

**ACCOUNTING STANDARD**

**AASB 1038**

July 2004

# **Life Insurance Contracts**



**Australian Government**

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**Australian Accounting  
Standards Board**

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## PREFACE

### Reasons for Re-issuing AASB 1038

The Australian Accounting Standards Board (AASB) is implementing the Financial Reporting Council's policy of adopting the Standards of the International Accounting Standards Board (IASB) for application to reporting periods beginning on or after 1 January 2005. The AASB has decided it will continue to issue sector-neutral Standards, that is, Standards applicable to both for-profit and not-for-profit entities, including public sector entities. Except for Standards that are specific to the not-for-profit or public sectors or that are of a purely domestic nature, the AASB is using the IASB Standards as the "foundation" Standards to which it adds material detailing the scope and applicability of a Standard in the Australian environment. Additions are made, where necessary, to broaden the content to cover sectors not addressed by an IASB Standard and domestic, regulatory or other issues.

The IASB defines International Financial Reporting Standards (IFRSs) as comprising:

- (a) International Financial Reporting Standards;
- (b) International Accounting Standards; and
- (c) Interpretations originated by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

The Australian equivalents to IFRSs are:

- (a) Accounting Standards issued by the AASB that are equivalent to Standards issued by the IASB, being AASBs 1 – 99 corresponding to the IFRS series and AASBs 101 – 199 corresponding to the IAS series; and
- (b) UIG Interpretations issued by the AASB corresponding to the Interpretations adopted by the IASB, as listed in AASB 1048 *Interpretation and Application of Standards*.

### Compliance with IFRSs

This Standard has been revised to incorporate the limited improvements to accounting for insurance contracts required by AASB 4 *Insurance Contracts* (the Australian equivalent to IFRS 4 *Insurance Contracts*). Life insurers applying this Standard and Australian equivalents to other IFRSs will therefore be compliant with IFRSs.

The following requirements in this Standard have been introduced to ensure compliance with IFRSs:

- (a) definition of an insurance contract (section 20 and Appendix);
- (b) embedded derivatives (paragraph 2.2.1);
- (c) deposit components (paragraph 2.3.1);
- (d) impairment of reinsurance assets (section 7);
- (e) presentation of acquired insurance contracts (section 13);
- (f) disclosure – explanation of recognised amounts (section 14);
- (g) disclosure – amount, timing and uncertainty of cash flows (section 15); and
- (h) participating business sold by foreign life operations (paragraphs 17.5.4 and 17.5.5)

In applying paragraphs and sections listed in (a) to (b) and (d) to (h) above, life insurers may refer to the *AASB 4 Implementation Guidance* which is the Australian equivalent of *IFRS 4 Implementation Guidance*.

## **Main Features of this Standard**

### **Application Date**

This Standard is applicable to annual reporting periods beginning on or after 1 January 2005. To promote comparability among the financial reports of Australian entities, early adoption of this Standard is not permitted.

### **First-time Application and Comparatives**

Application of this Standard will begin in the first annual reporting period beginning on or after 1 January 2005 in the context of adopting all Australian equivalents to IFRSs. The requirements of AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*, the Australian equivalent of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, must be observed. AASB 1 requires prior period information, presented as comparative information to be restated as if the requirements of this Standard had always applied. This differs from previous Australian requirements where changes in accounting policies did not require the restatement of the income statement and balance sheet of the preceding period. However, AASB 1 provides an exemption from the

requirement to restate comparative information for this Standard, AASB 139 *Financial Instruments: Recognition and Measurement*, AASB 4 and AASB 1023 *General Insurance Contracts*.

This Standard states that, except for the disclosures about accounting policies, and recognised assets, liabilities, income, expense and cash flows, an insurer need not apply the disclosure requirements in this Standard to comparative information that relates to annual periods beginning before 1 January 2005. However, where an insurer does apply the disclosure requirements in this Standard to comparative information that relates to annual periods beginning before 1 January 2005, if it is impracticable to apply any requirements of this Standard to comparative information that relates to annual periods beginning before 1 January 2005, an entity shall disclose that fact. In addition, in applying paragraph 15.1.1(c)(iii), an entity need not disclose information about claims development that occurred earlier than five years before the end of the first annual reporting period in which it applies this Standard. Furthermore, if it is impracticable, when an entity first applies this Standard, to prepare information about claims development that occurred before the beginning of the earliest period for which an entity presents full comparative information that complies with this Standard, the entity shall disclose that fact.

## **Main Requirements**

### **Definition of Insurance**

This Standard includes 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.

This Standard deals with those contracts that meet the definition of a life insurance contract. A life insurance contract is an insurance contract governed by the *Life Insurance Act 1995*, and specifically excludes private health insurance contracts written by life insurers but issued under the

*National Health Act 1953*. Insurance contracts that are not life insurance contracts are general insurance contracts and are to be treated under AASB 1023.

A contract governed by the Life Insurance Act, that does not meet the definition of a life insurance contract in this Standard, is a life investment contract. Life investment contracts are treated under AASB 139 *Financial Instruments: Recognition and Measurement*, to the extent that they give rise to financial assets or financial liabilities.

However, financial instruments with discretionary participation features are treated under this Standard as if they were life insurance contracts.

### **Assets Backing Life Insurance Liabilities or Life Investment Contract Liabilities**

The principle used by the AASB in developing this Standard is to require assets backing life insurance liabilities or life investment contract liabilities to be measured at fair value wherever possible without creating an inconsistency with IFRSs.

This Standard restricts insurers' measurement choices, under the applicable Australian Accounting Standards, when measuring assets backing life insurance liabilities or life investment contract liabilities. When assets are not backing life insurance liabilities or life investment contract liabilities, measurement choices available in other Australian Accounting Standards are not restricted.

Assets backing life insurance liabilities or life investment contract liabilities are measured on a basis that is consistent with the measurement of the life insurance liabilities or life investment contract liabilities. As this Standard requires life insurance liabilities to be measured using an expected present value calculation, and life investment contract liabilities to be measured at fair value under AASB 139, this Standard requires insurers to measure assets backing life insurance liabilities or life investment contract liabilities at fair value with changes in fair value recognised in the income statement wherever this option is available in the applicable Australian Accounting Standards. For example, under AASB 139, financial assets backing life insurance liabilities or life investment contract liabilities are designated, on first application of this Standard, or on initial recognition, as "at fair value through profit or loss".

This Standard does not define the expression "assets backing life insurance liabilities or life investment contract liabilities" and requires life insurers to disclose the process used to determine which assets back life insurance liabilities or life investment contract liabilities.

### **Discount Rates**

Life insurance liabilities are discounted for the time value of money using risk-free rates that are current observable, objective rates that relate to the nature, structure and term of the life insurance liabilities. However, to the extent that benefits under life insurance contracts are contractually linked to the performance of the actual assets held, discount rates are based upon the future anticipated earning rates of the assets held.

### **Disclosure**

This Standard introduces additional disclosure requirements. It requires disclosures for life insurance contracts that explain the recognised amounts in its balance sheet and income statement that arise from life insurance contracts, and that help users to understand the amount, timing and uncertainty of future cash flows from life insurance contracts. The insurer determines the appropriate level of aggregation that is required to satisfy the disclosure principles.

### **Embedded Derivatives**

This Standard is applied to derivatives embedded in a life insurance contract where the embedded derivatives are themselves life insurance contracts. Embedded derivatives that are not life insurance contracts are treated under AASB 139, unless exempted under this Standard.

### **Deposit Components**

Under AASB 1038 *Life Insurance Business*, issued in 1998, the deposit component of a life insurance contract is split from the life insurance component of a life insurance contract, such that the premiums and claims under the life insurance component are recognised in the income statement as income and expense, and the premiums and claims under the deposit component are recognised in the balance sheet as changes in life insurance liabilities. Premiums and claims are split when this is practicable and when the components can be measured reliably. Whilst premiums and claims are split, however, they remain within the scope of the life insurance standard.

Under this Standard, premiums and claims are split when the deposit component can be measured separately. That is, the premiums and claims under the life insurance component are recognised in the income statement as income and expense, and the premiums and claims under the deposit component are recognised in the balance sheet.

However, under this Standard, an insurer is also permitted to unbundle any deposit component that can be measured separately. Unbundling the deposit

component involves removing the deposit component from the scope of this Standard and treating it under AASB 139.

Under this Standard, therefore, where any deposit component under a life insurance contract can be measured separately, a life insurer first splits any premiums and claims arising from the deposit component of the life insurance contract from the premiums and claims arising from the life insurance component of the life insurance contract. Secondly, the premiums and claims arising from deposit component can either be recognised as changes in life insurance liabilities in the balance sheet and treated under this Standard, or the insurer may unbundle the deposit component and treat it under AASB 139.

Where any deposit component under a life insurance contract cannot be measured separately, the premiums and claims cannot be split and the deposit component cannot be unbundled and treated under AASB 139.

### **Life Investment Contracts**

Life investment contracts are contracts governed by the Life Insurance Act that do not meet the definition of a life insurance contract in this Standard. Similar contracts may also be issued by entities not subject to the Life Insurance Act. All such contracts are generically referred to as investment contracts.

Most investment contracts, including most life investment contracts, involve both the origination of one or more financial instruments and the provision of management services. The financial instrument element of the contract refers to those activities and associated cash flows that relate directly to the establishment of a financial asset or financial liability. For example, in respect of an investment-linked contract the financial instrument element would typically be the unit liability. The management services element refers to all activities and associated cash flows arising from the full range of management services provided, including investment management, financial planning and advice. The financial instrument element is treated under AASB 139 and the management services element is treated under AASB 118 *Revenue*.

This Standard requires financial assets and financial liabilities that arise under life investment contracts, as well as financial assets backing financial liabilities that arise under life investment contracts, to be measured consistently. Therefore, life investment contracts liabilities, and financial assets backing life investment contract liabilities are designated, on first application of this Standard, or on initial recognition, as “at fair value through profit or loss” under AASB 139.

Other non-financial assets backing life investment contract liabilities are treated under the applicable Australian Accounting Standards, but are required to be measured at fair value, with changes in fair value recognised in the income statement, where this measurement basis is allowable under the applicable Australian Accounting Standards.

## **Possible Future Changes to this Standard**

### **Fair Value Option**

IAS 39 *Financial Instruments: Recognition and Measurement* currently allows any financial asset or financial liability to be designated as “at fair value through profit or loss” on initial recognition or on first adoption of the standard. This Standard requires financial assets backing life insurance liabilities or life investment contract liabilities and life investment contract liabilities to be designated as “at fair value through profit or loss” under AASB 139.

The IASB has issued *Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement – The Fair Value Option*. Under these proposals there will be restrictions on the financial assets and financial liabilities that can be designated as “at fair value through profit or loss”. The AASB has issued ED 132 *Request for Comment on IASB ED Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement – The Fair Value Option*.

It is proposed that to be designated as “at fair value through profit or loss”, the fair value of financial assets and financial liabilities must be verifiable, that is, there must be a low variability in the range of reasonable fair value estimates. The fair value of some unlisted securities may not be considered to be verifiable.

In addition, it is proposed that to be designated as “at fair value through profit or loss” a financial asset or financial liability must meet one of five conditions. Under the IASB proposals, some financial assets and financial liabilities that this Standard requires to be designated as “at fair value through profit or loss” may no longer be able to be measured in this way. For example, a financial asset that meets the definition of a loan or receivable may not meet one of the five conditions. It is common for insurers to hold non-quoted fixed interest assets to back their insurance liabilities.

It is proposed, by the IASB, that the Standard arising from the Exposure Draft will apply to reporting periods beginning on or after 1 January 2005. ED 132 proposes that any changes to the fair value option be applicable for periods beginning on or after 1 January 2006, with early adoption permitted.

## **Phase II of IASB's Insurance Project**

This Standard incorporates Phase I of the IASB's Insurance Project, represented, in Australia, by AASB 4. The IASB is currently progressing Phase II of the Insurance Project, which will consider the recognition and measurement of insurance contracts. This project is not expected to be completed before 2007. It is expected that the outcome of Phase II will be a revised insurance contracts standard that will replace this Standard, AASB 1023 and AASB 4.

## COMPARISON WITH INTERNATIONAL PRONOUNCEMENTS

### AASB 1038 and IFRS 4

AASB 1038 *Life Insurance Contracts* incorporates the limited improvements to accounting for insurance contracts required by IFRS 4 *Insurance Contracts*.

Life insurers applying this Standard and Australian equivalents to other IFRSs will therefore be compliant with IFRSs.

IFRS 4 is being implemented in Australia using three accounting standards:

- (a) AASB 4 *Insurance Contracts* (the Australian equivalent to IFRS 4) which applies to fixed-fee service contracts that meet the definition of an insurance contract;
- (b) AASB 1023 *General Insurance Contracts* which applies to general insurance contracts; and
- (c) AASB 1038 which applies to life insurance contracts.

IFRS 4 applies to all insurance contracts and financial instruments with discretionary participation features whereas AASB 1038 applies to life insurance contracts and financial instruments with discretionary participation features, certain aspects of accounting for life investment contracts as well as certain aspects of accounting for assets that back life insurance liabilities or life investment contract liabilities.

Whereas IFRS 4 only includes limited improvements to accounting for insurance contracts and disclosure requirements, AASB 1038 addresses all aspects of the recognition, measurement and disclosure of life insurance contracts.

IFRS 4 allows insurers to make changes to accounting policies if the changes make the financial report more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs. Under the revised AASB 1038 life insurers need to change their accounting policies to reflect the revised requirements of the Standard but will not be able to make any additional changes to accounting policies.

IFRS 4 allows insurers to use a practice described as “shadow accounting”. The revised AASB 1038 does not allow shadow accounting.

## **AASB 1038 and IPSASs**

The International Public Sector Accounting Standards (IPSASs) are issued by the Public Sector Committee of the International Federation of Accountants.

There is no specific IPSAS dealing with accounting for insurance contracts at present.

## ACCOUNTING STANDARD AASB 1038

The Australian Accounting Standards Board makes Accounting Standard AASB 1038 *Life Insurance Contracts* under section 334 of the *Corporations Act 2001*.

