses is excluded from the scope of the provisions, except potentially in respect of a 'sole trader' who may have common business and personal interests, but only to the extent that the contract relates to goods and services acquired wholly or predominantly for the consumer's personal, domestic or household use.

A 'consumer contract' is a contract for:

- the supply of goods or services, or
- sale or grant of an interest in land

to an individual whose acquisition of the goods, services or interest in land is wholly or predominantly for personal, domestic or household use or consumption.

Under the ASIC Act, a similar definition of a consumer contract applies in relation financial products and services.

Section 15 of the Insurance Contracts Act has the effect that the unfair contract terms provisions will not apply to most insurance contract terms to the extent that those terms are regulated by the Insurance Contracts Act. Private health insurance contracts, State and Commonwealth government insurance contracts and re-insurance contracts (among others) are not regulated by the Insurance Contracts Act and so their terms fall for consideration under the unfair contract terms provisions.

A contract entered into after 1 July 2010, and is subject to ACL, is unfair if the terms:

- would cause a significant imbalance in the parties' rights and obligations arising under the contract;
- is not reasonably necessary to protect the legitimate interests of the party who would be advantaged by the term; and
- would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

Businesses that are subject to ACL as stated above should review standard contract terms and compliance arrangements prior to the introduction of the new provisions on 1 July 2010.

National Consumer Credit Protection (NCCP)

ASIC has been appointed as the lead regulator for the implementation of the NCCP. The program to bring the regulation of consumer credit under the Commonwealth – the National Consumer Credit Action Plan – will be introduced in two phases. The Commonwealth Government has assumed responsibility for the Uniform Consumer Credit Code (UCCC) by enacting it as Commonwealth law. The second phase will consider a review of unsolicited credit card limit extension offers, the possible regulation of reverse mortgages and further measures, where necessary, to address unfavourable lending practices.

Key elements of Phase One:

- Enacting the existing state legislation, the UCCC, into Commonwealth legislation.
- Establishing a national licensing regime to require providers of consumer credit and credit-related brokering services and advice to obtain a licence from ASIC.
- Extending the powers of ASIC to be the national regulator of the new credit framework with enhanced enforcement powers.
- Requiring licensees to observe a number of general conduct requirements including responsible lending practices.
- Requiring mandatory membership of an external dispute resolution (EDR) body by all providers of consumer credit and credit-related brokering services and advice.
- Extending the scope of credit products covered by the UCCC to regulate the provision of consumer mortgages over residential investment properties.
- Extending the operation of the Corporations Act to regulate margin lending.

Key elements of Phase Two:

- Enhancements to specific conduct obligations to stem unfavourable lending practices, such as a review of credit card limit extension offers; and other fringe lending issues as they arise.
- Regulation of the provision of credit for small businesses.
- Regulation of investment loans other than margin loans and mortgages for residential investment properties.
- Reform of mandatory comparison rates and default notices.
- Enhancements to the regulation and tailored disclosure of reverse mortgages.
- Examination of remaining existing state and territory reform projects.
- Insurers who offer credit products linked to investment life policies or linked credit cards or similar credit arrangements will be subject to the new regulations. For instance offering a related parties' credit card to policy holders may mean that you need to obtain a licence or authorisation from the credit provider.

Licensing will be in two stages:

- Anyone who engages in certain credit activities will need to register with ASIC between 1 April and 30 June 2010 (inclusive).
- Registered credit participants will then have six months to apply for an Australian credit licence, between 1 July 2010 and 31 December 2010.
- New entrants to the credit market will have to apply for an Australian Credit Licence from 1 July 2010.

Insurers should take care to review their products and services to determine if licensing is required.

6.2 Framework

The insurance industry exposes providers and policyholders to a variety of risks, including credit risk, market risk, event risk and operational risk. Every provider carries these risks to varying extents depending on the nature of the promises made to policyholders. Prudential regulation is largely about managing these risks in a way that supports the promises made to policyholders.

Frameworks for policyholder protection in insurance markets differ around the world. However, since the Wallis Inquiry of the late 1990s, the Australian policyholder protection framework has been founded on the following three strands of regulatory supervision:

- Australian Prudential Regulation Authority (APRA) – Solvency of insurance providers and prudential regulation to protect the interests of policyholders in ways that are consistent with the development of a viable, competitive and innovative insurance industry;
- Australian Securities and Investments Commission (ASIC) – Policyholder protection, product disclosure and the market integrity of insurance providers; and
- Australian Competition and Consumer Commission (ACCC) – Fairness and competition in the insurance industry.

The framework is complemented by general legislation governing conduct and disclosure for all industries, including insurance. The objectives of the Australian policyholder protection framework and the key mechanisms and activities that regulators have put in place to support the framework are explained below.

The key objectives of policyholder protection are to ensure:

- Prudential supervision of authorised insurers
- Product disclosure – providing policyholders with all relevant information upon which to base an informed decision
- Pricing and competition – offering policyholders a range of insurance products in a competitive environment
- Sales practice regulation – providing sales advice and customer service of the highest possible standard
- Ability to pay claims – maintaining sufficient capital and resources to pay claims as they fall due
- Use of personal information – storing and using information provided by policyholders appropriately, and
- Sources of redress – offering adequate sources of redress in the event of policyholder dissatisfaction.

Insurance Council of Australia – Code of Practice

The ICA released a new Code of Practice in July 2005 for general insurers, which took effect in July 2006. The only types of general insurance that are not covered by the Code are reinsurance and the lines of business that are covered by specific government statute, such as workers compensation and compulsory third party (CTP), marine insurance and medical indemnity insurance. Life insurance and health insurance are not included as these have different regulations.

Participation in the new Code continues to be discretionary. The key objectives of the Code are:

- to promote better, more informed relations between insurers and their customers;
- to improve customer confidence in the general insurance industry;
- to provide better mechanisms for the resolution of complaints and disputes between insurers and their customers; and
- to commit insurers and the professionals they rely upon to high standards of customer service.

A summary of the national legislation and codes that provide the regulatory backbone for policyholder protection in the insurance industry is provided on the next page.

Regulation of Direct Offshore Foreign Insurers (DOFIs)

With effect from 1 July 2008 the *Corporations Act 2001* and the *Insurance Act 1973* were amended to require anyone carrying on an insurance business in Australia, either directly or through the actions of another, to become an authorised insurer. The amendments to the Corporation Act provide that a financial services licensee, or an authorised representative of a financial service, must not deal in a general insurance product unless they are:

- A “general insurer” within the meaning of the Insurance Act
- A Lloyd’s underwriter within the meaning of the Insurance Act
- A person in respect of whom APRA has determined the requirement to be authorised under the Insurance Act does not apply.

Unless an exemption applies, it will be an offence for a DOFI to carry on insurance business in Australia without being authorised under the *Insurance Act 1973*. The Act has been amended to clarify what it means to carry on business in Australia.

Table 6.1 – Policyholder protection – An overview

			Commonwealth Legislation											Industry Supervision
		Corporations Act	Life Act	Insurance Act	Insurance Contracts Act	Trade Practices Act	Price Surveillance Act	Privacy Act	Financial Services Reform Act	National Health Act		Lifetime Health Cover	Medical Indemnity Act	General Code of Practice
	Regulatory Body	Licence requirements	APRA	APRA	ASIC	ACCC/ ASIC	ACCC	Privacy Commissioner	ASIC	PHIAC	PHIO	PHIAC	Medicare Australia / APRA	FOS
Pre Sale	Product and Insurance Business/ contracts	✓	✓	✓	✓				✓	✓	✓	✓		✓
	Pricing and competition					✓	✓			✓			✓	
Sale	Sales practice regulation					✓		✓	✓					✓
Claim	Ability to pay claims	✓	✓	✓						✓			✓	
	Sources of redress							✓	✓	✓	✓			✓
	Use of personal information							✓						

Lloyds in Australia

The *Insurance Act 1973* allows underwriting members of Lloyd's of London to write business in Australia. The business is written on Lloyd's behalf by underwriting agents (coverholders) and brokers in Australia who are issued with authorities by Lloyd's within specified classes. Lloyd's underwriting members operate in groups (syndicates) which are managed by Lloyd's registered "managing agents". Each syndicate is an annual venture which stops writing new business every year. New syndicates are formed the following year.

Members of each syndicate arrange their own participation in the syndicate with advice from registered "member agents". The agent will also generally administer the member's insurance business. The members must also deal only through Lloyd's accredited brokers in carrying on their insurance business.

6.3

Product disclosure, insurance business and insurance contracts

Corporations Act 2001

Consumers need clear and relevant product information that is directly comparable to information on other products in the insurance market. This ensures they can make informed decisions on which products best suit their needs. It also helps give the industry a reputation for reliability and honesty.

The most stringent requirements for ensuring appropriate product disclosure are set out in Chapter 7 of the *Corporations Act 2001* – Chapter 7 which builds upon the standards established in the *Insurance Contracts Act 1984*. The Corporations Act disclosure regime applies to most types of insurance with the exception of health, marine, workers' compensation and CTP. The Corporations Act licensing regime does not apply to APRA-licensed insurers who only have wholesale clients.

