Australian Unity

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Project Director
Insurance Contracts Exposure Draft ED/2010/8
International Accounting Standards Board
London
Submitted via website: www.ifrs.org

Australian Accounting Standards Board
Melbourne
Submitted via email: standard@aasb.gov.au

Australian Unity's Response:
IASB Insurance Contracts Exposure Draft ED/2010/8

Introduction

Australian Unity Limited is a national health, financial services and retirement living organisation with 560,000 customers, including 300,000 members and more than 1,400 employees. We operate the sixth largest private health insurance fund in Australia and provide cover for more than 300,000 people. We also operate a corporate private health fund, GU Health, which provides tailored products to corporate clients.

We welcome the opportunity to respond to the AASB Exposure Draft – Insurance Contracts dated August 2010. As the private health industry peak body, The Australian Health Insurance Association, is providing comprehensive responses to this Exposure Draft that fundamentally address our views, in this paper, Australian Unity would like to make only a few observations to highlight our specific concerns as they relate to Australian Unity business needs.

Characteristics of Australian Private Health Insurance (PHI) Industry

In the context of the Exposure Draft, the characteristics of Australian PHI include at least the following:

- Two key legislative requirements governing Australian PHI which differentiates it in its fundamental base from other types of insurances in Australia and from health insurance in many other countries are community rating and portability requirements.

- Under the community rating requirement, insurers are not permitted to risk rate or underwrite a PHI policy. The portability requirement disallows an insurer from applying to a person who transferred to a new policy from another policy (the old policy) waiting periods which would reduce the policyholder's hospital benefit entitlement in the initial months of the policy relative to his or her entitlement under the old policy. This requirement applies regardless of whether the transfer is between different products within the same insurer or between insurers.

- Under normal circumstances, premiums rates are reviewed every twelve months with premium rate adjustments being subject to approval by the government through an annual Premium Round process which applies to the entire industry. Insurers are also able to apply "out-of-cycle" premium increases (also subject to approval).

Contract Boundary

Under the current proposal "the point at which an insurer either is no longer required to provide coverage or has the right or the practical ability to reassess the risk of the particular policyholder and, as a result, can set a price that fully reflects that risk" marks the end of the existing contract and the commencement of a new contract.

There are at least two issues with applying this definition to PHI policies:

λ Due to community rating (including guaranteed acceptance), private health insurers are not permitted to assess the risk of a particular policyholder (and hence set a price that fully reflects that risk) at the commencement of the original contract. It would seem illogical then to use this condition to define the termination of the existing contract and the commencement of a new contract.

λ Clause 57 of Basis for Conclusion on Exposure Draft explains that if the insurer can reprice an existing contract on the basis of general market experience, but cannot at the that time reassess the individual policyholder's risk profile, that point lies within the boundary of the existing contract. The rationale is that "the insurance contract binds the insurer by requiring it to provide the policyholder with something of value (ie continuing insurance coverage without the need to undergo re-underwriting)".

λ It should be clear that this rationale cannot be applied to PHI polices. Due to the community rating and portability requirements, PHI policyholders can cancel his or her policy and immediately obtain a policy with similar terms, conditions and price point from another insurer without the need to undergo re-underwriting. Hence, maintaining the existing policy does not give the policyholder any additional value or the insurer any additional liability compared to terminating the policy and immediately commencing a new similar policy.

We are therefore of the opinion that it is unreasonable to apply the currently proposed contract boundary definition to PHI policies.

It should be noted that while a private health insurer is not permitted to set a price that fully reflects the risk of a particular policyholder, the insurer has the ability to do this for a group of policyholders at least on an annual basis. In fact, the market is accustomed to and expects annual repricing. In addition, an insurer can at any time change the benefit entitlement of all policies on the same product (provided adequate notice is given to the policyholders) and hence significantly alter its liabilities under the policies. For these reasons, we believe that PHI contracts cannot be deemed to be anything other than short-duration contracts.

Usefulness of Financial Statements

The introduction to the Exposure Draft states that one of the key objectives which would be achieved by the proposals in the Exposure Draft is providing "a comprehensive framework that will require insurers to provide information that is relevant to users of financial statements for economic decision making" (IN2 (a) of the Exposure Draft). We do not believe that the currently proposed standard achieves this objective in the case of private health insurers in Australia. We believe that the profit reported under the proposed standard will exhibit patterns and a level of volatility which are not reflective of the underlying economic profit of the business, making the reported financial results difficult to interpret if not potentially misleading.

As an example, consider a portfolio of contracts which were profitable at inception but have become unprofitable subsequently due to revisions to the fulfilment cash flow estimates. The portfolio will continue to report profits following a potentially significant loss in the period in which revisions to estimates were made. Without comprehensive analyses of the financial statements for prior reporting periods, we do not believe that the users of the statement can derive meaningful information from the statements regarding the underlying profitability of the contracts.

We also believe that the volatility arising from revisions to fulfilment cash estimates would make the reported financial results difficult to interpret. We feel that this currently presents a greater issue for private health insurers in Australia than many other types of insurances in Australia and other jurisdictions due to sovereign risk.

The Australian PHI industry continues to be subject to significant sovereign risk. Future experience will be significantly influenced by government policy in a range of areas including but not limited to funding of public hospitals, medical services and pharmaceuticals and incentives for encouraging the take-up of private health insurance. As such changes could not be predicted with any degree of certainty as to the nature, extent, timing and impact, significant revisions to the fulfilment cash flow estimates can be expected to be required when such changes are introduced and potentially in subsequent periods as estimates are adjusted as experience emerges.

An example of such a change in government policy is the increase in Medicare Levy Surcharge thresholds in 2008 which were estimated to significantly increase the lapse rates for younger policyholders and as a consequence significantly increase the average claim rate.

Transition Arrangement

Under the proposed transition provisions, all future profits which are expected to be derived from contracts that are existing at the time the proposed standards are first applied are to be transferred to retained earnings. If the contract boundary definition as currently proposed is adopted, it is expected that no material profit will be reported on some 40%-50% of a private health insurer's business even ten years after the proposed standards are first applied. The financial statements prepared under the proposed standards will therefore not give any meaningful results many years into the future. Insurers will most likely be required to prepare in parallel financial statements under the current financial reporting standards for purposes such as capital raising, further increasing its compliance costs.

Please contact Amanda Hagan at ahagan@australianunity.com.au or +61 3 8682 4001 if you wish to discuss our comments further.

Yours sincerely

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