Dated 15 July 2004

D.G. Boymal  
Chair – AASB

## ACCOUNTING STANDARD AASB 1038

### *LIFE INSURANCE CONTRACTS*

#### **1 Application**

**1.1 This Standard applies to each entity that is:**

- (a) *a life insurer; or*
  - (b) **the parent in a group that includes a life insurer;**
- and is:**
- (c) **required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a reporting entity;**
  - (d) **general purpose financial reports of each other reporting entity; and**
  - (e) **financial reports that are, or are held out to be, general purpose financial reports.**

1.1.1 This Standard applies to the consolidated financial statements of a group in relation to a life insurer subsidiary. Paragraph 4.2 is of particular relevance in this case.

**1.2 This Standard applies to annual reporting periods beginning on or after 1 January 2005.**

**1.3 This Standard shall not be applied to annual reporting periods beginning before 1 January 2005.**

- 1.4 The requirements specified in this Standard apply to the financial report where information resulting from their application is material in accordance with AASB 1031 *Materiality*.**
- 1.4.1 The requirements specified in this Standard apply to the financial report where information resulting from their application is material, in accordance with AASB 1031. An example of the application of materiality is that disclosures about life insurance contracts in the context of a group that includes a life insurer are required where the life insurance business is material in the context of the group.
- 1.4.2 For the purposes of AASB 134 *Interim Financial Reporting*, the determination of *policy liabilities* does not necessarily require a full actuarial valuation. In accordance with AASB 134, policy liabilities would need to be determined on a reliable basis, would be based on reasonable estimates, would include a full review of all assumptions, and would not be materially different from the policy liabilities determined by a full actuarial valuation.
- 1.5 When operative, this Standard supersedes AASB 1038 *Life Insurance Business* as approved by public notice in the *Commonwealth of Australia Gazette No 546, 19 November 1998*.**
- 1.6 AASB 1038 (issued in November 1998) remains applicable until superseded by this Standard.
- 1.7 Notice of this Standard was published in the *Commonwealth of Australia Gazette No S 294, 22 July 2004*.

## **2 Scope**

### **Life insurance contracts**

- 2.1 This Standard applies to:**
- (a) *life insurance contracts (including life reinsurance contracts) that a life insurer issues and to life reinsurance contracts that it holds;*
  - (b) *certain aspects of accounting for life investment contracts that a life insurer issues, or, in the case of a life investment contract that is reinsured, that it holds; and*

- (c) **certain assets backing life insurance liabilities or life investment contract liabilities.**

2.1.1 A life insurance contract is:

- (a) an *insurance contract*, as defined by this Standard, regulated under the *Life Insurance Act 1995*, or similar contracts issued by entities operating outside Australia; or
- (b) a financial instrument with a *discretionary participation feature*, which is regulated under the Life Insurance Act, or similar contracts issued by entities operating outside Australia.

2.1.2 All other insurance contracts are *general insurance contracts* and are treated under AASB 1023 *General Insurance Contracts* or AASB 4 *Insurance Contracts*.

2.1.3 A life insurer is defined as an *insurer* or *reinsurer*, registered under the Life Insurance Act, who issues life insurance contracts or life investment contracts, or a similar entity operating outside Australia.

2.1.4 This Standard applies to life insurance contracts issued by friendly societies registered under the Life Insurance Act. Private health insurance contracts that are issued under the *National Health Act 1953* by friendly societies registered under the Life Insurance Act are excluded from the scope of this Standard. Private health insurance contracts issued under the National Health Act are treated under AASB 1023.

2.1.5 Life insurers often sell contracts that do not meet the definition of a life insurance contract in this Standard. These contracts are referred to as life investment contracts for the purposes of this Standard. Section 12 addresses the requirements in relation to life investment contracts.

2.1.6 A financial instrument with a discretionary participation feature, issued by a life insurer, is defined as a life insurance contract for the purposes of this Standard and in measuring the life insurance liability, issuers of such instruments would apply paragraph 8.9. AASB 132 *Financial Instruments: Disclosure and Presentation* addresses additional disclosure in relation to these financial instruments.

## **Embedded derivatives**

- 2.2.1 AASB 139 *Financial Instruments: Recognition and Measurement* requires an entity to separate some embedded derivatives from their host contract, measure them at *fair value* and include changes in their fair value in the income statement. AASB 139 applies to derivatives embedded in a life insurance contract unless the embedded derivative is itself a life insurance contract.
- 2.2.2 As an exception to the requirement in AASB 139, an insurer need not separate, and measure at fair value, a policyholder's option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate) even if the exercise price differs from the carrying amount of the host *insurance liability*. However, the requirement in AASB 139 applies to a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in a financial variable (such as an equity or commodity price or index), or a non-financial variable that is not specific to a party to the contract. Furthermore, that requirement also applies if the holder's ability to exercise a put option or cash surrender option is triggered by a change in such a variable (for example, a put option that can be exercised if a stock market index reaches a specified level).
- 2.2.3 Paragraph 2.2.2 applies equally to options to surrender a financial instrument containing a discretionary participation feature.

## **Deposit components**

- 2.3.1 Some life insurance contracts contain both an insurance component and a *deposit component*. In some cases, an insurer is permitted to *unbundle* those components.
- 2.3.2 Unbundling is permitted if the insurer can measure the deposit component separately.
- 2.3.3 If a life insurer cannot measure the deposit component separately, an insurer shall not unbundle the deposit component.
- 2.3.4 To unbundle a life insurance contract, a life insurer:
- (a) treats the life insurance component as a life insurance contract in accordance with this Standard;
  - (b) subject to (c), treats the deposit component as a life investment contract in accordance with this Standard; and

- (c) where the deposit component includes a discretionary participation feature, treats this component as a separate life insurance contract in accordance with this Standard.

### **3 Purpose of Standard**

#### **3.1 The purpose of this Standard is to:**

- (a) **prescribe the accounting methods to be used for reporting on life insurance contracts consistent with AASB 4 *Insurance Contracts*, and the accounting methods to be used for certain aspects of life investment contracts;**
- (b) **prescribe the accounting methods to be used in accounting for assets backing life insurance liabilities or life investment contract liabilities; and**
- (c) **require disclosures about life insurance contracts and disclosures about certain aspects of life investment contracts.**

### **4 Entity and Consolidation Issues**

#### **The life insurer entity**

#### **4.1 A life insurer shall recognise in its financial report the assets, liabilities, income, expenses and equity of the entity, whether they are designated as relating to *policyholders* or to shareholders.**

- 4.1.1 Life insurers may have both policyholders and shareholders with a financial interest in the entity. It is sometimes argued that the interests of policyholders and the interests of shareholders form the bases of separate entities that should prepare separate primary financial statements. However, the view adopted in this Standard is that the interests of policyholders and shareholders are intertwined and form the basis of a single entity. The boundaries of this entity are defined by control. The directors of the life insurer, in pursuing its objectives, govern the decision-making in relation to the financial and operating policies of the life insurer, which includes the assets of the entity, whether they are designated as relating to policyholders or to shareholders.

- 4.1.2 Equity in a shareholder-owned life insurer will generally comprise only shareholder equity. Although participants in the industry commonly refer to “policyholder retained profits”, in relation to Australian business such amounts are unvested policyholder benefits liabilities. Under Australian legislation, “policyholder retained profits” relating to Australian *life insurance business* are paid to policyholders, although the timing of the payment is at the discretion of the life insurer. A life insurer will only have policyholder equity if that life insurer has foreign life insurance operations in a jurisdiction that permits retained profits to remain unallocated between policyholders and shareholders, and the policyholders’ component has yet to be determined.

### **Financial statements of groups that include a life insurer subsidiary**

- 4.2 The consolidated financial statements of a group that includes a life insurer subsidiary shall recognise all of the assets, liabilities, income and expenses of that subsidiary, whether they are designated as relating to the policyholders or to the shareholders of that life insurer. The life insurance contracts, life investment contracts and assets of a life insurer subsidiary and its group recognised in the consolidated financial statements of a group shall be measured in accordance with this Standard.**
- 4.2.1 For the same reasons that a life insurer entity is considered to comprise both policyholder and shareholder interests, the view adopted in this Standard is that the parent controls the interests of both policyholders and shareholders and, accordingly, the consolidated financial statements of the group include all of those interests. The parent of a life insurer effectively uses all of the resources of shareholders and policyholders in achieving its objectives and effectively controls policyholder interests for the benefit of both policyholders and shareholders.
- 4.2.2 Some life insurers are subsidiaries of entities other than life insurers, such as banks, and some are subsidiaries of other life insurers. The character of the parent of a life insurer has no bearing on whether consolidated financial statements, prepared in accordance with paragraph 4.2, are required.

## 5 Premiums and Claims

- 5.1** Subject to paragraph 5.2, insurance components of life insurance contract premiums are income and insurance components of life insurance contract claims are expenses and shall be recognised separately in the income statement. Deposit components of life insurance contract premiums are not income and deposit components of life insurance contract claims are not expenses and shall be recognised as changes in *life insurance liabilities*.
- 5.2** For life insurance contracts where unbundling of the deposit component is prohibited under paragraph 2.3.3, premiums shall be recognised as income and claims shall be recognised as expenses.
- 5.2.1 A wide variety of products are offered by life insurers – risk or insurance products, investment products and numerous hybrids of these two products. There will be hybrid products that fall within the scope of this Standard that have both deposit and insurance components.
- 5.2.2 Premiums may comprise amounts that give rise to:
- (a) income that is earned by providing services, including the bearing of risks; and
  - (b) amounts that are akin to deposits and which qualify for recognition as liabilities.
- 5.2.3 Similarly, claims may comprise amounts that give rise to:
- (a) expenses that are incurred in providing services, including the bearing of risks; and
  - (b) amounts that are akin to withdrawals from deposits and which qualify for recognition as reductions in liabilities.
- 5.2.4 The performance of a life insurer is best reflected when only income and expenses are recognised in the income statement. The inclusion of other types of cash flows limits the ability of users to assess the performance of a life insurer's operations relative to other entities or investments.

## 6 Reinsurance

### Reporting by cedants

#### 6.1 A cedant shall recognise:

- (a) premiums ceded to reinsurers as reinsurance expenses;
- (b) claim recoveries and commissions from reinsurers as income; and
- (c) claim recoveries and other inflows not yet received from a reinsurer as an asset.

6.1.1 Life insurers may reinsure some of their business. The cedant remains responsible for the total amount of successful claims of policyholders and, through reinsurance arrangements, may be entitled to recover amounts relating to some of those claims.

6.1.2 Reinsurance contracts are considered to be separate transactions from the original life insurance contracts and therefore give rise to separately recognisable amounts. The cedant recognises the gross amount of premiums received in accordance with paragraphs 5.1 and 5.2 and, where portions of the policies are reinsured, the ceded premiums are recognised as expenses (except where they would otherwise be recognised as deposits, if not reinsured). Any recoveries from reinsurers are recognised as income by the cedant (except for any amounts representing the return of deposits). Consistent with this approach, the gross amount of life insurance liabilities is recognised as a liability and claim recoveries not yet received from a reinsurer are recognised as a receivable by the cedant.

### Reporting by reinsurers

#### 6.2 Inwards reinsurance premiums and outwards reinsurance claims shall be recognised by the accepting reinsurer as for premiums and claims in accordance with paragraphs 5.1 and 5.2. Life insurance liabilities assumed shall be recognised as a liability by the accepting reinsurer in accordance with section 8.

6.2.1 From the perspective of the reinsurer, reinsurance premiums accepted are recognised in the same way as the cedant treats the acceptance of premiums under a *direct insurance contract*. Correspondingly, claims paid and payable to direct insurers are

recognised as expenses by the reinsurer. Consistent with these treatments, life insurance liabilities assumed are recognised as a liability by the accepting reinsurer.

## **7 Impairment of Reinsurance Assets**

- 7.1.1 If a cedant's reinsurance asset is impaired, the cedant shall reduce its carrying amount accordingly and recognise that impairment in the income statement. A reinsurance asset is impaired if, and only if:
- (a) there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the cedant may not receive amounts due to it under the terms of the contract; and
  - (b) that event has a reliably measurable impact on the amounts that the cedant will receive from the reinsurer.

## **8 Life Insurance Liabilities**

### **Present value and best estimates**

- 8.1 **Obligations arising from life insurance contracts (life insurance liabilities) shall be recognised as liabilities and shall be measured at each reporting date as:**
- (a) **the net present value of future receipts from and payments to policyholders, including participating benefits, allowing for the possibility of discontinuance before the end of insurance contract periods, plus planned margins of revenues over expenses relating to services yet to be provided to policyholders, on the basis of assumptions that are best estimates and using a discount rate determined in accordance with paragraphs 8.7 or 8.8; or**
  - (b) **the accumulated benefits to policyholders after allowing for the portion of acquisition costs expected to be recouped where the result would not be materially different from the application of paragraph 8.1(a).**
- 8.1.1 The participating benefits component of life insurance liabilities includes previously vested benefits and future supportable bonuses. In addition to life insurance liabilities, there may be other liabilities

that relate to participating policyholders. Insurance contract benefits attributable to participating policyholders that are not yet vested with specific policyholders are recognised as liabilities. These are further discussed in section 9.

- 8.1.2 Premiums are generally received in advance of the provision of services to policyholders, including the payment of claims. In return for premiums, life insurers provide services sometimes over long periods. Entering into a life insurance contract is considered to be the event that gives rise to future benefits and present obligations under a policy.
- 8.1.3 Where there are a number of variables relating to future uncertainties, a net present value approach to measuring life insurance liabilities is likely to provide the most appropriate measurement basis. The obligations under these more complex contracts are generally measured as the present value of the expected inflows, such as premiums and fees, and outflows, such as claims and other expenses, based on assumptions relating to whole populations of policyholders, and taking into account applicable taxation.
- 8.1.4 An accumulation approach involves accruing the entitlements in policyholders' records at the reporting date. If the fees expected to be charged by the life insurer to the policyholder in each future reporting period are expected to equal or exceed any expenses incurred by the life insurer, the life insurance liability calculated under the accumulation approach would not be materially different from that obtained using the approach in paragraph 8.1(a).
- 8.1.5 The ultimate cost of meeting claims under many life insurance contracts depends on the frequency of occurrence of particular future events such as death and surrender and in some cases may depend upon other factors such as the future levels of investment returns. Assumptions need to be made about these future events. In order to ensure that life insurance liabilities are measured reliably, such assumptions need to be "best estimates".
- 8.1.6 Best estimate assumptions used in determining the present value of life insurance liabilities, such as the best estimate of the bonus rate, are made on the basis of the assets available to the life insurer at the reporting date and do not include any allowance for future contributions by owners and other funds which may be provided in the future to support the business.