In general, the Corporations Act requires insurers to give product documentation to consumers before they buy a product. However, they can provide documentation up to five days after issuing risk insurance products but only if the consumer asks for the product to be issued immediately and it is not reasonably possible to give them documentation before issuing the product. Product disclosure documentation must be kept up to date for the lifespan of the product through the use of supplementary product disclosure documents.Insurers should have regard to the requirements of ASIC Regulatory Guide 168 in the development of disclosure documents.

The required disclosures include:

- a financial service guide (FSG) that includes information about the services provided, such as details of remuneration, commission, benefits, conflicts of interest and dispute resolution mechanisms,
- a statement of advice (SOA) setting out any personal advice given to a consumer and the basis on which it was given, and
- a product disclosure statement (PDS) detailing information a retail investor would expect to have on significant benefits and risks of the product, such as product features, expected returns, applicable tax rates, dispute resolution procedures, and the extent to which environmental, social and ethical considerations have been taken into account when making investment decisions.

Telephone sales also fall within the scope of this legislation. Consumers must be:

- clearly informed of the importance of using a PDS in making a decision
- given the option of having the PDS read out over the telephone
- given a PDS before becoming bound to buy a product
- contacted only between 8am and 9pm, excluding Sundays and certain public holidays and
- given an opportunity to be placed on a "no contact" register. These restrictions apply only to telephone sales to retail clients.

Telephone sales and internet content are also subject to additional regulation. The relecant regulator, The Australian Communications and Media Authority (ACMA), is a statutory authority within the federal government portfolio of Broadband, Communications and the Digital Economy which was established on 1 July 2005 by the merger of the Australian Broadcasting Authority and the Australian Communications Authority.

The ACMA is responsible for the regulation of:

- broadcasting
- the internet
- radiocommunications
- telecommunications.

The ACMA is responsible for anti-spamming legislation and internet content and for the "no-contact" register for call centres.ACMA is now moving to enforce its jurisdiction more assertively and has entered into a number of enforceable undertakings for breaches of the anti – spamming provisions.

Non-compliance with the Corporations Act

Non-compliance with the Corporations Act may attract financial penalties or imprisonment for up to five years. ASIC has the power to impose a range of administrative penalties on insurers, including suspension, variation or revocation of their licence.

Insurance Contracts Act

The Insurance Contracts Act places additional disclosure and procedural requirements on general insurers, such as:

- detailed requirements pertaining to policy and claim limitations and disclosures
- when arranging a new policy for home or motor insurance, the insurer must ask specific questions associated with the risk to be insured, otherwise the duty of disclosure will be deemed to be waived
- when renewing policies, the insured has a duty of disclosure as to matters that would increase the risk of the insurer
- the insurer must advise the intention and rate of renewal at least 14 days prior to expiry of existing policy, otherwise the policy is automatically renewed with no premium
- an unpaid instalment can prevent claim payment only if this is made clear to the insured and it is overdue by at least 14 days;
- building insurance covers purchases until sale completion or possession of the building
- the insured must be informed if liability cover is on a claims-made basis and
- insurers must disclose averaging provisions clearly and in writing.

6.4 Pricing and competition

Trade Practices Act 1974

The *Trade Practices Act (TPA) 1974* was enacted to address:

- anti-competitive and unfair market practices
- mergers and acquisitions of companies
- product safety and liability; and
- third-party access to facilities of national significance.

All state and territory governments have their own fair trading and consumer laws that mirror, or are based on the TPA, thereby extending the same principles to workers compensation and CTP insurers.

Medical indemnity insurers

Only registered APRA-authorised general insurers, including those owned by Medical Defence Organisations (MDOs), are permitted to offer medical indemnity insurance.

Under the Medical Indemnity (Prudential Supervision and Product Standards) Act 2003, the provision of medical indemnity products has been regulated to require minimum coverage of $5 million on a claims-made basis.

The Run-off Cover Scheme (ROCS) was introduced in 2004 to provide affordable medical indemnity cover to medical practitioners upon retirement. ROCS is funded by a levy on medical indemnity insurers (MIIs) who are then expected to on-charge the levy to practitioners (the “funding levy”), with appropriate disclosure on premium notices.

MIIs receive fees from Medicare Australia to cover:

- claims handling costs for eligible retirement claims
- the cost of issuing practitioner eligibility certificates for ROC and
- the cost of implementing systems to administer ROCS.

Health insurance

The Australian Government closely controls competition in the health insurance industry. While price differentiation is possible within the framework of a community rating scheme, the Government must approve any rise in premium rates that exceeds the Consumer Price Index (CPI) inflation rate. Product differentiation is also limited and levels of coverage are regulated.

Private health insurers are also subject to Lifetime Health Cover (LTHC) legislation. Under this law, premiums are held at a base rate for all members joining before the age of 30. Premiums for new policyholders are subject to a two per cent loading for each year after the age of 30. Therefore people who join early in life will be charged lower premiums than people who join later. LTHC is designed to encourage more people to join at a younger age and maintain their membership over their lifetime.

A 30 per cent tax rebate on all health insurance premiums applies to all Australians who are eligible for Medicare and are members of a private health fund. Policyholders may obtain this rebate in three ways:

- as a lower premium rate
- as a rebate on their annual income tax return or
- as a cash payment from the Medicare office.

Under the Government's proposal in the May 2009 Budget, from 1 July 2010, a three-tiered PHI rebate system will apply:

Tier 1: For singles earning more than $75,001 (couples $150,001), the PHI rebate will be 20 per cent for those up to 65 years (25 per cent for those over 65, and 30 per cent for those over 70 years).

Tier 2: For singles earning more than $90,001 (couples $180,001), the PHI rebate will be 10 per cent for those up to 65 years (15 per cent for those over 65, and 20 per cent for those over 70 years).

Tier 3: For singles earning more than $120,001 (couples $240,001), no PHI rebate will be provided.

Table 6.2 – New Private Health Incentive Tiers effective 1 July 2010

	Current MLS thresholds	TIER 1	TIER 2	TIER 3
Singles	<$75,000	$75,001 – $90,000	$90,001 – $120,000	>$120,001
Couples	<$150,000	$150,001 – $180,000	$180,001 – $240,000	>$240,001
MLS	1%	1%	1.25%	1.50%
PHI Rebate				
Up to 65 years	30	20	10	0
65-69 years	35	25	15	0
Over 70 years	40	30	20	0

Source: Treasurer of the Commonwealth of Australia Media Release, 12 May 2009, Rebalancing support for private health insurance

Health insurers are responsible for ensuring all policyholders are aware of the rebate and that it is implemented appropriately. In addition, the Government's "gap cover" initiatives seek to reduce out-of-pocket expenses incurred by policyholders. Such gap cover schemes offer 100 per cent coverage of a member's hospital costs when the member is treated in a hospital that has an agreement (such as the Hospital Purchasers Provider Agreement) with the health fund.

When the doctor also has an agreement with the hospital, these schemes enable health funds to pay benefits higher than the Medicare Benefits Schedule fee. With these agreements, health funds will be able to provide members with 100 per cent cover, not only for hospital costs but in-hospital medical costs as well. The schemes have been facilitated by the introduction of simplified billing whereby registered doctors and hospitals bill the health fund directly.

6.5

Sales practice regulation

The Corporations Act aims to ensure policyholders get quality sales advice and service by requiring advisers to:

- have appropriate skills and knowledge and
- adhere to prescribed conduct and disclosure standards.

Skills and knowledge

Under the Corporations Act, all providers of financial products or financial advice must hold an Australian Financial Services Licence (AFSL) or be appointed as an authorised representative of a licence holder.

Licence holders are required to:

- have documented procedures to monitor and supervise the activities of representatives to ensure they comply with financial services laws
- ensure all representatives who provide financial services are competent to provide those services
- maintain records of all training undertaken
- meet ongoing educational requirements and
- ensure "responsible officers" meet ASIC standards for knowledge and skills. All advisers and representatives giving financial advice must be trained to the standards set out in ASIC's Regulatory Guide 146.

Conduct and disclosure standards

Corporations Act requirements that relate to service standards include the following:

- Insurers must confirm, electronically or in writing, the issue, renewal, redemption or variation of policies within a reasonable time frame.
- Insurers must offer a 14-day "cooling-off" period during which customers have the right of return. This period starts on the earlier of the following dates: the date the confirmation requirements have been met, or the end of the fifth day after the product is issued or sold to the consumer. For risk insurance products, the amount refunded can be reduced in proportion to the period that has passed before the right of return is exercised.
- Consumers must be given the option to register a "no contact, no call" request, similar to marketing consents required under the *Privacy Act 1988*.

As AFSL holders, insurers are required to maintain a register of all authorised representatives and ensure that their representatives provide services honestly, efficiently and fairly. Other requirements of the Corporations Act relating to policyholder protection include:

- a requirement that the services are delivered efficiently, honestly and fairly. Compliance and organisation measures for the licensee must meet the requirements of ASIC Regulatory Guides 104 and 105.
- internal procedures for dealing with complaints. These must meet the standards set out in ASIC's Regulatory Guide 165; and
- procedures for keeping client money in a trust account that is separate from the licensee's or representative's own account.
- Conduct and disclosure standards in accordance with ASIC Regulatory Guide 175

6.6
Ability to pay claims

The Financial Claims Scheme (FCS), provides for eligible general insurance policyholders to claim under a dedicated compensation scheme for valid claims against a failed general insurer, instead of having to pursue claims in the normal liquidation process.

Eligible general insurance policyholders are individuals insured with an APRA-regulated general insurer, small businesses (annual turnover <$2million) and not-for-profit organisations.

The FCS also allows, for the first time, the appointment of judicial managers to failing general insurers with powers to advance the interests of policyholders and the stability of the financial system.

The FCS will be administered by APRA and will use government funds in the first instance to pay policyholders. The *Financial Claims Scheme (General Insurers) Levy Act 2008* provides for a levy to be imposed on general insurers where APRA is unable to recover the full costs of the scheme in the liquidation.

Medical indemnity assistance

The medical indemnity legislation, introduced by the Australian Government in 2002, is designed to contribute towards the availability of medical services in Australia. The package of legislation allows the Government to provide financial assistance to MDOs and MIIs to help these organisations keep medical indemnity insurance premiums at an affordable level.

The *Medical Indemnity Act 2002* enables participating MDOs and MIIs to make claims under four medical indemnity schemes which are administered by Medicare Australia on behalf of the Government.

- Incurred But Not Reported (IBNR) – designed to fund the IBNR liabilities of MDOs where they do not have adequate reserves to cover their liabilities. All MDOs that existed on 30 June 2002 may participate in this scheme unless the Minister determines otherwise. To date, United Medical Protection Limited is the only MDO to actively participate in the IBNR indemnity scheme.
- High Cost Claim Scheme (HCCS) – enables the Government to fund 50 per cent of the cost of payouts by MDOs and MIIs that are greater than the applicable threshold amount, up to the limit of a practitioner's indemnity cover.
- Run-Off Cover Scheme (ROCS) – a reinsurance run-off vehicle to assist MDOs and MIIs in respect of claims made against a private medical practitioner who has retired, has a permanent disability, is on maternity leave or has permanently left private medical practice in Australia.
- Exceptional Claims Scheme (ECS) – designed to assist MDOs and MIIs where settlement amounts of claims exceed a practitioner's indemnity insurance contract limit.

6.7 Use of personal information

All private insurance companies and agents became subject to amendments to the Federal Privacy Act from 21 December 2001. The legislation governs collection and use of personal information by most private companies within Australia, via the application of the following 10 National Privacy Principles:

- collection
- use and disclosure
- data quality
- data security
- openness
- access and correction
- identifiers
- anonymity
- trans-border data flows and
- sensitive information.

The legislation formalises many existing standards within the insurance industry, such as the General Insurance Information Principles.

Small companies (with turnover of less than $3 million), registered political parties, commonwealth government agencies and state or territory authorities and prescribed instrumentalities are generally excluded from this legislation. However, federal public sector organisations are bound by the National Privacy Principles set out in the Privacy Act.

Compliance with the privacy regulation is monitored by the Privacy Commissioner, who has the authority to impose penalties proportional to the seriousness of the breach. These include actions such as the pursuit of damages through the federal courts, financial compensation to the policyholder, cessation of activities which led to the breach and public naming of the offender with details of the breach published in the annual report.

6.8 Sources of redress

Complaints procedures to address any breakdown in policyholder protection are well established across the industry. Licence holders are accountable for losses suffered by retail clients as a result of the actions of their representatives. The Corporations Act requires all insurance companies to have clearly documented internal dispute resolution procedures for retail clients, and to belong to an external dispute resolution scheme which meets ASIC-approved standards.

The Financial Ombudsman Service (FOS) commenced operations on 1 July 2008. FOS brings together the dispute resolution services provided by:

- Insurance Ombudsman Service
- Banking and Financial Services Ombudsman
- Financial Industry Complaints Service

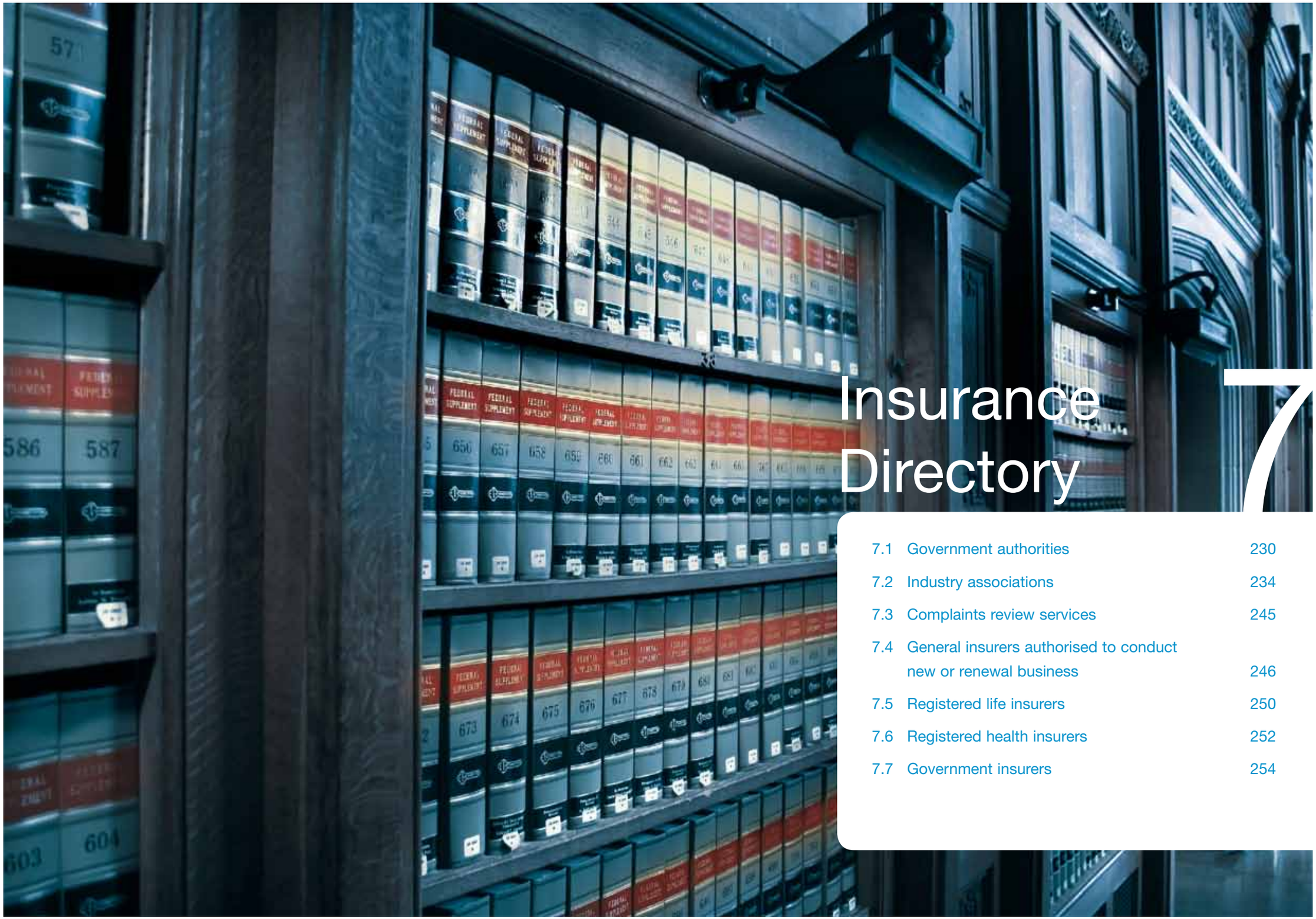
As a result, the new FOS comprises three divisions:

- General insurance
- Investments, life insurance and superannuation
- Banking and finance

each of which is headed by an individual industry Ombudsman.

Health insurance

Health insurance complaints are handled by the Private Health Insurance Ombudsman (PHIO), as authorised by the Government. PHIO provides a free service to consumers to assist with health insurance problems and enquiries. It also deals with complaints from health funds, private hospitals or medical practitioners regarding health insurance arrangements.



Insurance Directory

7

7.1 Government authorities

Government bodies that undertake insurance activities (e.g. Victorian Workcover Authority) are listed in the government insurers section of this chapter.

ACT Workcover

ACT Workcover is a government agency whose role is to prevent death, disease and injury in the workplace. Its work is supported by three main acts: the *Occupational Health and Safety Act 1989*, the *Workers Compensation Act 1951* and the *Dangerous Substances Act 2004*.

ACT Workcover oversees the operations of registered insurers that provide ACT workers' compensation insurance.