## Acquisition costs

- 8.1.7 Life insurance contracts written in one reporting period often give rise to benefits to the life insurer in subsequent reporting periods, such as future management fees and surrender penalties. Therefore, there are future benefits associated with the costs of acquiring life insurance contracts, and such costs are often substantial.
- 8.1.8 In the life insurance industry, *acquisition costs* are usually recognised as expenses in the reporting period in which they are incurred. This is generally offset by identifying a portion of the planned margins included in life insurance liabilities as relating to the recovery of acquisition costs. The most useful and reliable information available about the acquisition costs that will give rise to future economic benefits is the amount of future charges for acquisition costs identified as part of the process of determining life insurance liabilities.

## Recognition of planned margins as revenues

- 8.2 Planned margins of revenues over expenses for life insurance contracts shall be recognised in the income statement over the reporting periods during which the services, to which those margins relate, are provided to policyholders, and the revenues, relating to those services, are received.**
- 8.2.1 In setting premium rates, life insurers will include planned margins of revenues over expenses. As noted in paragraph 8.1.2, premiums are generally received in advance of the provision of services to policyholders.
- 8.2.2 In this Standard, planned margins are recognised in the income statement when, and only when, the life insurer has performed the services necessary to establish a valid claim to those margins and has received the revenues relating to those services. To ensure that planned margins are recognised during the reporting period in which the relevant services are provided, life insurance liabilities include a component relating to those margins. These margins are then “released” based on one or more factors or “profit carriers” which correspond to the performance of services and the earning of the margins. In relation to many products, the profit carrier might be premiums or claims.

## **Differences between actual and assumed experience**

- 8.3 Except in relation to investment earnings rate assumptions for participating business, the effect of changes in life insurance liabilities resulting from a difference between actual and assumed experience determined during the reporting period shall be recognised in the income statement as income or expenses in the reporting period in which the changes occur.**
- 8.3.1 The assumed patterns and frequencies of events used in determining life insurance liabilities are compared with actual events in each reporting period to assess their accuracy. The effects of differences between actual and assumed experience represents decreases or increases in the expected payments to policyholders and are income or expenses of the reporting period in which the differences occur. For example, where the assumed costs of death claims under a renewable term life product line are greater than the actual costs for a reporting period, income equal to the difference is recognised in the income statement for the current reporting period.
- 8.3.2 The recognition of the net amount of changes in life insurance liabilities resulting from a difference between actual and assumed experience identified during the reporting period as income or an expense is consistent with the use of assumptions that are best estimates as at each reporting date.

## **Changes to underlying assumptions**

- 8.4 Assumptions used for measuring life insurance liabilities shall be reviewed for each reporting period. Where the review leads to changes in assumptions, with the exception of new business, the changes shall be deemed to occur at the reporting date.**
- 8.4.1 Assumptions used for measuring new business may be deemed to have occurred at the beginning of the reporting period, or at the date of commencement of the new business or at the end of the reporting period.
- 8.4.2 In preparing interim financial reports, the reporting date is the interim reporting date. Accordingly, changes in assumptions are deemed to occur at the interim reporting date.
- 8.5 The financial effects of changes to the assumptions underlying the measurement of life insurance liabilities made during the reporting period shall be recognised in the income statement**

over the future reporting periods during which services are provided to policyholders, except that:

- (a) any estimated excess of the present value of future expenses over the present value of future revenues for a group of related products arising during the reporting period shall be recognised as an expense of the reporting period;
- (b) the reversal of an expense previously recognised in accordance with paragraph 8.5(a) shall be recognised as income of the reporting period in which the reversal of the loss is recognised;
- (c) the effects of a change to adopted discount rates and related economic assumptions caused by changes in investment market and general economic conditions shall be recognised as income or expense of the reporting period in which the change occurs; and
- (d) material calculation errors and similar errors shall be treated in accordance with *AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors*.

- 8.5.1 The assumptions underlying the measurement of life insurance liabilities are reviewed at each reporting date. Based on past experience and revised expectations about the future, it may become apparent that particular assumptions are not consistent with likely future experience and need to be changed. Such changes are effectively a reassessment of the likely patterns and frequencies of future events. The normal revision of assumptions is not considered to be an error.
- 8.5.2 Apart from the circumstances identified in paragraph 8.5, changes to underlying assumptions are effectively recognised over future reporting periods by adjusting the planned margins included in life insurance liabilities. If the effect of a changed assumption is a decrease in the present value of present obligations to policyholders, the planned margin is increased. If the effect is an increase in the present value of obligations to policyholders, the planned margin is reduced. The overall amount of life insurance liabilities is not affected by these changes to underlying assumptions, as long as the planned margin of revenues over expenses is not eliminated.
- 8.5.3 Material calculation errors and similar errors are treated in accordance with AASB 108. Under AASB 108, except to the extent that it is impracticable to determine either the period-specific effects

or the cumulative effect of the error, an entity corrects material prior period errors retrospectively in the first financial report authorised for issue after their discovery by:

- (a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or
- (b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

### **Changes to discount rates and related economic assumptions**

- 8.5.4 As with other assumptions, the discount rates and related economic assumptions used in determining life insurance liabilities are reviewed at each reporting date. The effects of a change to adopted discount rates and related economic assumptions caused by changes in investment market and economic conditions are recognised in the reporting period in which the change is made. For a life insurer with a typical spread of investments, if market yields fall, investment values generally rise and the resulting increases in investment values are recognised as income in the reporting period in which they occur. Where the discount rates are adjusted in line with such falls in market rates, life insurance liabilities for such contracts will increase and an expense will be recognised, having an offsetting (but not usually matching) effect on the increased investment values.
- 8.5.5 In relation to participating business (which is discussed in section 9), the effect of a change to the assumptions about discount rates, explained in paragraph 8.5.4, is a result of adjusting the best estimate of life insurance liabilities, including future participating benefits. For example, if market rates of return rise, investment values generally fall and the resulting decreases in investment values are recognised as an expense in the reporting period in which they occur. The fall in investment values will clearly impact on the ability of the life insurer to support future participating benefits. These are likely to be reduced, with an offsetting effect on the reduced investment values.

### **Liability adequacy test**

- 8.6 Life insurers shall perform a *liability adequacy test*.**
  - 8.6.1 Situations may arise where the present value of the planned margin of revenues over expenses for a group of related products will be

adjusted as a result of changing underlying assumptions to the extent that the planned margin is eliminated and becomes a planned loss. That is, a review of expected future cash flows indicates that the present value of estimated future expenses for a group of related products exceeds the present value of estimated future revenues. In such circumstances, the excess of the present value of expenses over revenues arising during the reporting period is recognised in the income statement in the reporting period in which the assessment is made. The loss reflects a higher present obligation due to adverse future experience, which is now expected in future years. Whilst the future cash flows giving rise to the loss are yet to occur, this treatment is justified on the basis that entering into life insurance contracts is an event that gives rise to a present obligation to meet the expected future claims.

- 8.6.2 A group of related products, for the purpose of the calculating the planned margin, performing the liability adequacy test and for disclosure, would be products that have substantially the same contractual terms and were priced on the basis of substantially the same assumptions.
- 8.6.3 In reviewing expected future cash flows, the insurer takes into account both future cash flows under insurance contracts it has issued and the related reinsurance contracts.
- 8.6.4 Where an intangible asset has arisen under paragraph 13.1.1(b), a loss arises when the present value of planned margins of revenues over expenses is less than the related intangible asset. This test is to be performed for groups of related products and the intangible asset is allocated, on a reasonable basis, across these groups. Any loss is recognised as an expense in the income statement. In recognising the loss in the income statement, the life insurer first writes down the related intangible asset and then reflects any additional liability in the life insurance liabilities.

### **Discount rates**

- 8.7 To the extent that the benefits under life insurance contracts are not contractually linked to the performance of the assets held, the life insurance liabilities shall be discounted for the time value of money using risk-free discount rates based on current observable, objective rates that relate to the nature, structure and term of the future obligations.**
- 8.8 To the extent that the benefits under life insurance contracts are contractually linked to the performance of the assets held, the life insurance liabilities shall be discounted using discount rates**

**based on the market returns on assets backing life insurance liabilities.**

- 8.8.1 In applying paragraph 8.7, the discount rates adopted are not intended to reflect risks inherent in the liability cash flows, which might be allowed for by a reduction in the discount rate in a fair value measurement, nor are they intended to reflect the insurance and other non-financial risks and uncertainties reflected in the life insurance liabilities. The discount rates are not intended to include allowance for the cost of any options or guarantees that are separately measured as part of the life insurance liabilities.
- 8.8.2 In applying paragraph 8.7, typically, government bond rates may be appropriate discount rates for the purposes of this Standard, or they may be an appropriate starting point in determining such discount rates.

**Financial instruments with discretionary participation features**

- 8.9 **Financial instruments with discretionary participation features are life insurance contracts for the purposes of this Standard and shall be treated in accordance with paragraphs 8.1 to 8.8 and section 9.**

## **9 Participating Benefits**

- 9.1 **Except for transfers from unvested policyholder benefits liabilities, participating benefits vested in policyholders in relation to the reporting period shall be recognised in the income statement as expenses for the reporting period. Such benefits which remain payable as at the reporting date shall be recognised as a component of life insurance liabilities.**
- 9.2 **Participating benefits that have been allocated in relation to the reporting period to participating policyholders generally, but that have not yet vested in specific policyholders, shall be recognised as expenses for the reporting period. Amounts that have been allocated to participating policyholders generally, but that have not vested in specific policyholders as at the reporting date, shall be recognised as unvested policyholder benefits liabilities.**
- 9.2.1 Some life insurers sell participating business. Participating policyholders are generally eligible to receive the same types of

benefits as other policyholders and, in addition, are entitled to participate in the profits relating to participating business. For example, a participating policyholder may receive a low contractually determined rate of return on savings together with term life cover and, in addition, receive benefits that depend on the investment performance of the pool of assets associated with participating policies and on the risk experience of participating policyholders. These additional benefits are often called bonuses and are at the discretion of the life insurer. In some reporting periods the life insurer may withhold a portion of the “profits” from the pool of participating business and recognise these “profits” as unvested policyholder benefits liabilities. In other reporting periods the life insurer may “top up” the vested benefits to participating policyholders. Such vesting of benefits is often done to provide a reasonably level vesting of benefits over time, despite volatility in periodic profits from participating business.

- 9.2.2 It is sometimes argued that the discretionary nature of participating benefits means that they should be treated as appropriations of profit in the same way as dividends to shareholders. Because life insurance liabilities relating to all types of policyholders are recognised as liabilities under the Life Insurance Act, it is appropriate for the participating benefits vested in relation to the reporting period, other than transfers from unvested policyholder benefits liabilities, to be recognised as expenses of the reporting period.
- 9.2.3 Mutual life insurers are effectively owned by their policyholder members. Nevertheless, the mutual life insurer also has obligations to its policyholders. These obligations are classified as policy liabilities. Benefits vested in a mutual life insurer’s policyholders, other than transfers from unvested policyholder benefits liabilities, are also to be recognised as expenses in the reporting period in which they are vested.
- 9.2.4 For financial reporting purposes, participating benefits vested in policyholders in a reporting period but not yet paid are included in life insurance liabilities and are measured at net present values. In the case of investment account participating business this may be approximately the same as the amount actually allocated to policyholder accounts. In the case of traditional participating business, there may be a significant difference between the net present value and the face value of the amount vested in policyholders. The net present value is relevant for financial reporting purposes because it is the best estimate of the net present value of the amount that the life insurer expects to pay out in the

future using information based on experience up to the reporting date.

- 9.2.5 Where a life insurer “tops up” the vested benefits from previously recognised unvested policyholder benefits liabilities, a transfer between liabilities is recognised. If a life insurer tops up the vested benefits for participating policyholders other than from unvested policyholder benefits liabilities, the amount of the “top up” is recognised as an expense of the reporting period in which the additional benefits are vested.

## **10 Assets Backing Life Insurance Liabilities or Life Investment Contract Liabilities**

### **Fair value approach**

- 10.1.1 Paragraphs 10.2 to 10.7.3 address the measurement of certain assets backing life insurance liabilities or life investment contract liabilities. The fair value approach to the measurement of assets backing life insurance liabilities or life investment contract liabilities is consistent with the present value measurement approach for life insurance liabilities required by this Standard and the fair value measurement approach for life investment contract liabilities required by this Standard. Where assets are not backing life insurance liabilities or life investment contract liabilities life insurers apply the applicable accounting standards making use of any measurement choices available.

### **Measurement**

- 10.2 ***Financial assets that are within the scope of AASB 139 and that back life insurance liabilities or life investment contract liabilities, shall be designated as “at fair value through profit or loss” under AASB 139, on first application of this Standard or on initial recognition of the assets.***
- 10.2.1 An insurer applies AASB 139 to its financial assets. AASB 139 defines financial assets as “at fair value through profit or loss” as either a financial asset that is classified as held for trading, or as a financial asset that is designated as “at fair value through profit or loss” upon initial recognition. AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* allows entities to designate financial assets as “at fair value through profit or loss” on first application of the Standard.