Level 3, Block B Callam offices, Easty Street Woden ACT 2606 www.ors.act.gov.au/workcover	Tel: (02) 6207 3000 Fax: (02) 6205 0336 Email: workcover@act.gov.au
Acting Commissioner	Mr M McCabe

Australian Prudential Regulation Authority

Level 26, 400 George St New South Wales 2000 www.apra.gov.au	Tel: (02) 9210 3000 Fax: (02) 9210 3411 Email: aprainfo@apra.gov.au
Chairman	Mr J Laker

Australian Securities and Investments Commission

PO Box 4000 Gippsland Mail Centre Victoria 3841 www.asic.gov.au	Tel: (03) 5177 3988 Fax: (03) 5177 3999 Email: info.enquiries@asic.gov.au
Chairman	Mr A M D'Aloisio

Motor Accident Insurance Commission

The Motor Accident Insurance Commission is the regulatory authority responsible for the management of the compulsory third-party (CTP) scheme in Queensland and insurers licensed under the scheme. Established under the *Motor Accident Insurance Act 1994*, the commission commenced operations on 1 September 1994 as a statutory body reporting to the state Treasurer. The chief executive is the Insurance Commissioner who, in this capacity, is also the Nominal Defendant.

The commission is funded by a statutory levy payable with the CTP insurance premium. Interest earned on investments of the Motor Accident Insurance Fund and revenue from compliance fines, combined with a small surplus from the statutory levy, fund the commission's research initiatives.

Level 9, 33 Charlotte Street Queensland 4001 www.maic.qld.gov.au	Tel: (07) 3227 8088 Fax: (07) 3229 3214 Email: maic@maic.qld.gov.au
Insurance Commissioner	Mr John Hand

Motor Accidents Authority

The Motor Accidents Authority (MAA) is a statutory corporation established to administer the NSW Motor Accidents Scheme, the CTP personal injury insurance scheme for motor vehicles registered in New South Wales. The major aim of the authority is to lead and support a CTP scheme that minimises the impact of motor vehicle accidents.

Level 25, 580 George St Sydney New South Wales 2000 www.maa.nsw.gov.au	Tel: 1300 137 131 Fax: 1300 137 707 Email: maa@maa.nsw.gov.au
Chairman	Mr R Grellman

Private Health Insurance Administration Council

Suite 16, Level 1
71 Leichhardt St
Kingston
Australian Capital Territory 2604
www.phiac.gov.au

Tel: (02) 6215 7900
Fax: (02) 6215 7977
Email: phiac@phiac.gov.au

Chief Executive Officer — Mr S Gath

Workcover Western Australia

WorkCover's mission is to minimise the social and economic impact on workers of work-related injury and disease and achieve cost effectiveness for employers and the community. To ensure the state's workers compensation and rehabilitation scheme runs smoothly for the people of Western Australia, WorkCover:

- provides information and community education on all aspects of the scheme
- monitors compliance with the Act to ensure employers are insured for workers compensation to their full liability
- promotes the injury management and vocational rehabilitation of injured workers to help them successfully return to work
- ensures all workers employed in a prescribed noisy workplace have the necessary hearing tests
- provides a conciliation and review process to resolve disputed workers compensation matters
- undertakes research and provides statistics in the areas of rehabilitation, injury prevention and noise-induced hearing loss.

2 Bedbrook Pl
Shenton Park
Western Australia 6008
www.workcover.wa.gov.au

Tel: (08) 9388 5555
Toll free: 1300 794 744
Fax: (08) 9388 5550
Email: postmaster@workcover.wa.gov.au

Chairman — Mr G Joyce
CEO — Ms M Reynolds

Workplace Standards Tasmania

Workplace Standards Tasmania is a division of the Department of Infrastructure, Energy and Resources and is responsible for administering much of the legislation that regulates business in Tasmania. Occupational health and safety and workers compensation, long service leave, shop trading hours, bank holidays and some occupational registrations are key areas. It also has responsibility for many industrial relations matters. An employer may obtain workers' compensation insurance by choosing an insurance company licensed by Workplace Standards Tasmania.

PO Box 56
Rosny Park Tasmania 7018
www.wst.tas.gov.au

Tel: (03) 6233 7657
Toll free: 1300 366 322
Fax: (03) 6233 8338
Email: wstinfo@justice.tas.gov.au

7.2
Industry associations

Association of Financial Advisers Ltd

Originally formed as the Life Underwriters Association of Australia & New Zealand. The Association of Financial Advisers (AFA) provides training courses for the financial services industry. AFA training courses cover risk management (life and general insurance), superannuation, estate planning and investment planning.

Level 6, 447 Kent St
New South Wales 2000
www.afa.asn.au

Tel: (02) 9267 5003
Fax: (02) 9267 5003
Email: info@afa.asn.au
Tollfree: 1800 656 009

President (National) — Mr D Bateman

Australasian Institute of Chartered Loss Adjusters

The Australasian Institute of Chartered Loss Adjusters (AICLA) is the Australian and New Zealand organisation of professionals in the loss adjusting business. Its object is the elevation of standards in loss adjusting in Australia, NZ and South-East Asia. Loss adjustors must pass an examination to join the institute. AICLA runs a tiered examination system for loss adjusters, including a diploma in business loss adjusting, through the Australian and New Zealand Institute of Insurance and Finance.

GPO Box 1705
Brisbane
Queensland 4001
www.aicla.org

Tel: (07) 3229 6663
Fax: (07) 3221 7267
Email: adminoffice@aicla.org

President — Mr S Thorpe

Australasian Institute of Marine Surveyors

The institute was formed in New South Wales and provides technical assistance to members who are qualified marine surveyors. It also provides information to members of the public who may seek the services of a marine surveyor.

PO Box 53
Berowra
New South Wales 2081
www.aimsurveyors.com.au

Email: secretary@aimsurveyors.com.au

President — Capt S C Beale

Australian Friendly Societies Association

The Australian Friendly Societies Association (AFSA) is the peak industry body for friendly societies and has some 100 members. It negotiates with government on behalf of members, maintains a professional statistical database, conducts training sessions and seminars, and advises members on compliance.

Lakeside Business Centre, Level 4,
150 Albert Road South Melbourne
Victoria 3205

Tel: (03) 9685 7543
Fax: (03) 9685 7599
Email: info@afsa.com.au

President — Mr C Wright

Australian Health Insurance Association Ltd

The Australian Health Insurance Association (AHIA) is an industry association with 23 registered health fund members. These funds represent 94 per cent of the population covered by private health insurance. AHIA provides members with research and statistical services, including assistance with technical matters. It liaises with federal and state governments and other industry organisations, and provides media comment on behalf of the health insurance industry.

Unit 17G, Level 1
2 King St
Deakin
Australian Capital Territory 2600
www.ahia.org.au

Tel: (02) 6202 1000
Fax: (02) 6202 1001
Email: admin@ahia.org.au

President — Mr T Smith

Australian Health Service Alliance Ltd

The Australian Health Service Alliance (AHSA) is a company that represents 24 of the 43 Registered Private Health Funds across Australia. It is responsible for facilitating arrangements between hospitals, doctors and health service providers on behalf of its member funds. Its services include:

- arranging business partnership agreements for members with about 467 private hospitals and other health care providers
- reviewing hospital services
- development of episodic (case-mix) billing and payment models for purchasing health care services
- development of medical-provider contracts with doctors
- industry based research to add value to funds and their members
- collecting, merging, verifying, auditing and dispatching Hospital Case-mix Protocol data for 24 health funds from about 467 hospitals.

979 Burke Rd
Camberwell
Victoria 3124
www.ahsa.com.au

Tel: (03) 9813 4088
Fax: (03) 9813 4099
Email: enquiries@ahsa.com.au

Chairman

Mr V Tozer

Australian Insurance Law Association

The Australian Insurance Law Association (AILA) is the Australian section of the International Association for Insurance Law (AIDA).AIDA was founded in the 1960s in Luxembourg and now has more than 55 national sections worldwide. The not-for-profit organisation aims to promote collaboration between industry officials and practising lawyers and academics by providing a forum for the review and development of insurance law through seminars, workshops and conferences.

38 Ellingworth Pde
Box Hill
Victoria 3128
www.aila.com.au

Tel: (03) 9899 5382
Fax: (03) 9890 6310
Email: national@aila.com.au

President

Mr C Rodd

Australian & New Zealand Institute of Insurance and Finance

The institute is the professional organisation in Australia, New Zealand and South-East Asia for persons engaged in insurance business and is concerned with education, training and professional development in all branches of insurance. The institute conducts direct examinations, mainly in insurance subjects, to educate and promote the career progression of insurance professionals. On completion, qualified persons may be elected as fellows, senior associates and members of the institute. It runs discussion groups and clubs throughout Australia and New Zealand.

600 Bourke St, Level 8
Melbourne
Victoria 3000
www.theinstitute.com.au

Tel: (03) 9613 7280
Fax: (03) 9642 4166
Email: customerservice@theinstitute.com.au

President

Mr J Richardson

Finance Sector Union of Australia

The Finance Sector Union of Australia (FSU) represents employees in the finance industry in Australia. It is committed to fostering members' ambitions and protecting their rights and interests in accordance with the objectives of the union and relevant industrial laws. It advises and supports employees, and aims to ensure their needs are met.

The FSU is a registered organisation under the Workplace Relations Act 1996 and is affiliated with the Australia Council of Trade Unions. It has branches in all states and national offices in Melbourne and Sydney. Full-time officials are elected for a four-year term by members.

341 Queen St
Melbourne Victoria 3000
www.fsunion.org.au

Tel: 1300 366 378
Fax: 1300 307 943
Email: fsuinfo@fsunion.org.au

Sydney/ACT:
Level 2, 321 Pitt St
New South Wales 2000

Tel: 1300 366 378
Fax: 1300 307 943
Email: nswact@fsunion.org.au

President

Ms C Gordon

Financial Services Accountants Association Ltd

The Financial Services Accountants Association (FSAA) was formed in 2000 from the merger of two industry accounting bodies, one involved with general insurance, the other with life insurance. The unified group aims to provide better service to its members, which include accountants and finance managers. Its services include training and development programs. Through the FSAA network, colleagues exchange ideas and keep abreast of developments in the industry.

PO Box 24
Willoughby
New South Wales 2068
www.fsaa.com.au

Tel: (02) 9451 3223
Fax: (02) 9451 3234
Email: administration@fsaa.com.au

Federal President — Mr V Walter

Health Insurance Restricted Membership Association of Australia Inc

The Health Insurance Restricted Membership Association of Australia (HIRMAA) is an association of 14 not-for-profit employee-based registered health insurance funds. It represents member funds in discussions with the Department of Health and PHIAC.

2/826 Whitehorse Rd
Box Hill
Victoria 3128
www.hirmaa.com.au

Tel: (03) 9896 9370
Fax: (03) 9896 9393
Email: ron.wilson@hirmaa.com.au

Executive Director — Mr R Wilson

IBNA Ltd

IBNA (formerly Insurance Brokers Network Australia Ltd) is a network of more than 80 accredited insurance brokers throughout Australia. Members provide products and services to IBNA shareholders, clients and underwriters.

Level 10
1 Elizabeth Plaza
North Sydney
New South Wales, 2060
www.ibna.com.au

Tel: (02) 8913 1640
Fax: (02) 9929 0451
Email: ibna@ibna.com.au

Managing Director — Mr G Watman

Institute of Accident Assessors

The institute is a professional body formed in New South Wales and provides technical assistance to members who are qualified automotive loss assessors in all states of Australia.

11-13 Byrne St
Auburn
New South Wales 2144
www.motorassessors.com.au

Tel: (02) 9648 1412
Fax: (02) 9648 4241
Email: iaa@motorassessors.com.au

President — Mr P Marks

Institute of Actuaries of Australia

The institute's main objectives are to:

- enhance the status of the actuarial profession in Australia
- make representations to governments and other bodies on matters with actuarial implications
- encourage the study of actuarial science
- provide a forum for discussion of matters of interest to the profession.

Level 7, Challis House
4 Martin Pl
New South Wales 2000
www.actuaries.asn.au

Tel: (02) 9233 3466
Fax: (02) 9233 3446
Email: actuaries@actuaries.asn.au

President — Mr T Thompson

Institute of Public Insurance Assessors Inc

The institute was formed in 1993 with the broad aims of promoting the profession of public-loss assessing, maintaining professional standards and widening consumer awareness of the service. Its objectives are:

- to maintain an institute for members who act for policyholders in the preparation, negotiation and settlement of insurance claims
- to ensure members maintain a professional standard of conduct and abide by the ethics of the institute
- to provide a forum for co-operation and exchange of information among members and related organisations
- to encourage and assist in the education of members, prospective members and related individuals and organisations
- to ensure the public has access to the same claims-handling expertise as insurance companies
- to promote the service to the public and relevant organisations.

The institute has close ties with sister organisations in the UK (the Institute of Public Loss Assessors or IPLA) and the US (the National Association of Public Insurance Adjusters or NAPIA).

6 Boronia St , Suite 1	Tel: (02) 9437 3088
Wollstonecraft	Fax: (02) 9437 3066
New South Wales 2065	Email: ipia@prorm.com.au
President	Mr M Arnold

Insurance Advisers Association of Australia Inc

The Insurance Advisers Association of Australia's (IAAA) 220 members are insurance agents providing insurance sales, service and advice to consumers. IAAA encourages the professional development of members and has a Certified Professional Insurance Adviser (CPIA) program, requiring yearly training that allows a member to retain certification.

PO Box 597	Tel: (03) 9390 9355
St Albans	Fax: (03) 8390 7877
Victoria 3021	Email: info@iaaa.com.au
www.iaaa.com.au	
President	Mr B Enever

Insurance Council of Australia Ltd

The Insurance Council of Australia (ICA) represents the interests of the general insurance industry. The Council was formed in 1975 and operates as an independent, not-for-profit organisation wholly owned by its members. The Council represents its members, handles issues and develops industry positions through government lobby, public affairs, industry forum, issues management and consumer services – all of which are backed up by technical and research resources.

Head Office	Tel: (02) 9253 5100
PO Box R1832	Fax: (02) 9253 5111
Royal Exchange, Sydney	www.insurancecouncil.com.au
New South Wales 1225	
President	Mr T R Towell

Insurance Premium Finance Association of Australia Ltd

The association's primary role is educational and concerned with self-regulation and dispute resolution. It provides legal advice and works to raise awareness of compliance issues among members. The premium funders are generally owned by the insurance industry and a large part of the funds are sourced from insurance companies.

c/- KPMG Level 4
161 Collins St
Melbourne Victoria 3000

President Mr T Priddle

Insurance Reference Services

The Insurance Reference Services (IRS), Australia's only national register of insurance claims, was established in 1991 and is owned and controlled by the insurance industry.

It aims to help the industry fight fraud. The IRS provides a comprehensive and easily accessible source of insurance and commercial credit and public record information, and holds more than 18 million claims from all major classes of general insurance throughout Australia. IRS provides services to members through an agreement with Baycorp Advantage.

PO Box 966
North Sydney
New South Wales 2059
www.vedaadvantage.com

Tel: (02) 9278 7000
Fax: (02) 9278 7333
Email: subscriber.assist@vedaadvantage.com

CEO & Managing Director Mr R Matthews

Investment and Financial Services Association

The Investment and Financial Services Association (IFSA) is a national not-for-profit association representing the investment and financial services sector. Its member companies provide managed investments, superannuation, life insurance and other financial services. IFSA represents members in dealings with governments, the media and the community. The Australian Retirement Income Streams Association merged with IFSA in 2002.

IFSA's mission is to play a role in the development of the social, economic and regulatory framework in which members operate, and help them to serve their customers better. IFSA works closely with legislators, regulators and other key shareholder groups to promote industry efficiency and ensure an effective and workable regulatory environment.

Suite 1, Level 24
44 Market St
New South Wales 2000
www.ifsa.com.au

Tel: (02) 9299 3022
Fax: (02) 9299 3198
Email: ifsa@ifsa.com.au

Chairman Mr D Deverall

Medical Indemnity Insurers' Association of Australia

The Medical Indemnity Insurer's Association of Australia (MIIAA) exists in order to:

- Inform and influence the national dialogue, debate and policy setting on matters relating to the systems of medical risk management and compensation for medical harm.
- Represent the voice of all insured doctors in such debates and policy setting.
- Enhance the reputation of the member organisations as major contributors to the well being of the profession and the community.
- Collaborate on the negotiation and implementation of government policy, legislation and regulation.

Westpac House, Level 24
91 King William St
Adelaide
South Australia 5000
www.miiaa.com.au

Tel: (08) 8113 5312
Email: chairman@miiaa.com.au

Chairman Dr A Miller

National Insurance Brokers Association of Australia

The National Insurance Brokers Association of Australia (NIBA) is an independent organisation of about 500 brokers representing the interests of members to the community, government and industry. Its services include technical and educational support for brokers. Initiatives for improvement of the industry include the Qualified Practising Insurance Broker (QPIB) program. QPIBs must meet rigid requirements in addition to those required for government registration. NIBA brokers abide by the general insurance brokers' code of practice and subscribe to the Insurance Brokers Dispute Facility.

111 Pacific Hwy , Level 18	Tel: (02) 9964 9400
North Sydney	Fax: (02) 9964 9332
New South Wales 2060	Email: niba@niba.com.au
www.niba.com.au	
President	Mr P Goddard

Risk Management Institute of Australaisia

The Risk Management Institution of Australasia Ltd is a company limited by guarantee dedicated to advancing the discipline and practice of risk management. It was incorporated in 2003, following decisions by members of the Australasian Institute of Risk Management Limited (AIRM) and ARIMA Limited to merge to form a new organisation.

Po Box 97	Tel: (03) 8341 1000
Carlton South	Fax: (03) 9347 5575
Victoria 3053	Email: admin@rmia.org.au
www.rmia.org.au	
President	Mr G Whitehorn

7.3 Complaints review services

The role and responsibilities of each complaints review service are discussed in the sources of redress section of Chapter 5.