- 10.2.2 Those financial assets that are within the scope of AASB 139 and that the insurer considers back life insurance liabilities or life investment contract liabilities are designated as “at fair value through profit or loss” under AASB 139, on first application of this Standard, or on initial recognition as assets.
- 10.3 Investment property that is within the scope of AASB 140 *Investment Property* and that backs life insurance liabilities or life investment contract liabilities, shall be measured at fair value using the fair value model under AASB 140.**
- 10.4 Property, plant and equipment that is within the scope of AASB 116 *Property, Plant and Equipment* and that backs life insurance liabilities or life investment contract liabilities shall be measured using the revaluation model under AASB 116.**
- 10.4.1 An insurer applies AASB 116 to its property, plant and equipment. Under AASB 116 property includes owner-occupied property and property being constructed or developed for future use as investment property. Under AASB 116, the cost model, for measurement subsequent to initial recognition, is to carry property, plant and equipment at cost. However, AASB 116 has a revaluation model: an entity, subsequent to initial recognition, may carry its property, plant and equipment assets at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.
- 10.4.2 Those property, plant and equipment assets that are within the scope of AASB 116 and that the insurer considers back life insurance liabilities or life investment contract liabilities are measured using the revaluation model under AASB 116, that is, they are measured at fair value with increases in fair value credited directly to equity and decreases recognised as an expense, unless they reverse a previous increase.
- 10.5 Investments in associates that:**
- (a) **are within the scope of AASB 128 *Investments in Associates*;**
  - (b) **back either life insurance liabilities or life investment contract liabilities; and**
  - (c) **are held by mutual funds, unit trusts and similar entities including investment-linked insurance funds;**

**shall be designated as “at fair value through profit or loss” under AASB 139 on first application of this Standard or on initial recognition of the assets.**

- 10.5.1 An insurer applies AASB 128 to its investments in associates. AASB 128 requires investments in associates to be accounted for using the equity method but it does not apply to investments in associates held by mutual funds, unit trusts and similar entities including investment-linked insurance funds that are treated under AASB 139 and designated as “at fair value through profit or loss”.

**10.6 Venturers’ interests in jointly controlled entities that:**

- (a) **are within the scope of AASB 131 *Interests in Joint Ventures*;**
- (b) **back either life insurance liabilities or life investment contract liabilities; and**
- (c) **are held by mutual funds, unit trusts and similar entities including investment-linked insurance funds;**

**shall be designated as “at fair value through profit or loss” under AASB 139, on first application of this Standard, or on initial recognition of the assets.**

- 10.6.1 Entities apply AASB 131 to interests in joint ventures. AASB 131 requires investments in joint ventures to be proportionately consolidated or to be accounted for using the equity method. However, AASB 131 does not apply to venturers’ interests in jointly controlled entities held by mutual funds, unit trusts and similar entities including investment-linked insurance funds that are treated under AASB 139 and designated as “at fair value through profit or loss”.

**Separate financial statements**

**10.7 When preparing *separate financial statements*, those investments in subsidiaries, jointly controlled entities and associates:**

- (a) **that are within the scope of AASB 127 *Consolidated and Separate Financial Statements*;**
- (b) **that back life insurance liabilities or life investment contract liabilities; and**

- (c) **that are not classified as held for sale (or included in a disposal group that is classified as held for sale) under AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*;**

**shall be designated as “at fair value through profit or loss” under AASB 139, on first application of this Standard or on initial recognition of the assets.**

- 10.7.1 An insurer applies AASB 127 to its investments in subsidiaries, jointly controlled entities and associates when preparing separate financial statements. Under AASB 127, in the parent’s separate financial statements, the investments in subsidiaries, jointly controlled entities and associates can either be accounted for at cost or in accordance with AASB 139.
- 10.7.2 In the parent’s separate financial statements, investments in subsidiaries, jointly controlled entities and associates that are within the scope of AASB 127, that are not classified as held for sale, under AASB 5, and that the insurer considers back life insurance liabilities or life investment contract liabilities, are to be designated as “at fair value through profit or loss” under AASB 139, on first application of this Standard, or on initial recognition of the assets.
- 10.7.3 When preparing consolidated financial statements, subsidiaries are consolidated and investments in jointly controlled entities and associates are accounted for using the equity method in accordance with AASB 127.

## **11 Imputed Inflows and Outflows**

**11.1 Subject to paragraph 18.3, a life insurer shall recognise imputed inflows and outflows as income and expenses when, and only when, such imputed flows relate to transactions with external entities.**

- 11.1.1 Life insurers often impute inflows and outflows to different classes of policyholders in order to help ensure that they are treated equitably. For example, a life insurer may own the buildings that it occupies. The funds of a particular group of policyholders are used to acquire and operate such buildings whilst a wider group of policyholders and shareholders may benefit from the use of the buildings. In the owner-occupied building example, the life insurer imputes an inflow of rent income to the policyholders whose funds

are used to acquire and operate the buildings and imputes an outflow of rent cost to the other policyholders and to shareholders.

- 11.1.2 In cases where there are no transactions with external entities, such as with owner-occupied buildings, the life insurer is dealing with itself. There is no transaction or other past event that gives rise to income or an expense. Any inflows and outflows imputed for internal management purposes would be eliminated in preparing external financial reports except in relation to the disaggregated disclosures required by paragraphs 18.1 and 18.2.
- 11.1.3 In some cases, life insurers impute inflows and outflows where external entities are involved. For example, life insurers often lend funds to their employees at concessional rates of interest with the funds being provided by a particular group of policyholders, whilst other policyholders and any shareholders benefit from the services provided by those employees. Because external parties are involved, such imputed inflows and outflows are recognised as income and expenses when they can be reliably measured.

## **12 Life Investment Contracts**

**12.1 Life investment contract liabilities shall be designated as “at fair value through profit or loss” under AASB 139, on first application of this Standard or on initial recognition of the liabilities.**

- 12.1.1 Some life investment contracts involve both the origination of one or more financial instruments and the provision of management services. Life investment contract liabilities arise under the financial instrument element and are treated under AASB 139. The management services element, including associated acquisition costs, is treated under AASB 118 *Revenue*, this element may also give rise to assets and liabilities. Life insurers shall refer to paragraph 14(b)(iii) in the Appendix to AASB 118.

## **13 Life Insurance Contracts Acquired in a Business Combination or Portfolio Transfer**

- 13.1.1 To comply with AASB 3 *Business Combinations*, an insurer shall, at the acquisition date, measure at fair value the insurance liabilities assumed and *insurance assets* acquired in a business combination. However, an insurer is permitted, but not required, to use an

expanded presentation that splits the fair value of acquired insurance contracts into two components:

- (a) a liability measured in accordance with the insurer's accounting policies for life insurance contracts that it issues; and
- (b) an intangible asset, representing the difference between:
  - (i) the fair value of the contractual insurance rights acquired and insurance obligations assumed; and
  - (ii) the amount described in paragraph 13.1.1(a).

The subsequent measurement of this asset shall be consistent with the measurement of the related life insurance liability.

- 13.1.2 An insurer acquiring a portfolio of life insurance contracts may use an expanded presentation described in paragraph 13.1.1.
- 13.1.3 The intangible assets described in paragraphs 13.1.1 and 13.1.2 are excluded from the scope of AASB 136 *Impairment of Assets* and from the scope of AASB 138 *Intangible Assets* in respect of recognition and measurement. AASB 136 and AASB 138 apply to customer lists and customer relationships reflecting the expectation of future contracts that are not part of the contractual insurance rights and contractual insurance obligations that existed at the date of a business combination or portfolio transfer.
- 13.1.4 AASB 138 includes disclosure requirements in relation to this intangible asset.
- 13.1.5 Where a life insurer recognises an intangible asset under paragraph 13.1.1(b), this intangible asset is considered when performing the liability adequacy test referred to in paragraph 8.6.

## **14 Life Insurance Contracts Disclosure – Explanation of Recognised Amounts**

- 14.1 A life insurer shall disclose information that identifies and explains the amounts in its financial report arising from life insurance contracts.**

- 14.1.1 To comply with paragraph 14.1, a life insurer shall disclose:
- (a) its accounting policies for life insurance contracts and related assets, liabilities, income and expense;
  - (b) the recognised assets, liabilities, income, expense and cash flows arising from life insurance contracts. Furthermore, if the life insurer is a cedant, it shall disclose:
    - (i) gains and losses recognised in profit or loss at the time of buying reinsurance; and
    - (ii) if the cedant defers and amortises gains and losses arising at the time of buying reinsurance, the amortisation for the period and the amounts remaining unamortised at the beginning and end of the period;
  - (c) the process used to determine the assumptions that have the greatest effect on the measurement of the recognised amounts described in (b). When practicable, a life insurer shall also give quantified disclosure of those assumptions;
  - (d) 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
  - (e) reconciliations of changes in life insurance liabilities and reinsurance assets.
- 14.1.2 When applying paragraph 14.1.1(b) and disclosing recognised income arising from life insurance contracts, life insurers would normally disclose income from direct and reinsurance business. In accordance with the principles embodied in this Standard, with the exception of premium revenue recognised in accordance with paragraph 5.1, all revenues are recognised and disclosed before the effects of any transfers to or from life insurance liabilities. Disclosure of the effects of transfers to and from life insurance liabilities is required by paragraph 14.1.1(e).
- 14.1.3 In accordance with the principles embodied in this Standard, with the exception of claims expense recognised in accordance with paragraph 5.1, all expenses are recognised and disclosed before the effects of any transfers to or from life insurance liabilities. Disclosure of the effects of transfers to and from life insurance liabilities is required by paragraph 14.1.1(e).

- 14.1.4 To disclose and explain the expenses arising from life insurance contracts, life insurers would normally disclose:
- (a) outwards reinsurance expense;
  - (b) operating expenses:
    - (i) claims expense;
    - (ii) policy acquisition expenses, separated into material components including commission;
    - (iii) policy maintenance expenses; and
    - (iv) investment management expenses;
  - (c) the basis for the apportionment of operating expenses between:
    - (i) life insurance contract acquisition;
    - (ii) life insurance contract maintenance;
    - (iii) investment management expenses;
    - (iv) life investment contract acquisition;
    - (v) life investment contract maintenance; and
    - (vi) other expenses.
- 14.1.5 When applying paragraphs 14.1.1(c) and 14.1.1(d) and disclosing the process used to determine assumptions, quantified disclosure of assumptions and the effect of changes in assumptions the life insurer would normally show the impact of changes in assumptions on future profit margins and life insurance liabilities. The assumptions that would normally have the greatest effect on the measurement of recognised amounts described in paragraph 14.1.1(b) are:
- (a) discount rates and inflation rates;
  - (b) profit carriers used for each major product group;
  - (c) future maintenance and investment management expenses, the rate of inflation applicable to them and any automatic indexation of benefits and premiums;

- (d) rates of taxation;
- (e) mortality and morbidity, by reference to the identity of the tables;
- (f) rates of discontinuance;
- (g) surrender values;
- (h) rates of growth of unit prices in respect of unit-linked benefits;
- (i) rates of future supportable participating benefits; and
- (j) the crediting policy adopted in determining future supportable participating benefits.

14.1.6 When applying paragraph 14.1.1(b) and disclosing the recognised liabilities arising from life insurance contracts, life insurers would normally disclose the following components of life insurance liabilities:

- (a) future policy benefits, including participating benefits;
- (b) balance of future expenses;
- (c) planned margins of revenues over expenses;
- (d) future charges for acquisition costs; and
- (e) balance of future revenues.

14.1.7 When a life insurer is presenting the disclosures required by paragraphs 14.1.1(c) and 14.1.1(d) the insurer determines the level and extent of disclosure that is appropriate having regard to its circumstances and the qualitative characteristics of financial reports under the *Framework for the Preparation and Presentation of Financial Statements* of understandability, relevance, reliability and comparability.

## **15 Life Insurance Contracts Disclosure – Amount, Timing and Uncertainty of Cash Flows**

**15.1 A life insurer shall disclose information that helps users to understand the amount, timing and uncertainty of future cash flows from life insurance contracts.**

15.1.1 To comply with paragraph 15.1, a life insurer shall disclose:

- (a) its objectives in managing risks arising from life insurance contracts and its policies for mitigating risk;
- (b) those terms and conditions of life insurance contracts that have a material effect on the amount, timing and uncertainty of the life insurer's future cash flows;
- (c) information about *insurance risk* (both before and after risk mitigation by reinsurance), including information about:
  - (i) the sensitivity of profit or loss and equity to changes in variables that have a material effect on them;
  - (ii) concentrations of insurance risk; and
  - (iii) actual claims compared with previous estimates (i.e. claims development). The disclosure about claims development shall go back to the period when the earliest material claim arose for which there is still uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. A life insurer need not disclose this information for claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year;
- (d) the information about interest rate risk and credit risk that AASB 132 would require if the life insurance contracts were within the scope of AASB 132; and
- (e) information about exposures to interest rate risk or market risk under embedded derivatives contained in a host life insurance contract if the life insurer is not required to, and does not, measure the embedded derivatives at fair value.

- 15.1.2 The claims development disclosure required by paragraph 15.1.1(c)(iii) only applies to classes of business where claims are not typically resolved within one year. For many life insurance products this disclosure would not normally be required. Furthermore, claims development disclosure would not normally be needed for annuity contracts, for example, because each periodic payment arises, in effect, from a separate claim about which there is no uncertainty.

## **16 Other Disclosures Relating to Life Insurance Contracts**

- 16.1 Where any premiums and any claims are separated into their revenue, expense and change in life insurance liability components in accordance with paragraph 5.1, total premiums and total claims shall be disclosed.**
- 16.1.1 The mix of products written by a life insurer will vary between life insurers. Comparability between life insurers is enhanced by the disclosure of total premiums and total claims.

## **17 Disclosures Relating to Life Insurance Contracts and Life Investment Contracts**

### **Financial Performance**

- 17.1 The following components of profit or loss shall be shown, separated between policyholder and shareholder interests:**
- (a) profit related to movement in life insurance liabilities;**
  - (b) profit related to movement in life investment contract liabilities and movement in assets or liabilities arising in respect of the management services element of life investment contracts;**
  - (c) investment earnings on assets in excess of policy liabilities; and**
  - (d) other items, separated into material components.**
- 17.2 The following components of profit related to movements in life insurance liabilities, life investment contract liabilities and assets**

**or liabilities arising in respect of the management services element of life investment contracts shall be shown:**

- (a) planned margins of revenues over expenses;**
- (b) the difference between actual and assumed experience;**
- (c) the effects of changes to underlying assumptions;**
- (d) loss recognition on groups of related products or reversal of previously recognised losses required by paragraph 8.6; and**
- (e) other movements, separated into material components.**

### **Restrictions on assets**

**17.3 Restrictions attaching to assets held for the benefit of policyholders shall be disclosed.**

- 17.3.1 There are a number of restrictions on the use of assets invested for policyholders in statutory funds. It is important that these restrictions be disclosed so that users of the financial report can assess their impact.