Financial Ombudsman Service

GPO Box 3	Toll free: 1300 780 808
Melbourne	Fax: (03) 9613 6399
Victoria 3001	Email: info@fos.org.au
www.fos.org.au	
Chief Ombudsman	Mr C Neave AM

Private Health Insurance Ombudsman

362 Kent Street, Level 7	Tel: (02) 8235 8777
Sydney	Toll free: 1800 640 695
New South Wales 2000	Fax: (02) 8235 8778
www.phio.org.au	Email: info@phio.org.au
Acting Ombudsman	Ms S Gravel

7.4

General insurers authorised to conduct new or renewal business

ACE Insurance Ltd
Tel: (02) 9335 3200
www.aceinsurance.com.au

Aioi Insurance Co Ltd
Tel: (02) 9278 4888
www.ioi-sonpo.co.jp/en/index.html

Allianz Australia Insurance Ltd
Tel: 13 26 64
www.allianz.com.au

American Home Assurance Co
Tel: (02) 9240 1711
www.chartisinsurance.com

Ansvar Insurance Ltd
Tel: 1800 729 513
www.ansvarinsurance.com.au

ANZcover Insurance Pty Ltd
Tel: 13 13 14
www.anz.com.au

ANZ Lenders Mortgage Insurance Pty Ltd
Tel: 13 13 14
www.anz.com.au

Aspen Insurance UK Limited
Tel: +44 (0) 207 184 8000
www.aspen-re.com

Assetinsure Pty Ltd
Tel: (02) 9251 8055
www.assetinsure.com.au

Atradius Credit Insurance N.V.
Tel: (02) 9201 5222
www.atradius.com/au

Avant Insurance Limited
Tel: 1800 128 268
www.avant.org.au

Avea Insurance Agency
Tel: (08) 9202 5300
www.fortron.com.au

Australian Alliance Insurance Co Ltd
Tel: 13 50 50
www.apia.com.au
www.shannons.com.au
www.aami.com

Australian Associated Motor Insurers Ltd
Tel: 13 22 44
www.aami.com.au
www.justcarinsurance.com.au

Australian Family Assurance Limited
Tel: 1800 808 027
www.fcadirect.net

Australian Finance Group
Tel: (02) 8908 3600
1300 130 387
www.afgonline.com.au

Auto & General Insurance Company Limited
Tel: (07) 3377 8801
www.agic.com.au

Axis Specialty Australia
Tel: (02) 8235 1000
www.axiscapital.com

Barristers' Sickness and Accident Fund Pty Ltd
Tel: (02) 9232 4055
www.nswbar.asn.au

BHP Billiton Marine & General Insurances Pty Ltd
Tel: (02) 9609 3015
www.bhpbilliton.com

Calliden Insurance Limited
Tel: (02) 9551 1111
www.calliden.com.au

Catholic Church Insurances Ltd
Tel: 1300 655 001
www.ccinsurances.com.au

CGU Insurance Ltd
Tel: 13 15 32
www.cgu.com.au

CGU-VACC Insurance Ltd
Tel: 13 15 32
www.cgu.com.au

Chubb Insurance Co of Australia Ltd
Tel: (02) 9273 0100
www.chubb.com

CIC Allianz Insurance Ltd
Tel: 13 26 64
www.allianz.com.au

General insurers authorised to conduct new or renewal business (continued)

Coface Australia
Tel: (02) 8235 8600
www.coface.com.au

Combined Insurance Co of America
(trading as Combined Insurance Co of Australia)
Tel: 1300 300 480
www.combined.com.au

Commonwealth Insurance Ltd
Tel: 13 24 23
www.comminsure.com.au

Credicorp Insurance Pty Ltd
Tel: 13 32 82
www.cua.com.au

Cumis Insurance Society Inc
(as a part of the Cuna Mutual Group)
www.cumis.com

Curasalus Insurance Pty Ltd
(formerly known as Orica Insurance Pty Ltd)
Tel: (03) 9665 7111
www.orica.com.au

Elders Insurance Ltd
Tel: 1300 307 941
www.insurance.elders.com.au

Employers Mutual Ltd
Tel: 1800 469 931
www.employersmutual.com.au

First American Title Insurance Co of Australia Pty Ltd
Tel: (02) 8235 4433
www.firsttitle.com.au

FM Insurance Co Ltd
Tel: (02) 8273 1400
www.fmglobal.com

General Reinsurance Australia Ltd
Tel: (02) 8236 6100
www.genre.com

Genworth Financial Mortgage Insurance Pty Limited
Tel: 1300 655 422
www.genworth.com.au

GIO General Ltd
Tel: 13 10 10
www.gio.com.au

Great Lakes Australia
Tel: (02) 9272 8061
www.gla.com.au

Guild Insurance Ltd
Tel: 1800 810 213
www.guildgroup.com.au

Hallmark General Insurance Co Ltd
Tel: (02) 8249 3500
www.gemoney.com.au

Hannover Reinsurance
International Insurance Company of Hannover Ltd
Tel: (02) 9251 6911
www.hannover-re.com

HBF Insurance Pty Ltd
Tel: (08) 9265 6111 or 133 423
www.hbf.com.au

HDI Gerling Australia
Insurance Company Pty Limited
Tel: (02) 8274 4200
www.hid-gerling.com

Hollard Insurance Co Pty Ltd (The)
Tel: (02) 9253 6600
www.hollard.com.au

Hotel Employers Mutual Limited
Tel: (02) 8251 9069
www.hotelemployersmutual.com.au

HSB Engineering Insurance Ltd
Tel: 1300 739 472
www.hsbaustralia.com

IAG Re Australia Limited
Tel: (02) 9292 9222
www.iag.com.au

ING General Insurance Pty Ltd
Tel: 1800 815 688
www.ing.com.au

Insurance Australia Ltd
Tel: (02) 9292 9222
www.iag.com.au

Insurance Manufacturers of Australia Pty Ltd
Tel: 13 21 32
www.nrma.com.au
www.racv.com.au

LawCover Insurance Pty Ltd
Tel: (02) 9264 8855
www.lawcover.com.au

Liberty Mutual Insurance Co
(Trading as Liberty Internaional Underwriters)
Tel: (02) 8298 5800
www.liuaustralia.com.au

MDA National Insurance Pty Ltd
Tel: (02) 9023 3300
www.mdanational.com.au

Medical Insurance Australia Pty Ltd
Tel: (08) 8238 4444
www.miga.com.au

MIPS Insurance Pty Ltd
(Formerly Health Professionals Insurance Australia Pty Ltd)
Tel (03) 8620 8888
www.mips.com.au

General insurers authorised to conduct new or renewal business (continued)

Mortgage Risk Management Pty Ltd
Tel: 1300 943 322
www.widebayaust.com.au

MTA Insurance Ltd
(Formerly MTQ Insurance Ltd)
Tel: (07) 3392 1366
www.mtai.com.au

Mutual Community General Insurance Pty Ltd
Tel: 13 12 43
www.mutualcommunity.com.au

Munich Reinsurance Company
Tel: (02) 9272 8000
www.munichre.com

NIPPONKOA Insurance Co Ltd
Tel: (02) 8224 4194
www.nipponkoa.co.jp/english

Optus Insurance Services Pty Ltd
Tel: 1800 123 124
www.optus.com.au

Pacific International Insurance Limited
Tel: (02) 9820 3433
www.pacificintins.com

Permanent LMI Pty Ltd
Tel: (02) 9231 7777
www.qbelmi.com.au

QBE Insurance (Australia) Limited
QBE Insurance (International) Limited
QBE Lenders' Mortgage Insurance Limited
Tel: (02) 9375 4444
www.qbe.com

RAA Insurance Ltd
Tel: (08) 8202 4600
www.raa.net

RAC Insurance Pty Ltd
Tel: 13 17 03
www.rac.com.au

RACQ Insurance Ltd
Tel: 13 19 05
www.racq.com.au

RACT Insurance Pty Ltd
Tel: 13 27 22
www.ract.com.au

RealCover Insurances Pty Limited
http://realcover.com.au

SCOR Reinsurance Asia Pacific Pte Ltd
www.scor.com

Sirius International Insurance Corporation
www.siriusgroup.com

Sompo Japan Insurance Inc
www.sompo-japan.com/english

St Andrew's Insurance (Australia) Pty Ltd
Tel: 1300 780 553
www.standrewsaus.com.au

St George Insurance Australia Pty Limited
Tel: 13 33 30
www.stgeorge.com.au

StateCover Mutual Ltd
Tel: (02) 8270 6000
www.statecover.com.au

Stewart Title Ltd
Tel: (02) 9081 6200
www.stewart.com

Suncorp Metway Insurance Limited
Tel: 13 11 55
www.suncorp.com.au

Sunderland Marine Mutual Insurance Co Ltd
Tel: (03) 9650 6288
www.smmi.co.uk

Swann Insurance (Australia) Pty Ltd
Tel: 1300 307 926
www.swanninsurance.com

Swiss Reinsurance Company
Swiss Re International SE
Tel: (02) 8295 9500
www.swissre.com

The New India Assurance Co. Limited
Tel: (02) 9241 3388
http://newindia.co.in

Tokio Marine & Nichido Fire Insurance Co Ltd (The)
Tel: (02) 9232 2833

Transatlantic Reinsurance Co
Tel; (02) 9274 3061
www.transre.com

TT Club Mutual Insurance Limited
Tel: (02) 8262 5800
www.ttclub.com

Vero Insurance Ltd
Tel: 13 18 13
www.vero.com.au

Virginia Surety Company INC
Tel: (03) 9211 3000
www.aon.com

Wesfarmers Federation Insurance Ltd
Wesfarmers General Insurance Limited
Tel: 1300 934 934
www.wfi.com.au

Westpac General Insurance Ltd
Tel: 1300 130 272
www.westpac.com.au

General insurers authorised to conduct new or renewal business (continued)

Westpac Lenders Mortgage Insurance Ltd
Tel: 1300 130 272
www.westpac.com.au

Westport Insurance Corporation
Tel (02): 8295 9500
www.swissre.com

W.R. Berkley Insurance Australia
Tel: (02) 9006 1140
www.wrblondon.com/australia

XL Insurance Co Ltd
Tel: (02) 8270 1400
www.xlinsurance.com

Youi Pty Ltd
Tel: 1300 009 684
www.youi.com.au

Zurich Australian Insurance Ltd
Tel: (02) 9995 1111
www.zurich.com.au

7.5
Registered life insurers

Allianz Australia Life Insurance Limited
Tel: 13 10 00
www.allianz.com.au

American International Assurance Co (Australia) Ltd
Tel: 1800 333 613
www.aia.com.au

AMP Life Ltd
Tel: 13 32 67
www.amp.com.au

Asteron Life Limited
Tel: (02) 8275 3500
www.asteron.com.au

BT Life Ltd
Tel: 13 21 35
www.bt.com.au

Challenger Life No 2 Ltd
Tel: (02) 9994 7000
www.challenger.com.au

Colonial Mutual Life Assurance Society Ltd (The) (Trading as CommInsure)
Tel: 13 10 56
www.comminsure.com.au

Combined Life Insurance Co of Australia Ltd
Tel: 1300 300 480
www.combined.com

Cuna Mutual Life Australia Ltd
Tel: (02) 9295 5555
www.cunamutual.com.au

General Reinsurance Life Australia Ltd
Tel: (02) 8236 6100
www.genre.com

Global Life Reinsurance Company Of Australia
Tel: (02) 8274 4200
www.hdi-gerling.com

Hallmark Life Insurance Co Ltd
Tel: 1800 800 230
www.gemoney.com.au

Hannover Life Re of Australasia Ltd
Tel: (02) 9251 6911
www.hannoverlifere.com

HCF Life Insurance Co Pty Ltd
Tel: 13 13 34
www.hcf.com.au

ING Life Ltd
Tel: (02) 9234 8111
www.ing.com.au

IOOF Life Ltd
Tel: 13 13 69
www.ioof.com.au

Macquarie Life Ltd
Tel: 1800 005 057
www.macquarie.com.au

MBF Life Ltd
Tel: 13 26 23
www.mbf.com.au

Metlife Insurance Ltd
Tel: 1300 555 625
www.metlife.com.au

MLC Ltd
Tel: 13 37 71
www.mlc.com.au

MLC Lifetime Co Ltd
Tel: 13 26 52
www.mlc.com.au

Munich Reinsurance Co of Australasia Ltd
Tel: (02) 9272 8000
www.munichre.com

National Mutual Life Association of Australasia Ltd (trading as AXA)
Tel: 13 72 92
www.axa.com.au

Norwich Union Life Australia Ltd
(Trading as Aviva)
Tel: 1300 428 482
www.avivagroup.com.au

RGA Reinsurance Co of Australia Ltd
Tel: (02) 8264 5800
www.rgare.com

St Andrews Life Insurance Pty Ltd
Tel: 1300 780 553
www.standrewsaus.com.au

St George Life Ltd
Tel: 13 33 30
www.stgeorge.com.au

Suncorp Life & Superannuation Ltd
Tel: 13 11 55
www.suncorp.com.au

Registered life insurers (continued)

Swiss Re Life & Health Australia Ltd
Tel: (02) 8295 9500
www.swissre.com

TOWER Australia Ltd
Tel: (02) 9448 9000
www.toweraustralia.com.au

Westpac Life Insurance Services Ltd
Tel: 1300 130 272
www.westpac.com.au

Zurich Australia Ltd
Tel: 132 687
www.zurich.com.au

7.6

Registered health insurers

ACA Health Benefits Fund (R)
Tel: (02) 9847 3390
www.acahealth.com.au

Australian Health Management Group Ltd
Tel: 134 246
www.ahm.com.au

Australian Unity Health Ltd
Tel: 13 29 39
www.australianunity.com.au

BUPA Australia Health Pty Ltd
(trading as HBA & Mutual Community)
Tel: 131 243
www.hba.com.au

CBHS Health Fund Ltd (R)
Tel: 1300 654 123
www.cbhs.com.au

Cessnock District Health Benefits Fund Ltd
Tel: (02) 4990 1385
www.cdhbf.com.au

CUA Health Limited
Tel: 13 32 82
www.cua.com.au

Defence Health Ltd (R)
Tel: 1800 335 925
www.defencehealth.com.au

Doctors' Health Fund Ltd, The
Tel: 1800 226 126
www.doctorshealthfund.com.au

GMHBA Ltd
Tel: (03) 5224 8771
www.gmhba.com.au

Grand United Corporate Health Limited
Tel: 1800 249 966
www.guhealth.com.au

HBF Health Funds Inc
Tel: 13 34 23
www.hbf.com.au

Health Care Insurance Ltd (R)
Tel: 1800 804 950
www.hciltd.com.au

Healthguard Health Benefits Fund Ltd
(trading as Central West Health)
Tel: 133 206
www.centralwesthealth.com.au

Health Insurance Fund of Western Australia Inc
Tel: 1300 134 060
www.hif.com.au

Health-Partners Inc
Tel: 1300 113 113
www.healthpartners.com.au

Hospitals Contribution Fund of Australia Ltd (The)
Tel: 13 13 34
www.hcf.com.au

Latrobe Health Services Inc
Tel: 1300 362 144
www.latrobehealth.com.au

Lysaght Peoplecare Ltd (R)
Tel: (02) 4224 4333
www.peoplecare.com.au

Manchester Unity Australia Ltd
Tel: 13 13 72
www.manchesterunity.com.au

MBF Australia Ltd
Tel: 1300 653 525
www.mbf.com.au

MBF Alliances Pty Ltd
Tel: 13 26 23
www.mbf.com.au

Medibank Private Ltd
Tel: 13 23 31
www.medibank.com.au

Mildura District Hospital Fund Ltd
Tel: (03) 5021 7099

National Health Benefits Australia Pty Ltd
Tel: 1800 148 626

Navy Health Ltd (R)
Tel: (03) 9896 9300
www.navyhealth.com.au

NIB Health Funds Ltd
Tel: (02) 4914 1100
www.nib.com.au

Registered health insurers (continued)

Phoenix Health Fund Ltd (R)
Tel: (02) 4935 5738 or 1800 028 817
www.phoenixhealthfund.com.au

Police Health Limited
Tel: 1800 603 603
www.policehealth.com.au

Queensland Country Health Ltd
Tel: 1800 813 415

Queensland Teachers' Union Health Fund Ltd (R)
Tel: (07) 4928 3314
www.tuh.com.au

Railway & Transport Health Fund Ltd (R)
Tel: 1300 886 123
www.rthealthfund.com.au

Reserve Bank Health Society Ltd (R)
Tel: (02) 9551 9035

St. Lukes Health
Tel: 1300 651 988
www.stlukes.com.au

Teachers' Federation Health Ltd (R)
Tel: 1300 728 188
www.teachershealth.com.au

Transport Health Pty Ltd (R)
Tel: (03) 8420 1888
www.transporthealth.com.au

Westfund Ltd
Tel: 1300 552 132
www.westfund.com.au

7.7
Government insurers

ACT Insurance Authority
Tel: (02) 6207 0184
www.treasury.act.gov.au/actia/
Group: ACT Govt

Australian Reinsurance Pool Corporation
Tel: (02) 8223 6777
www.arpc.gov.au
Group: Cwlth Govt

Comcare
Tel: 1300 366 979
www.comcare.gov.au
Group: Cwlth Govt

Comcover Member Services
Tel: (02) 6215 2222
www.finance.gov.au/comcover
Group: Cwlth Govt

Defence Service Homes Insurance Scheme
Tel: 1300 552 662
www.dsh.gov.au
Group: Cwlth Govt

Export Finance & Insurance Corporation
Tel: (02) 9201 2111
www.efic.gov.au
Group: Cwlth Govt

Insurance Commission of WA
Tel: (08) 9264 3333
www.icwa.wa.gov.au
Group: WA Govt

Motor Accident Commission (SA)
Tel: (08) 8221 6377
www.mac.sa.gov.au
Group: SA Govt

Motor Accidents Insurance Board (Tas)
Tel: 1800 006 224
www.maib.tas.gov.au
Group: Tas Govt

NSW Self Insurance Corporation
Tel: (02) 9228 3829
www.sicorp.nsw.gov.au
Group: NSW Govt

NSW WorkCover Authority
Tel: 13 10 50
www.workcover.nsw.gov.au
Group: NSW Govt

South Australian Government Captive Insurance Corporation (SAICORP)
Tel: (08) 8226 9500
www.treasury.sa.gov.au
Group: SA Govt

Territory Insurance Office (NT)
Tel: 1300 301 833
www.tiofi.com.au
Group: NT Govt