### **Guaranteed or assured returns of funds invested**

**17.4 A life insurer shall separately disclose:**

- (a) in respect of contracts with discretionary participation features, the amount of policy liabilities that relates to the guaranteed element;**
- (b) in respect of investment-linked contracts, the amount of policy liabilities subject to investment performance guarantees; and**
- (c) in respect of any other contracts not addressed in (a) or (b) with a fixed or guaranteed termination value, the amount of the current termination values.**

- 17.4.1 Many life insurers issue contracts that provide some form of guarantee or assurance about the return of funds invested. It is useful for users of life insurers' financial reports to have information about the extent of such guarantees or assurances, since they involve the life insurer bearing investment risks on behalf of policyholders.

## Equity

### 17.5 The following components of equity shall be disclosed:

- (a) **retained earnings wholly attributable to shareholders; and**
- (b) **retained earnings where the allocation between participating policyholders and shareholders has yet to be determined.**

17.5.1 Information about the different components of retained earnings is useful in meeting the accountability obligations of the life insurer for the whole business and in showing the relative positions of the major stakeholders.

17.5.2 A life insurer that has issued participating business may have “retained profits” generated from that business. In relation to Australian participating policyholders, these “retained profits” are liabilities in accordance with the Life Insurance Act. However, in foreign life insurance operations, “retained profits” may exist which have yet to be allocated between policyholders and shareholders. Such “retained profits” are separately disclosed. It is relevant to note that “retained profits” directly attributable to shareholders may reside in both statutory funds and a shareholder fund.

17.5.3 Where, in foreign life operations, “retained profits” exist, which have yet to be allocated and which are treated as equity then the insurer applies paragraphs 17.5.4 and 17.5.5 to this participating business written by foreign life operations.

17.5.4 Where a life insurance contract with a discretionary participation feature is issued by a foreign life operation, the issuer of such a contract:

- (a) may, but need not, recognise the guaranteed element separately from the discretionary participation feature. If the issuer does not recognise them separately, it classifies the whole contract as a liability. If the issuer classifies them separately, it classifies the guaranteed element as a liability;
- (b) shall, if it recognises the discretionary participation feature separately from the guaranteed element, classify that feature as either a liability or a separate component of equity. This Standard does not specify how the issuer determines whether that feature is a liability or equity. The

issuer may split that feature into liability and equity components and shall use a consistent accounting policy for that split. The issuer shall not classify that feature as an intermediate category that is neither liability nor equity;

- (c) may recognise all premiums received as revenue without separating any portion that relates to the equity component. The resulting changes in the guaranteed element and in the portion of the discretionary participation feature classified as a liability shall be recognised in profit or loss. If part of the entire discretionary participation feature is classified in equity, a portion of profit or loss may be attributable to that feature (in the same way that a portion may be attributable to minority interests). The issuer shall recognise the portion of profit or loss attributable to any equity component of a discretionary participation feature as an allocation of profit or loss, not as expense or income (see AASB 101 *Presentation of Financial Statements*);
- (d) shall, if the contract contains an embedded derivative within the scope of AASB 139, apply AASB 139 to that embedded derivative; and
- (e) shall, in all respects not described in paragraphs 14-20 of AASB 4 and paragraphs 34(a)-(d) of AASB 4, continue its existing accounting policies for such contracts, unless it changes those accounting policies in a way that complies with paragraphs 21-30 of AASB 4.

17.5.5 The requirements in paragraph 17.5.4 also apply to a life investment contract issued by a foreign life insurer that contains a discretionary participation feature. In addition:

- (a) if the issuer classifies the entire discretionary participation feature as a liability, it shall apply the liability adequacy test in paragraph 8.6 to the whole contract (i.e. both the guaranteed element and the discretionary participation feature). The issuer need not determine the amount that would result from applying AASB 139 to the guaranteed element;
- (b) if the issuer classifies part or that entire feature as a separate component of equity, the liability recognised for the whole contract shall not be less than the amount that would result from applying AASB 139 to the guaranteed element. That amount shall include the intrinsic value of an option to surrender the contract, but need not include its

time value if paragraph 2.2.2 exempts that option from measurement at fair value. The issuer need not disclose the amount that would result from applying AASB 139 to the guaranteed element, nor need it present that amount separately. Furthermore, the issuer need not determine that amount if the total liability recognised is clearly higher; and

- (c) although these contracts contain financial instruments, the issuer may continue to recognise the premiums for those contracts as revenue and recognise as an expense the resulting increase in the carrying amount of the liability, subject to the requirements of paragraphs 5.1 and 5.2.

### **Solvency information**

**17.8 A life insurer shall disclose the regulatory solvency position of each statutory fund. A group shall disclose the regulatory solvency position of each life insurer in the group.**

- 17.8.1 Under the Life Insurance Act, life insurers are required to hold reserves in excess of the amount of policy liabilities. These additional reserves are necessary to support the life insurer's capital requirements under its business plan and to provide a cushion against adverse experience in managing long-term risks. Because solvency is an important aspect of a life insurer's financial position, information about it is useful to users of financial reports.

### **Managed funds and other fiduciary activities**

**17.9 The nature and amount of the life insurer's activities relating to managed funds and trust activities, and whether arrangements exist to ensure that such activities are managed independently from its other activities, shall be disclosed.**

### **Actuarial information**

**17.10 The following shall be disclosed in notes:**

- (a) **if other than the reporting date, the effective date of the actuarial report on policy liabilities and solvency reserves;**
- (b) **the name and qualifications of the actuary;**

- (c) **whether the amount of policy liabilities has been determined in accordance with the requirements of the Life Insurance Act; and**
- (d) **whether the actuary is satisfied as to the accuracy of the data from which the amount of policy liabilities has been determined.**

### **Assets backing life insurance liabilities or life investment contract liabilities**

- 17.11 An insurer shall disclose the process used to determine which assets back life insurance liabilities or life investment contract liabilities.**

#### **Other disclosures**

- 17.12.1 Australian Accounting Standards and the Life Insurance Act differ in their requirements. Accordingly, life insurers are encouraged to disclose a reconciliation between:
- (a) the profit for the reporting period reported under Australian Accounting Standards and the profit for the reporting period reported under the Life Insurance Act; and
  - (b) the retained earnings at the reporting date in accordance with Australian Accounting Standards and the retained earnings at the reporting date in accordance with the Life Insurance Act.
- 17.13.1 This Standard addresses disclosure requirements in relation to life insurance contracts and certain disclosure requirements in relation to life investment contracts. Other Australian Accounting Standards may be relevant to a life insurer's financial report. In particular, the disclosure requirements in AASB 132 would normally be relevant to life insurers.

## **18 Disaggregated Information**

### **Statutory funds and the shareholder fund**

- 18.1 For each statutory fund and for the shareholder fund the following shall be disclosed:**
- (a) **investment assets;**

- (b) other assets;
- (c) life insurance liabilities;
- (d) life investment contract liabilities and assets or liabilities arising in respect of the management services element of life investment contracts;
- (e) liabilities other than life insurance liabilities or life investment contract liabilities;
- (f) retained earnings, showing the amount directly attributable to shareholders and other retained earnings;
- (g) premium revenue split between life insurance contracts and life investment contracts;
- (h) investment income;
- (i) claims expense split between life insurance contracts and life investment contracts;
- (j) other operating expenses;
- (k) investment income paid or allocated to policyholders;
- (l) profit or loss before tax;
- (m) profit or loss after tax; and
- (n) transfers to or from other funds.

18.1.1 Disaggregated information for each life fund and the shareholder fund is useful because, under Australian legislation, each life insurer may have more than one fund and, in general, the assets of each life fund are only available to meet the liabilities and expenses of that life fund.

### **Investment-linked and non-investment-linked business**

**18.2 A life insurer shall disclose the information required by paragraphs 18.1(a) to 18.1(m) disaggregated between those amounts relating to investment-linked business and those relating to non-investment-linked business.**

- 18.2.1 The risks and potential rewards for a life insurer differ substantially as between investment-linked business and non-investment-linked business. Accordingly, disaggregated information about these is considered to be useful in assessing the financial performance and financial position of a life insurer. The information required by paragraph 18.2 is for the entity's life insurance business as a whole, it is not required for each life fund.

### **Geographical segments**

- 18.2.2 Further disaggregated information may be required by AASB 114 *Segment Reporting*.

### **Imputed inflows and outflows**

- 18.3 Disclosures required by paragraphs 18.1 and 18.2 shall include all imputed inflows and outflows as income and expenses where they can be reliably measured.**
- 18.3.1 As discussed in paragraph 11.1.1, life insurers often impute inflows and outflows to different classes of policyholders and shareholders to help ensure that they are treated equitably. Whereas, in relation to the income statement and the balance sheet, paragraph 11.1 only permits the recognition of imputed inflows and outflows relating to transactions with external parties, paragraph 18.3 requires all imputed inflows and outflows to be included in the disaggregated information to reflect the performance of each segment of the life insurer.

## **19 Transitional Provisions**

- 19.1 An entity need not apply the disclosure requirements in this Standard to comparative information that relates to annual periods beginning before 1 January 2005, except for the disclosures required by paragraphs 14.1.1(a) and 14.1.1(b) about accounting policies, and recognised assets, liabilities, income and expense and cash flows.**
- 19.2 When an entity applies the disclosure requirements in this Standard to comparative information that relates to annual periods beginning before 1 January 2005, if it is impracticable to apply a particular requirement of this Standard to comparative information that relates to annual periods beginning before 1 January 2005, an entity shall disclose that fact. AASB 108 explains the term "impracticable".**

**19.3** In applying paragraph 15.1.1(c)(iii), an entity need not disclose information about claims development that occurred earlier than five years before the end of the first annual reporting period in which it applies this Standard. Furthermore, if it is impracticable, when an entity first applies this Standard, to prepare information about claims development that occurred before the beginning of the earliest period for which an entity presents full comparative information that complies with this Standard, the entity shall disclose that fact.

19.3.1 There are also references to transitional measurement requirements in paragraphs 10.2-10.2.2, 10.5, 10.6, 10.7, 10.7.2 and 12.1.

## **20** Definitions

### **20.1** In this Standard:

***acquisition costs*** means the fixed and variable costs of acquiring new business, including commissions and similar distribution costs, and costs of accepting, issuing and initially recording policies

(Acquisition costs relate to the costs incurred in acquiring specific life insurance contracts during the reporting period. They do not include the general growth and development costs incurred by a life insurer.)

***cedant*** means the policyholder under a life reinsurance contract

***deposit component*** means a contractual component that is not accounted for as a derivative under AASB 139 *Financial Instruments: Recognition and Measurement* and would be within the scope of AASB 139 if it were a separate instrument

***direct insurance contract*** means an insurance contract that is not a reinsurance contract

***discretionary participation feature*** means a contractual right to receive, as a supplement to guaranteed benefits, additional benefits:

- (a) that are likely to be a significant portion of the total contractual benefits;

- (b) whose amount or timing is contractually at the discretion of the issuer; and
- (c) that are contractually based on:
  - (i) the performance of a specified pool of contracts or a specified type of contract;
  - (ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or
  - (iii) the profit or loss of the company, fund or other entity that issues the contract

*fair value* means the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction

*financial asset* means any asset that is:

- (a) cash;
- (b) an equity instrument of another entity;
- (c) a contractual right:
  - (i) to receive cash or another *financial asset* from another entity; or
  - (ii) to exchange *financial assets* or *financial liabilities* with another entity under conditions that are potentially favourable to the entity; or
- (d) a contract that will or may be settled in the entity's own equity instruments and is:
  - (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
  - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or other financial assets for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves

contracts for the future receipt or delivery of the entity's own equity instruments

*financial instrument* means any contract that gives rise to a *financial asset* of one entity and a *financial liability* or equity instrument of another entity

*financial liability* is any liability that is:

- (a) a contractual obligation:
  - (i) to deliver cash or another *financial asset* to another entity; or
  - (ii) to exchange *financial assets* or *financial liabilities* with another entity under conditions that are potentially unfavourable to the entity; or
- (b) a contract that will or may be settled in the entity's own equity instruments and is:
  - (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
  - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another *financial asset* for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments

*financial risk* means 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

*general insurance contract* means an *insurance contract* that is not a *life insurance contract*

*guaranteed benefits* means payments or other benefits to which a particular *policyholder* or investor has an unconditional

**right that is not subject to the contractual discretion of the issuer**

***guaranteed element* means an obligation to pay *guaranteed benefits* included in a contract that contains a *discretionary participation feature***

***insurance asset* means an insurer's net contractual rights under an *insurance contract***

***insurance contract* means 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***

(Refer to Appendix for additional guidance in applying this definition.)

***insurance liability* means an insurer's net contractual obligations under an *insurance contract***

***insurance risk* means risk, other than *financial risk*, transferred from the holder of a contract to the issuer**

***insured event* means an uncertain future event covered by an *insurance contract* and creates *insurance risk***

***insurer* means the party that has an obligation under an *insurance contract* to compensate a *policyholder* if an *insured event* occurs**

***investment-linked* means where the benefit amount under a *life insurance contract* or *life investment contract* is directly linked to the market value of the investments held in the particular investment-linked fund**

***liability adequacy test* means an assessment of whether the carrying amount of an *insurance liability* needs to be increased (or the carrying amount of the related deferred acquisition costs or related intangible assets decreased) based on a review of future cash flows**

***life insurance business* means all *life insurance contract* and *life investment contract* business conducted by a *life insurer***

***life insurance contract*** means an *insurance contract*, or a **financial instrument with a discretionary participation feature**, regulated under the Life Insurance Act, and similar contracts issued by entities operating outside Australia.

(Private health insurance contracts issued under the *National Health Act 1953* but written by friendly societies registered under the Life Insurance Act, are not *life insurance contracts* but are *general insurance contracts*.)