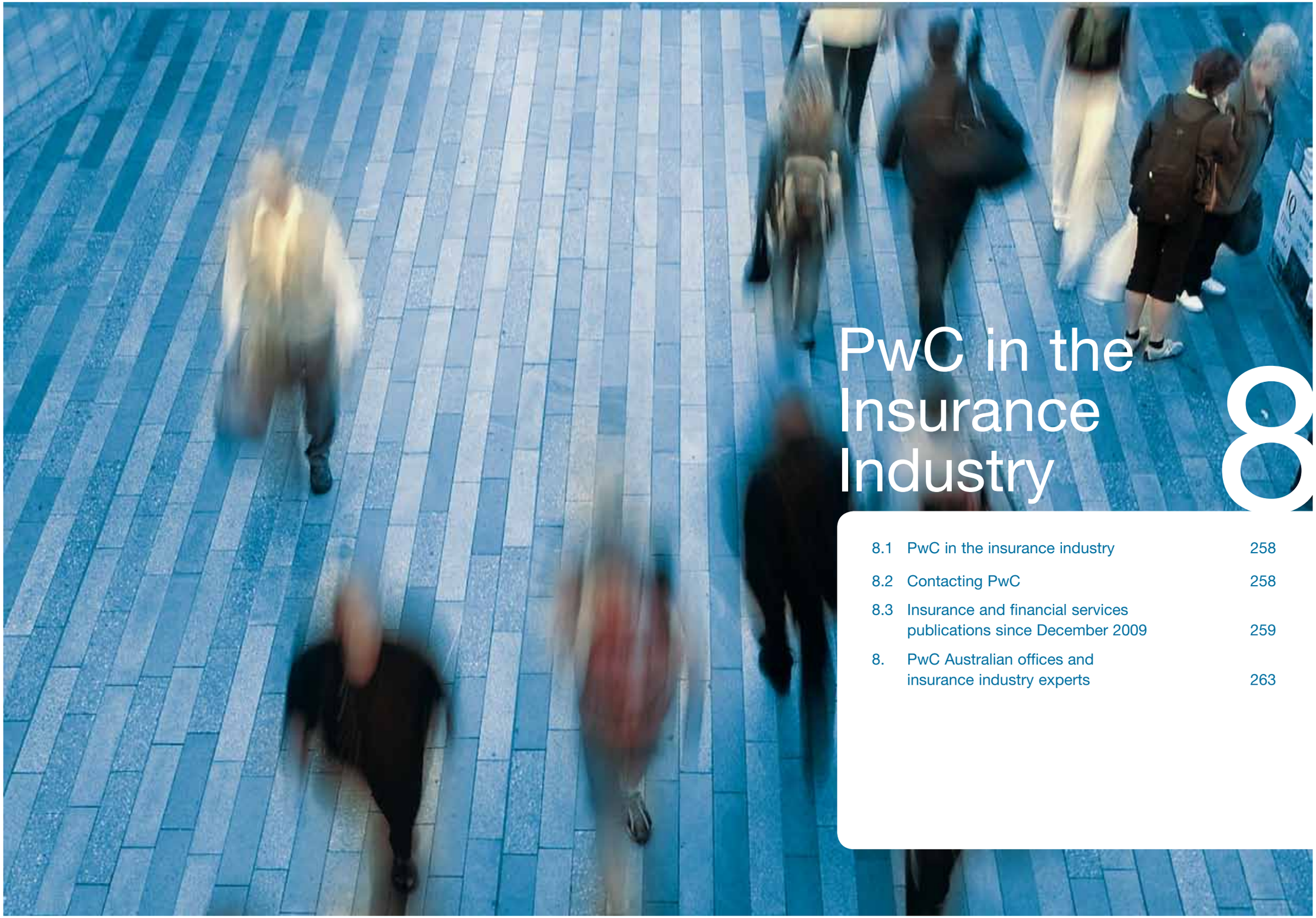
Transport Accident Commission (Vic)
Tel: 1300 654 329
www.tac.vic.gov.au
Group: Vic Govt

Victorian Managed Insurance Authority
Tel: (03) 9270 6900
www.vmia.vic.gov.au
Group: Vic Govt

Victorian WorkCover Authority
Tel: (03) 9641 1444
www.workcover.vic.gov.au
Group: Vic Govt

WorkCover Corporation (SA)
Tel: 13 18 55
www.workcover.com
Group: SA Govt

WorkCover Queensland
Tel: 1300 362 128
www.workcoverqld.com.au
Group: Qld Govt



PwC in the Insurance Industry

8

8.1 PwC in the insurance industry

PricewaterhouseCoopers provides industry-focused assurance, tax, and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 163,000 people in 151 countries across the network of PricewaterhouseCoopers firms share their thinking, experience and solutions to develop fresh perspectives and practical advice.

We are the leading assurance and advisory services provider for the insurance industry in Australia. This publication is one avenue through which we aim to add value to our clients by providing them with a useful reference with the latest annual industry statistics, key developments and regulations. The publication was composed based on the knowledge and contributions of many of our insurance industry experts.

We also release a number of other publications to alert and assist our clients in dealing with the latest global developments in insurance and financial services as a whole.

8.2 Contacting PwC

Please contact your local PricewaterhouseCoopers office to obtain any of the publications listed below or to, speak with one of our industry experts to discuss how we can help enhance the value of your business.

8.3 Insurance and financial services publications since December 2009

Proposed changes to accounting for insurance contracts

Is there light at the end of the tunnel?

The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) are planning to issue an exposure draft in May that would significantly change the accounting for insurance contracts.

Whilst the IASB has tentatively agreed to an approach that will look familiar to the Australian general insurance industry, there are some key issues that could have wide ranging impacts. All roads lead to the life insurance industry being greatly impacted.

In this paper we summarise the Boards' current thinking and highlight the key uncertainties that remain in the lead up to the proposals being finalised.

Publication date: April 2010

Insurance Insights – Unclaimed monies

The State Revenue Offices have recently ramped up their investigations into the compliance by businesses with the unclaimed monies legislation. This focus has included insurance companies. Knowing the obligations and being prepared will assist you in ensuring that they comply and will reduce the risk of potential penalties being imposed as a result of an investigation or audit by the relevant administration bodies.

Publication date: April 2010

Publications continued

Insurance Insights – Sharpening the focus on risk management for insurers

Findings from the PwC Annual Global CEO survey found that insurance CEOs are now increasing their attention on almost every aspect of risk management and doing so to a greater extent than CEOs in other sectors. In this insight, we set out a suggested mapping framework to assess current effectiveness and risk management functions at insurers.

Publication date: February 2010

The Henry Tax Review

The final report from the Henry tax review together with the Government's response was released on 2 May 2010.

While the Henry review report laid out a platform for comprehensive tax reform, the Government's response was far from a blueprint for the future.

In this edition of Taxtalk, we are pleased to provide an in-depth analysis on the impact of these recommendations on specfic areas of tax and the financial services industry.

Publication date: May 2010

IFRS in brief

Our financial reporting newsletter, IFRS in brief, focuses on topical accounting issues. These issues have significant potential impact on entities' profit and loss statements, balance sheets, disclosure obligations, and communication with their stakeholders.

Frequency: Fortnightly

VALUE ACCOUNTS Holdings 2010

This publication presents the sample annual and interim financial reports of a fictitious public company, VALUE ACCOUNTS Holdings Limited.

It illustrates the financial reporting disclosure requirements that apply under Australian equivalents to International Financial Reporting Standards on issue at 15 January 2010. Supporting commentary is also provided.

Frequency: Annually
Publication date: February 2010

Audit Committee Matters

Audit Committee Matters provides diligent audit committee members, and those associated with audit committees, insights into current industry issues.

The March 2010 edition of Audit Committee Matters includes the following topics:

- Audit committees outlook: What is changing?
- Beyond the financial crisis: How robust is your risk management?

Frequency: Quarterly
Publication date: March 2010

GS007 – What have we learned from the first year?

The importance of a robust control framework continues to be emphasised by regulators and the investment management community. The need for service organisations to demonstrate a sound control environment in light of increasing competition for business indicates senior management will continue to take a close interest in their GS007 reports for the foreseeable future. In this document, a series of questions and responses will assist organisations understand how their GS007 report compares to others.

Frequency: Ad-hoc
Publication date: February 2010

Publications continued

World Watch

World Watch Issue 1, 2010 demonstrates how companies that successfully navigated their way through the worst of the global downturn now face an extended period of unease. With uncertain economic growth, tighter regulatory frameworks and the introduction of new reporting guidelines, companies face increasing pressure to demonstrate responsible corporate behaviour.

This edition of our governance and corporate reporting magazine includes 36 pages of news and views from around the world.

Frequency: Annually
Publication date: January 2010

How sustainable is your business?

This publication investigates the balance between diligently managing non-share-owning stakeholder interests with the interests of shareholders themselves. Six health check points for a sustainable business are provided.

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How sustainable is your business model?

Business models underpin all businesses. However, some prove to be defective, with occasionally catastrophic results. One way to help ensure that business models are reliable is to examine the assumptions on which they are based, and in particular, their vulnerability to exceptionally unlikely events or long-term changes.

This publication challenges assumptions that underlie business modelling and provides six health check points in reviewing your business model.

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