***life insurance liability*** means a *life insurer's* net contractual obligations under a *life insurance contract*

***life insurer*** means an entity registered under the *Life Insurance Act 1995*, that issues *life insurance contracts* or *life investment contracts*, and similar entities operating outside Australia

***life investment contract*** means a contract which is regulated under the *Life Insurance Act 1995* but which does not meet the definition of a *life insurance contract* in this Standard, and similar contracts issued by entities operating outside Australia

***life investment contract liability*** means a *life insurer's* net contractual obligations under a *life investment contract* which arise under the financial instrument component of a *life investment contract*

***life reinsurance contract*** means a *life insurance contract* issued by one *insurer* (the *reinsurer*) to compensate another insurer (the *cedant*) for losses on one or more contracts issued by the *cedant*

***non-investment-linked business*** means *life insurance business* other than *investment-linked business*

***policyholder*** means a party that has a right to compensation under an *insurance contract* if an *insured event* occurs

***policy liability*** means a liability that arises under a *life insurance contract* or a *life investment contract* including any asset or liability arising in respect of the management services element of a *life investment contract*

***reinsurance assets*** means a *cedant's* net contractual rights under a *reinsurance contract*

***reinsurance contract*** means an *insurance contract* issued by one *insurer (the reinsurer)* to compensate another insurer (the *cedant*) for losses on one or more contracts issued by the *cedant*

***reinsurer*** means the party that has an obligation under a *reinsurance contract* to compensate a *cedant* if an *insured event* occurs

***separate financial statements*** are those presented by a parent in which its investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees

***statutory fund*** means a statutory fund under the *Life Insurance Act 1995*

***unbundle*** means to account for the components of a contract as if they were separate contracts

## APPENDIX

### DEFINITION OF AN INSURANCE CONTRACT

*This appendix is an integral part of AASB 1038.*

- 1 This Appendix gives guidance on the definition of an insurance contract in section 20 of this Standard. It addresses the following issues:
  - (a) the term ‘uncertain future event’ (paragraphs 2-4);
  - (b) insurance risk and other risks (paragraphs 5-14);
  - (c) examples of life insurance contracts (paragraphs 15-18);
  - (d) significant insurance risk (paragraphs 19-25); and
  - (e) changes in the level of insurance risk (paragraphs 26 and 27).

#### Uncertain future event

- 2 Uncertainty (or risk) is the essence of an insurance contract. Accordingly, at least one of the following is uncertain at the inception of an insurance contract:
  - (a) whether an *insured event* will occur;
  - (b) when it will occur; or
  - (c) how much the insurer will need to pay if it occurs.
- 3 In some insurance contracts, the insured event is the discovery of a loss during the term of the contract, even if the loss arises from an event that occurred before the inception of the contract. In other insurance contracts, the insured event is an event that occurs during the term of the contract, even if the resulting loss is discovered after the end of the contract term.
- 4 Some insurance contracts cover events that have already occurred, but whose financial effect is still uncertain. An example is a reinsurance contract that covers the direct insurer against adverse development of claims already reported by policyholders. In such contracts, the insured event is the discovery of the ultimate cost of those claims.

## **Distinction between insurance risk and other risks**

- 5 The definition of an insurance contract refers to insurance risk, which this Standard defines as risk, other than financial risk, transferred from the holder of a contract to the issuer. A contract that exposes the issuer to financial risk without significant insurance risk is not an insurance contract.
- 6 The definition of financial risk in section 20 of this Standard includes a list of financial and non-financial variables. That list includes non-financial variables that are not specific to a party to the contract, such as an index of earthquake losses in a particular region or an index of temperatures in a particular city. It excludes non-financial variables that are specific to a party to the contract.
- 7 Some contracts expose the issuer to financial risk, in addition to significant insurance risk. For example, many life insurance contracts both guarantee a minimum rate of return to policyholders (creating financial risk) and promise death benefits that at some times significantly exceed the policyholder's account balance (creating insurance risk in the form of mortality risk). Such contracts are insurance contracts.
- 8 Under some contracts, an insured event triggers the payment of an amount linked to a price index. Such contracts are insurance contracts, provided the payment that is contingent on the insured event can be significant. For example, a life-contingent annuity linked to a cost-of-living index transfers insurance risk because payment is triggered by an uncertain event – the survival of the annuitant. The link to the price index is an embedded derivative, but it also transfers insurance risk. If the resulting transfer of insurance risk is significant, the embedded derivative meets the definition of an insurance contract, in which case it need not be separated and measured at fair value (see paragraph 2.2.1 of this Standard).
- 9 The definition of insurance risk refers to risk that the insurer accepts from the policyholder. In other words, insurance risk is a pre-existing risk transferred from the policyholder to the insurer. Thus, a new risk created by the contract is not insurance risk.
- 10 The definition of an insurance contract refers to an adverse effect on the policyholder. The definition does not limit the payment by the insurer to an amount equal to the financial impact of the adverse event. For example, the definition does not limit payment under a term life insurance contract to the financial loss suffered by the deceased's dependants, nor does it preclude the payment of

predetermined amounts to quantify the loss caused by death or an accident.

- 11 Some contracts require a payment if a specified uncertain event occurs, but do not require an adverse effect on the policyholder as a precondition for payment. Such a contract is not an insurance contract even if the holder uses the contract to mitigate an underlying risk exposure. For example, if the holder uses a derivative to hedge an underlying non-financial variable that is correlated with cash flows from an asset of the entity, the derivative is not an insurance contract because payment is not conditional on whether the holder is adversely affected by a reduction in the cash flows from the asset. Conversely, the definition of an insurance contract refers to an uncertain event for which an adverse effect on the policyholder is a contractual precondition for payment. This contractual precondition does not require the insurer to investigate whether the event actually caused an adverse effect, but permits the insurer to deny payment if it is not satisfied that the event caused an adverse effect.
- 12 Lapse or persistency risk (i.e. the risk that the counterparty will cancel the contract earlier or later than the issuer had expected in pricing the contract) is not insurance risk because the payment to the counterparty is not contingent on an uncertain future event that adversely affects the counterparty. Similarly, expense risk (i.e. the risk of unexpected increases in the administrative costs associated with the servicing of a contract, rather than in costs associated with insured events) is not insurance risk because an unexpected increase in expenses does not adversely affect the counterparty.
- 13 Therefore, a contract that exposes the issuer to lapse risk, persistency risk or expense risk is not an insurance contract unless it also exposes the issuer to insurance risk. However, if the issuer of that contract mitigates that risk by using a second contract to transfer part of that risk to another party, the second contract exposes that other party to insurance risk.
- 14 An insurer can accept significant insurance risk from the policyholder only if the insurer is an entity separate from the policyholder. In the case of a mutual insurer, the mutual accepts risk from each policyholder and pools that risk. Although policyholders bear that pooled risk collectively in their capacity as owners, the mutual has still accepted the risk that is the essence of an insurance contract.

## Examples of life insurance contracts

- 15 The following are examples of contracts that are life insurance contracts, if the transfer of insurance risk is significant:
- (a) life insurance contracts (although death is certain, it is uncertain when death will occur or, for some types of life insurance, whether death will occur within the period covered by the insurance);
  - (b) life-contingent annuities and pensions (i.e. contracts that provide compensation for the uncertain future event – the survival of the annuitant or pensioner – to assist the annuitant or pensioner in maintaining a given standard of living, which would otherwise be adversely affected by his or her survival); and
  - (c) life reinsurance contracts.
- 16 The following are examples of items that are not life insurance contracts:
- (a) investment contracts that are governed under the *Life Insurance Act 1995* but do not expose the insurer to significant insurance risk, for example life insurance contracts in which the insurer bears no significant mortality risk (such contracts are non-insurance financial instruments or service contracts, see paragraphs 17 and 18 of this Appendix);
  - (b) contracts that have the legal form of insurance, but pass all significant insurance risk back to the policyholder through non-cancellable and enforceable mechanisms that adjust future payments by the policyholder as a direct result of insured losses, for example some financial reinsurance contracts or some group contracts (such contracts are normally non-insurance financial instruments or service contracts, see paragraphs 17 and 18 of this Appendix);
  - (c) self-insurance, in other words retaining a risk that could have been covered by insurance (there is no insurance contract because there is no agreement with another party);
  - (d) contracts (such as gambling contracts) that require a payment if a specified uncertain future event occurs, but do not require, as a contractual precondition for payment, that the event adversely affects the policyholder. However, this

does not preclude the specification of a predetermined payout to quantify the loss caused by a specified event such as death or an accident;

- (e) derivatives that expose one party to financial risk but not insurance risk, because they require that party to make payment based solely on changes in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, 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 (see AASB 139); and
- (f) general insurance contracts.

17 If the contracts described in paragraph 16 of this Appendix create financial assets or financial liabilities, they are within the scope of AASB 139. Among other things, this means that the parties to the contract use what is sometimes called deposit accounting, which involves the following:

- (a) one party recognises the consideration received as a financial liability, rather than as revenue; and
- (b) the other party recognises the consideration paid as a financial asset, rather than as an expense.

18 If the contracts described in paragraph 16 of this Appendix do not create financial assets or financial liabilities, AASB 118 applies. Under AASB 118, revenue associated with a transaction involving the rendering of services is recognised by reference to the stage of completion of the transaction if the outcome of the transaction can be estimated reliably.

### **Significant insurance risk**

19 A contract is an insurance contract only if it transfers significant insurance risk. Paragraphs 5 to 14 of this Appendix discuss insurance risk. The following paragraphs discuss the assessment of whether insurance risk is significant.

20 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 (i.e. have no discernible effect on the economics of the transaction). If significant additional benefits would be payable in scenarios that

have commercial substance, the condition in the previous sentence may be met even if the insured event is extremely unlikely or even if the expected (i.e. probability-weighted) present value of contingent cash flows is a small proportion of the expected present value of all the remaining contractual cash flows.

- 21 The additional benefits described in paragraph 20 of this Appendix refer to amounts that exceed those that would be payable if no insured event occurred (excluding scenarios that lack commercial substance). Those additional amounts include claims handling and claims assessment costs, but exclude:
- (a) the loss of the ability to charge the policyholder for future services. For example, in an investment-linked life insurance contract, the death of the policyholder means that the insurer can no longer perform investment management services and collect a fee for doing so. However, this economic loss for the insurer does not reflect insurance risk, just as a mutual fund manager does not take on insurance risk in relation to the possible death of the client. Therefore, the potential loss of future investment management fees is not relevant in assessing how much insurance risk is transferred by a contract;
  - (b) waiver on death of charges that would be made on cancellation or surrender. Because the contract brought those charges into existence, the waiver of these charges does not compensate the policyholder for a pre-existing risk. Hence, they are not relevant in assessing how much insurance risk is transferred by a contract;
  - (c) a payment conditional on an event that does not cause a significant loss to the holder of the contract. For example, consider a contract that requires the issuer to pay one million currency units if an asset suffers physical damage causing an insignificant economic loss of one currency unit to the holder. In this contract, the holder transfers to the insurer the insignificant risk of losing one currency unit. At the same time, the contract creates non-insurance risk that the issuer will need to pay 999,999 currency units if the specified event occurs. Because the issuer does not accept significant insurance risk from the holder, this contract is not an insurance contract; and
  - (d) possible reinsurance recoveries. The insurer accounts for these separately.

- 22 An insurer shall assess the significance of insurance risk contract by contract, rather than by reference to materiality to the financial report.<sup>1</sup> Thus, insurance risk may be significant even if there is a minimal probability of material losses for a whole book of contracts. This contract-by-contract assessment makes it easier to classify a contract as an insurance contract. However, if a relatively homogeneous book of small contracts is known to consist of contracts that all transfer insurance risk, an insurer need not examine each contract within that book to identify a few non-derivative contracts that transfer insignificant insurance risk.
- 23 It follows from paragraphs 20 to 22 of this Appendix that if a contract pays a death benefit exceeding the amount payable on survival, the contract is an insurance contract unless the additional death benefit is insignificant (judged by reference to the contract rather than to an entire book of contracts). As noted in paragraph 21(b) of this Appendix, the waiver on death of cancellation or surrender charges is not included in this assessment if this waiver does not compensate the policyholder for a pre-existing risk. Similarly, an annuity contract that pays out regular sums for the rest of a policyholder's life is an insurance contract, unless the aggregate life contingent payments are insignificant.
- 24 Paragraph 20 of this Appendix refers to additional benefits. These additional benefits could include a requirement to pay benefits earlier if the insured event occurs earlier and the payment is not adjusted for the time value of money. An example is whole life insurance for a fixed amount (in other words, insurance that provides a fixed death benefit whenever the policyholder dies, with no expiry date for the cover). It is certain that the policyholder will die, but the date of death is uncertain. The insurer will suffer a loss on those individual contracts for which policyholders die early, even if there is no overall loss on the whole book of contracts.
- 25 If an insurance contract is unbundled into a deposit component and an insurance component, the significance of insurance risk transfer is assessed by reference to the insurance component. The significance of insurance risk transferred by an embedded derivative is assessed by reference to the embedded derivative.

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<sup>1</sup> For this purpose, contracts entered into simultaneously with a single counterparty (or contracts that are otherwise interdependent) form a single contract.

## **Changes in the level of insurance risk**

- 26 Some contracts do not transfer any insurance risk to the issuer at inception, although they do transfer insurance risk at a later time. For example, consider a contract that provides a specified investment return and includes an option for the policyholder to use the proceeds of the investment on maturity to buy a life-contingent annuity at the current annuity rates charged by the insurer to other new annuitants when the policyholder exercises the option. The contract transfers no insurance risk to the issuer until the option is exercised, because the insurer remains free to price the annuity on a basis that reflects the insurance risk transferred to the insurer at that time. However, if the contract specifies the annuity rates (or a basis for setting the annuity rates), the contract transfers insurance risk to the issuer at inception.
- 27 A contract that qualifies as an insurance contract remains an insurance contract until all rights and obligations are extinguished or expire.

## **DIFFERENCES BETWEEN UPDATED AASB 1038 AND PREVIOUS AASB 1038**

*This analysis of differences accompanies, but is not part of, AASB 1038.*

This section identifies differences between this Standard, AASB 1038 *Life Insurance Contracts* (“updated AASB 1038”), and AASB 1038 *Life Insurance Business* (“previous AASB 1038”) under the following headings:

- A: Incompatibilities between updated AASB 1038 and previous AASB 1038
- B: Previous AASB 1038 is more detailed or restrictive
- C: Updated AASB 1038 is more detailed or restrictive
- D: Previous AASB 1038 disclosures are more extensive
- E: Updated AASB 1038 disclosures are more extensive

The analysis of differences should not be taken as providing an exhaustive list of differences.

### **Introduction**

Updated AASB 1038 applies to those contracts that meet the definition of a life insurance contract. Updated AASB 1038 also applies to certain aspects of accounting for life investment contracts.

Updated AASB 1038 includes a definition of an insurance contract. An insurance contract is defined as a contract under which an insurer accepts significant insurance risk from a policyholder by agreeing to compensate the policyholder if a specified uncertain future event adversely affects the policyholder. A life insurance contract is an insurance contract regulated under the *Life Insurance Act 1995* or a financial instrument with a discretionary participation feature regulated under the Life Insurance Act. A life investment contract is a contract regulated under the Life Insurance Act that does not meet the definition of an insurance contract.

The scope of previous AASB 1038 is wider as it applies to life insurers, prescribes the methods to be used for reporting on life insurance business and requires disclosures about life insurance business.

As updated AASB 1038 applies principally to life insurance contracts, the requirements in relation to life insurers' assets in previous AASB 1038 have been removed. However, whilst life insurers' assets are not treated principally under updated AASB 1038, updated AASB 1038 does restrict the measurement choices available under the other standards applicable. Under previous AASB 1038 all life insurers' assets are measured at net market value. Under updated AASB 1038 all assets backing life insurance liabilities or life investment contract liabilities are measured at fair value with changes in fair value recognised in the income statement, where this measurement basis is allowable under the applicable standards.

As updated AASB 1038 applies principally to life insurance contracts, certain embedded derivatives are treated under AASB 139 *Financial Instruments: Recognition and Measurement*. Previous AASB 1038 does not address embedded derivatives.

The requirements that are consistent with the Margin on Services model, contained in previous AASB 1038, have been retained. However, updated AASB 1038 includes additional or altered requirements in relation to:

*(a) Discounting*

Previous AASB 1038 requires policy liabilities to be discounted. Updated AASB 1038 also requires discounting but requires the use of different discount rates. To the extent that the benefits under life insurance contracts are not contractually linked to the performance of the assets held, updated AASB 1038 requires life insurance liabilities to be discounted for the time value of money using risk-free discount rates based on current, observable, objective rates that directly relate to the nature, structure and term of the future obligations. However, to the extent that the benefits under life insurance contracts are contractually linked to the performance of the assets held, updated AASB 1038 requires life insurance liabilities to be discounted based on the market returns on assets backing life insurance liabilities. Previous AASB 1038 requires discount rates to be based on market returns on investments supporting policy liabilities.

*(b) Disclosure*

Updated AASB 1038 introduces disclosure principles. It requires disclosures that explain the recognised amounts in the balance sheet and income statement that arise from insurance contracts, and that help users to understand the amount, timing and uncertainty of future cash flows from insurance contracts. The insurer determines the appropriate level of aggregation that is required to satisfy the disclosure principles.

## Differences

### A. Incompatibilities between previous AASB 1038 and updated AASB 1038

#### A.1 Scope

Updated AASB 1038 applies to life insurers or the parent in a group that includes a life insurer. A life insurer is an entity registered under the Life Insurance Act that issues life insurance contracts or life investment contracts. Paragraph 2.1 of updated AASB 1038 states that the Standard applies to those contracts that meet the definition of a life insurance contract.

Previous AASB 1038 also applies to life insurers or the parent in a group that includes a life insurer. However, paragraph 3.1 of previous AASB 1038 states that the purpose of the Standard is to prescribe the methods to be used for reporting on life insurance business. Previous AASB 1038 defines life insurance business as all business conducted by a life insurer.

Updated AASB 1038 includes a definition of an insurance contract. An insurance contract is defined as a contract under which an insurer accepts significant insurance risk from a policyholder by agreeing to compensate the policyholder if a specified uncertain future event adversely affects the policyholder. A life insurance contract is defined as:

- (a) an insurance contract that is regulated under the Life Insurance Act or similar contracts issued by entities operating outside Australia; and
- (b) a financial instrument with a discretionary participation feature, which is regulated under the Life Insurance Act, or similar contracts issued by entities operating outside Australia.

Paragraph 2.1.4 of updated AASB 1038 states that the Standard applies to contracts issued by friendly societies that meet the definition of a life insurance contract. Private health insurance contracts regulated under the *National Health Act 1953*, issued by friendly societies registered under the Life Insurance Act do not meet the definition of a life insurance contract and are treated under AASB 1023 *General Insurance Contracts*.

#### A.2 Life investment contracts

Under paragraph 12.1 of updated AASB 1038 life investment contracts are not treated under updated AASB 1038 but are treated under AASB 139 to the extent that they give rise to financial assets and financial liabilities.

A life investment contract typically involves both the origination of one or more financial instruments and the provision of management services. A typical contract comprises a financial instrument element and a management services element. Life investment contract liabilities arise under the financial instrument element and are treated under AASB 139. The management services element, including associated acquisition costs, is treated under AASB 118 *Revenue*.

Life investment contract liabilities are to be designated as “at fair value through profit or loss” under AASB 139 (see paragraph 12.1 of AASB 1038).

Under previous AASB 1038 life investment contracts are accounted for using requirements consistent with the Margin on Services model, which is the same treatment as for life insurance contracts.

### **A.3 Discount rates**

Under paragraph 8.7 of updated AASB 1038, to the extent that the benefits under life insurance contracts are not contractually linked to the performance of the assets held, the life insurance liability is discounted for the time value of money using risk-free discount rates that are current observable, objective rates that relate to the nature, structure and term of the outstanding claims liabilities. This reflects the principle that the measurement of insurance liabilities is independent of the assets supporting those liabilities. However, under paragraph 8.8 of updated AASB 1038, to the extent that the benefits under life insurance contracts are contractually linked to the performance of the assets held, life insurance liabilities are discounted based on the market returns on assets backing life insurance liabilities.

Paragraph 9.6 of previous AASB 1038 requires discount rates to be based on market returns on investments supporting policy liabilities in respect of liabilities relating to all life insurance business.

### **A.4 Insurers’ assets**

Under updated AASB 1038 insurers’ assets are treated under the applicable accounting standards, for example an insurer’s investments in equities are treated under AASB 139. However, under paragraph 10.1.1 of updated AASB 1038 all assets backing life insurance liabilities or life investment contract liabilities are measured at fair value, with changes in fair value recognised in the income statement, where this is allowable under the applicable accounting standards.

Under paragraph 12.1 of previous AASB 1038 all life insurers’ assets are measured at net market value as at the reporting date. Any changes in net market value are recognised in the income statement in the year in which the changes occur.

#### *Excess of Market Value Over Net Assets (EMVONA)*

Under paragraph 5.3 of previous AASB 1038 in the consolidated financial report of a life insurer, an interest in a subsidiary is, in effect, measured at market value. The net amount of the subsidiary's assets and liabilities are consolidated and, in addition, any excess of the net market value of the interest in the subsidiary over the net amount of that subsidiary's assets and liabilities (the "EMVONA asset") is recognised in the consolidated financial report as a separate asset.

Under paragraph 10.1.1 of updated AASB 1038 all assets backing life insurance liabilities or life investment contract liabilities are measured at fair value, with changes in fair value recognised in the income statement, where this is allowable under the applicable accounting standards. Under AASB 138 *Intangible Assets* the EMVONA asset cannot be recognised to the extent that it represents internally generated goodwill. AASB 138 only allows the recognition of acquired goodwill. In addition, under AASB 127 *Consolidated and Separate Financial Statements* the consolidation process does not allow for recognition of the EMVONA asset.

#### *Financial Assets*

Within the limits of the requirements of AASB 139, updated AASB 1038, paragraph 10.2, requires financial assets backing life insurance liabilities or life investment contract liabilities to be measured as "at fair value through profit or loss". AASB 139 allows entities to designate any financial asset as "at fair value through profit or loss" on initial recognition. Updated AASB 1038 allows an insurer to designate any financial asset as "at fair value through profit or loss" on first application of updated AASB 1038. However, to impose discipline on the designation as "at fair value through profit or loss", AASB 139 does not allow the transfer of assets into or out of this category after initial recognition or after first application of updated AASB 1038. For example, an insurer with reported life insurance liabilities of \$95m has determined that the assets backing life insurance liabilities are \$100m. If the development were such that liabilities increased to \$110m, under AASB 139 an insurer would not be able to redesignate additional existing assets as "at fair value through profit or loss". In determining which assets back life insurance liabilities or life investment contract liabilities, therefore, an insurer makes appropriate allowance for the potential for future deterioration in those liabilities.

Under previous AASB 1038, paragraph 12.1, all financial assets of a life insurer are measured at net market value.

### *Investment Property*

Under paragraph 10.3 of updated AASB 1038 an insurer applies AASB 140 *Investment Property* to its investment property. Under AASB 140, with the exceptions noted in (a) and (b) below, an entity may choose as its accounting policy either a fair value model or a cost model, and applies that policy to all of its investment property. The exceptions are that an entity may:

- (a) choose either the fair value model or the cost model for all investment property backing liabilities that pay a return linked directly to the fair value of, or returns from, specified assets including that investment property; and
- (b) choose either the fair value model or the cost model for all other investment property, regardless of the choice made in (a).

Under paragraph 10.3 of updated AASB 1038 any investment property within the scope of AASB 140, that the insurer considers backs life insurance liabilities or life investment contract liabilities, is measured using the fair value model in AASB 140, that is, is measured at fair value with changes in fair value recognised in the income statement.

It is likely that a life insurer will hold investment property backing life insurance liabilities or life investment contract liabilities that pay a return linked directly to the fair value of, or returns from, specified assets including that investment property. Under updated AASB 1038, paragraph 10.3, the insurer will measure these liabilities using the fair value model.

If all investment property backing life insurance liabilities or life investment contract liabilities backs liabilities that pay a return linked directly to the fair value of, or returns from, specified assets including that investment property, then any other investment property held that does not back life insurance liabilities or life investment contract liabilities can be measured under (b) above using either the fair value model or the cost model under AASB 140.

Where a life insurer holds investment property that backs life insurance liabilities or life investment contract liabilities, and where the life insurance liabilities or life investment contract liabilities do not pay a return linked directly to the fair value of, or returns from, specified assets including that investment property, then, in using the fair value model for the investment property that backs those life insurance liabilities or life investment contract liabilities, the insurer will be required to measure any other investment property using the fair value model, even where they are not backing life insurance liabilities or life investment contract liabilities.

Under paragraph 12.1 of previous AASB 1038 all investment property of a life insurer is measured at net market value.

*Owner-occupied land and buildings*

Under paragraph 10.4 of updated AASB 1038 owner-occupied land and buildings are treated under AASB 116 *Property, Plant and Equipment*. AASB 116 allows measurement at cost or fair value via a revaluation reserve. Under paragraph 10.4 of updated AASB 1038 where owner-occupied land and buildings backs life insurance liabilities or life investment contract liabilities the insurer applies the fair value measurement allowed under AASB 116. Where owner-occupied land and buildings do not back life insurance liabilities or life investment contract liabilities the insurer chooses either the fair value measurement or cost measurement allowed under AASB 116.

Under paragraph 12.1 of previous AASB 1038 all owner-occupied land and buildings of a life insurer are measured at net market value.

*Associates*

Under paragraph 10.5 of updated AASB 1038 investments in associates are treated under AASB 128 *Investments in Associates*. Under AASB 128 investments in associates are accounted for using the equity method. However, investments in associates held by mutual funds, unit trusts and similar entities including investment-linked insurance funds that are treated under AASB 139 and are designated as “at fair value through profit or loss” are not accounted for using the equity method.

Under updated AASB 1038 investments in associates that back life insurance liabilities or life investment contract liabilities and that are held by mutual funds, unit trusts and similar entities including investment-linked insurance funds are to be treated under AASB 139 and designated as “at fair value through profit or loss”.

Under paragraph 12.1 of previous AASB 1038 all investments in associates held by life insurers are measured at net market value.

*Venturer's interests in jointly controlled entities*

Under paragraph 10.6 of updated AASB 1038 venturer's interests in jointly controlled entities are treated under AASB 131 *Interests in Joint Ventures*. Under AASB 131 venturer's interests in jointly controlled entities are accounted for using the equity method. However, venturer's interests in jointly controlled entities held by mutual funds, unit trusts and similar entities including investment-linked insurance funds that are treated under

AASB 139 and are designated as “at fair value through profit or loss” are not accounted for using the equity method.

Under updated AASB 1038 venturer’s interests in jointly controlled entities that back life insurance liabilities or life investment contract liabilities and that are held by mutual funds, unit trusts and similar entities including investment-linked insurance funds, are to be treated under AASB 139 and designated as “at fair value through profit or loss”.

Under paragraph 12.1 of previous AASB 1038 all interests in jointly controlled entities held by life insurers are measured at net market value.

#### **A.5 Deposit components**

Under paragraph 6.1 of previous AASB 1038 the deposit component of a life insurance contract is split from the life insurance component of a life insurance contract, such that the premiums and claims under the life insurance component are recognised in the income statement as income and expense, and the premiums and claims under the deposit component are recognised in the balance sheet as changes in life insurance liabilities. Premiums and claims are split when this is practicable and when the components can be measured reliably. Whilst premiums and claims are split, however, they remain within the scope of previous AASB 1038.

Under paragraph 5.1 of updated AASB 1038, premiums and claims are split when the deposit component can be measured separately. That is, the premiums and claims under the life insurance component are recognised in the income statement as income and expense, and the premiums and claims under the deposit component are recognised in the balance sheet.

However, under paragraph 2.3.2 of updated AASB 1038 an insurer is also permitted to unbundle any deposit component that can be measured separately. Unbundling the deposit component involves removing the deposit component from the scope of updated AASB 1038 and treating it under AASB 139.

Under updated AASB 1038, therefore, where any deposit component under a life insurance contract can be measured separately, a life insurer first splits any premiums and claims arising from the deposit component of the life insurance contract from the premiums and claims arising from the life insurance component of the life insurance contract. Secondly, the premiums and claims arising from deposit component can either be recognised as changes in life insurance liabilities in the balance sheet and treated under updated AASB 1038, or the insurer can unbundle the deposit component and treat it under AASB 139.

Under paragraphs 5.2 and 2.3.3 of updated AASB 1038, where any deposit component under a life insurance contract cannot be measured separately, the premiums and claims cannot be split and the deposit component cannot be unbundled and treated under AASB 139.

#### **A.6 Embedded derivatives**

Under paragraph 2.2.1 of updated AASB 1038, a derivative that is embedded in a host insurance contract, and that is not itself an insurance contract, is treated under AASB 139 and measured at fair value, with changes in fair value recognised in the income statement. Under previous AASB 1038 an embedded derivative is treated as part of the life insurance business.

Under paragraph 2.2.2 of updated AASB 1038, however, an insurer need not separate a policyholder's option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate) even if the exercise price differs from the carrying amount of the host insurance liability. The requirement in AASB 139 applies to a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in a financial variable (such as an equity or commodity price or index), or a non-financial variable that is not specific to a party to the contract. Furthermore, that requirement also applies if the holder's ability to exercise a put option or cash surrender option is triggered by a change in such a variable (for example, a put option that can be exercised if a stock market index reaches a specified level).

Under paragraph 2.2.1 of updated AASB 1038, a derivative that is embedded in a host insurance contract and that is itself an insurance contract, is treated under updated AASB 1038. This is consistent with previous AASB 1038.

#### **A.7 Foreign participating business**

Under paragraphs 11.1 and 11.2 of previous AASB 1038 and paragraphs 9.1 and 9.2 of updated AASB 1038 vested participating benefits and unvested participating benefits in relation to the reporting period are recognised as expenses for the reporting period. Benefits that remain payable are recognised as a component of life insurance liabilities. This treatment is consistent with the requirements of the Life Insurance Act which requires vested and unvested benefits to be treated as a liability and which does not allow treatment as equity.

However, participating business written in other jurisdictions is not subject to the Life Insurance Act. As noted in paragraph 17.5.3 of updated AASB 1038, in foreign life insurance operations "retained profits" may exist that are unvested and that are treated as equity. Under previous AASB 1038 such retained profits can be treated as equity and are separately disclosed.

Under updated AASB 1038, where retained profits arising from foreign operations are treated as equity (in relation to both participating life insurance contracts and participating life investment contracts), the insurer applies paragraphs 17.5.4 and 17.5.5 to this business.

Paragraph 17.5.4 of updated AASB 1038 requires that an issuer of a life insurance contract with a discretionary participation feature written in a foreign jurisdiction:

- (a) may, but need not, recognise the guaranteed element separately from the discretionary participation feature. If the issuer does not recognise them separately, it classifies the whole contract as a liability. If the issuer classifies them separately, it classifies the guaranteed element as a liability;
- (b) if it recognises the discretionary participation feature separately from the guaranteed element, classify that feature as either a liability or a separate component of equity. The issuer shall not classify that feature as an intermediate category that is neither liability nor equity;
- (c) may recognise all premiums received as revenue without separating any portion that relates to the equity component. If part of the entire discretionary participation feature is classified in equity, a portion of profit or loss may be attributable to that feature (in the same way that a portion may be attributable to minority interests);
- (d) if the contract contains an embedded derivative within the scope of AASB 139, apply AASB 139 to that embedded derivative; and
- (e) in all respects not described in paragraphs 14-20 of AASB 4 and paragraphs 34(a)-(d) of AASB 4, continue its existing accounting policies for such contracts, unless it changes those accounting policies in a way that complies with paragraphs 21-30 of AASB 4.

Paragraph 17.5.5 of updated AASB 1038 states that requirements in paragraph 17.5.4 also apply to a life investment contract written in a foreign jurisdiction that contains a discretionary participation feature. In addition:

- (a) if the issuer classifies the entire discretionary participation feature as a liability, it applies the liability adequacy test in paragraph 8.6 of updated AASB 1038 to the whole contract;
- (b) if the issuer classifies part or that entire feature as a separate component of equity, the liability recognised for the whole contract cannot be less than the amount that would result from applying AASB 139 to the guaranteed element; and

- (c) although these contracts contain financial instruments, the issuer may continue to recognise the premiums for those contracts as revenue and recognise as an expense the resulting increase in the carrying amount of the liability, subject to the requirements of paragraphs 5.1 and 5.2 of updated AASB 1038.

#### **A.8 Investment revenue**

Under paragraph 8.1 of previous AASB 1038 returns on all investments controlled by a life insurer are recognised as revenue.

Investment revenue is not within the scope of updated AASB 1038 but is treated under the applicable accounting standards, including AASB 132 *Financial Instruments: Presentation and Disclosure*.

#### **A.9 Treatment of errors**

Under paragraph 8.5(d) of updated AASB 1038 material calculation errors and similar errors in respect of assumptions underlying the measurement of life insurance liabilities are treated in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Under paragraph 9.5(d) of previous AASB 1038 calculation errors and similar errors in respect of assumptions underlying the measurement of policy liabilities are recognised as revenues or expenses in the period in which they are identified.

#### **A.10 Other liabilities**

Under paragraph 10.1 of previous AASB 1038 other liabilities are measured at net present values as at the reporting date.

Other liabilities are not within the scope of updated AASB 1038 but are treated under the applicable accounting standards, including AASB 139.

#### **A.11 Tax assets and liabilities**

Under paragraph 14.1(a) of previous AASB 1038 tax assets and liabilities are measured at present values.

Tax assets and liabilities are not within the scope of updated AASB 1038 but are treated under AASB 112 *Income Taxes*. AASB 112 does not allow discounting of tax assets or liabilities.

### **B. Previous AASB 1038 is more detailed or restrictive**

None noted.

## **C. Updated AASB 1038 is more detailed or restrictive**

### **C.1 Insurance assets and liabilities acquired in a business combination**

Under paragraph 13.1.1 of updated AASB 1038 an insurer is permitted but not required to use an expanded presentation that splits the fair value of acquired insurance contracts into two components:

- (a) a liability measured in accordance with the insurer's accounting policies for general insurance contracts that it issues; and
- (b) an intangible asset, representing the difference between:
  - (i) the fair value of the contractual insurance rights acquired and insurance obligations assumed; and
  - (ii) the amount described in paragraph 13.3.1(a).

Under previous AASB 1038 there are no specific provisions relating to the presentation of acquired insurance contracts and insurers apply normal consolidation requirements.

### **C.2 Impairment of reinsurance assets**

Under paragraph 7.1.1 of updated AASB 1038 a reinsurance asset is impaired if there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the cedant may not receive amounts due to it under the terms of the reinsurance contract. Where a reinsurance asset is impaired the cedant reduces its carrying amount and recognises the impairment in the income statement.

Previous AASB 1038 did not address the impairment of reinsurance assets.

## **D. Previous AASB 1038 disclosures are more extensive**

### **D.1 Assets**

Under paragraph 16.1 of previous AASB 1038 insurers disclose the following assets in broad order of their liquidity:

- (a) investments, showing separately:
  - (i) equity securities;
  - (ii) debt securities;

- (iii) properties; and
- (iv) other, by major class where applicable;
- (b) operating assets;
- (c) reinsurance recoveries receivable; and
- (d) any excess net market value asset recognised together with the components disaggregated by subsidiary and explanations of:
  - (i) the factors giving rise to that asset; and
  - (ii) any changes in that asset from the previous financial year.

Under paragraph 14.1.1(b) of updated AASB 1038 insurers disclose the recognised assets arising from insurance contracts. Updated AASB 1038 does not require specific disclosures of the various categories of asset.

## **D.2 Liabilities**

Under paragraph 16.3 of previous AASB 1038 insurers disclose policy liabilities, unvested policyholder benefit liabilities and other liabilities in broad order of their liquidity. The following components of policy liabilities are also disclosed:

- (a) future policy benefits, including participating benefits;
- (b) balance of future expenses;
- (c) planned margins of revenues over expenses;
- (d) future charges for acquisition costs balance of future revenues; and
- (f) other items, separated into material components.

Under paragraph 14.1.1(b) of updated AASB 1038 insurers disclose the recognised liabilities arising from insurance contracts. Paragraph 14.1.6 of updated AASB 1038 lists the components of life insurance liabilities that would normally be disclosed but does not require specific disclosures of the various liability components.

## **D.3 Revenue**

Under paragraph 15.1 of previous AASB 1038 insurers disclose the following revenues and related explanations:

- (a) premium revenue;
- (b) the accounting policy adopted in recognising premium revenue;
- (c) inwards reinsurance revenues;
- (d) investment revenue, showing separately revenues from:
  - (i) equity securities;
  - (ii) debt securities;
  - (iii) properties; and
  - (iv) other;
- (e) revenue arising from the recognition of a deficiency of the net market values of interests in subsidiaries over the net amount of subsidiaries' assets and liabilities; and
- (f) other revenue.

Under paragraph 14.1.1(b) of updated AASB 1038 insurers disclose the recognised income arising from insurance contracts. However, updated AASB 1038 does not require specific disclosures of the various categories of income.

#### **D.4 Expenses**

Under paragraph 15.2 of previous AASB 1038 insurers disclose the following expenses and related explanations:

- (a) outwards reinsurance expense;
- (b) operating expenses showing separately:
  - (i) claims expense;
  - (ii) policy acquisition expenses, separated into material components including commission;
  - (iii) policy maintenance expenses;
  - (iv) investment management expenses; and
  - (v) other;

- (c) the accounting policy adopted in recognising claims expense;
- (d) the basis for apportionment of operating expenses between policy acquisition, policy maintenance and investment management expenses; and
- (e) any expense arising from the recognition of a deficiency of the net market values of interests in subsidiaries over the net amount of subsidiaries' assets and liabilities.

Under paragraph 14.1.1(b) of updated AASB 1038 insurers disclose the recognised expenses arising from insurance contracts. Paragraph 14.1.4 of updated AASB 1038 lists the expenses that would normally be disclosed but does not require specific disclosures of the various categories of expense.

### **D.3 Assumptions**

Under paragraph 17.2 of previous AASB 1038 insurers disclose the following key assumptions used in determining policy liabilities:

- (a) discount rates, asset mix and inflation rates;
- (b) profit carriers used for each major product group;
- (c) future maintenance and investment management expenses, the rate of inflation applicable to them and any automatic indexation of benefits and premiums;
- (d) rates of taxation; and
- (e) mortality and morbidity, by reference to the identity of the tables.

Under paragraph 14.1.1(c) of updated AASB 1038 insurers, when practicable, give quantified disclosure of assumptions that have the greatest effect on the measurement of recognised amounts. In paragraph 14.1.5, updated AASB 1038 lists the assumptions that would normally have the greatest effect on the measurement of recognised amounts but does not require disclosure of specific assumptions.

## **E. Updated AASB 1038 disclosures are more extensive**

### **E.1 Insurance contracts – explanation of recognised amounts**

Under paragraph 14.1 of updated AASB 1038 insurers disclose information that identifies and explains the amounts in its financial report arising from insurance contracts. An insurer discloses:

- (a) its accounting policies for insurance contracts and related assets, liabilities, income and expense;
- (b) the recognised assets, liabilities, income, expense and cash flows arising from insurance contracts. Furthermore, if the insurer is a cedant, it discloses:
  - (i) gains and losses recognised in the income statement on buying reinsurance; and
  - (ii) if the cedant defers and amortises gains and losses arising on buying reinsurance, the amortisation for the period and the amounts remaining unamortised at the beginning and end of the period;
- (c) **the process used to determine the assumptions that have the greatest effect on the measurement of the recognised amounts described in (b). When practicable, an insurer also gives quantified disclosure of those assumptions;**
- (d) **the effect of changes in assumptions used to measure insurance assets and insurance liabilities, showing separately the effect of each change that has a material effect on the financial report; and**
- (e) **reconciliations of changes in insurance liabilities, reinsurance assets and, if any, related deferred acquisition costs.**

Updated AASB 1038 requires insurers to apply these disclosure principles. As documented in section D of this document, previous AASB 1038 requires specific disclosures about various categories and components of assets, liabilities, revenues and expenses.

## **E.2 Insurance contracts – amount, timing and uncertainty of cash flows**

Under paragraph 15.1 of updated AASB 1038 insurers disclose information that helps users to understand the amount, timing and uncertainty of future cash flows from insurance contracts. An insurer discloses:

- (a) its objectives in managing risks arising from insurance contracts and its policies for mitigating risk;
- (b) those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of the insurer's future cash flows;
- (c) information about insurance risk (both before and after risk mitigation by reinsurance), including information about:

- (i) the sensitivity of profit or loss and equity to changes in variables that have a material effect on them;
- (ii) concentrations of insurance risk; and
- (iii) actual claims compared with previous estimates (i.e. claims development). The disclosure about claims development goes back to the period when the earliest material claim arose for which there is still uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. An insurer need not disclose this information for claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year;
- (d) the information about interest rate risk and credit risk that AASB 132 *Financial Instruments: Disclosure and Presentation* would require if the insurance contracts were within the scope of AASB 132; and
- (e) information about exposures to interest rate risk or market risk under embedded derivatives contained in a host insurance contract if the insurer is not required to, and does not, measure the embedded derivatives at fair value.

Updated AASB 1038 requires insurers to apply these disclosure principles. As documented in section D of this document, previous AASB 1038 requires specific disclosures about assumptions used in determining policy liabilities.

### **E.3 Assets backing insurance liabilities**

Under paragraph 17.11 of updated AASB 1038 a life insurer discloses the process used to determine which assets back life insurance liabilities or life investment contracts.

Previous AASB 1038 does not include such a disclosure requirement.

### **E.4 Guaranteed or assured returns of funds invested**

Under paragraph 17.4 of updated AASB 1038 a life insurer discloses:

- (a) in respect of contracts with discretionary participation features, the amount of policy liabilities that relates to the guaranteed element;
- (b) in respect of investment-linked contracts, the amount of policy liabilities subject to investment performance guarantees; and

- (c) in respect of any other contracts not addressed in (a) or (b) with a fixed or guaranteed termination value, the amount of the current termination values.

Under paragraph 16.4 of previous AASB 1038 a life insurer discloses the amount of policy liabilities relating to guaranteed or assured returns of funds invested. Previous AASB 1038 does not require this amount to be separated into different types of guarantee as is required by updated AASB 1038.