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International Accounting Standards Board
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Submitted via www.ifrs.org

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**IASB Insurance Contracts Exposure Draft ED/2010/8**

## SUMMARY

The Australian Health Insurance Association (AHIA) welcomes the opportunity to provide comment on the Insurance Contracts Exposure Draft released by the International Accounting Standards Board (IASB) on 30 July 2010.

## THE AUSTRALIAN HEALTH INSURANCE ASSOCIATION

The Australian Health Insurance Association (AHIA) is the peak body that represents 21 private health insurers throughout Australia, collectively representing approximately 94% of those Australians who hold private health cover. This submission represents the views of AHIA Members on the Insurance Contracts Exposure Draft published by the IASB.

The role and objectives of the AHIA are:

- To foster and promote the principles, practice, development and philosophy of voluntary health insurance;
- To make representations and submissions where deemed necessary or desirable to the appropriate persons or authorities in respect of any matter affecting the interests of members; and
- To provide a medium through which opinions of members may be ascertained or expressed.

About half of the Australian population holds some form of private health insurance cover, with total premium revenue exceeding A$14 billion in 2009/10.

**PRIVATE HEALTH INSURANCE IN AUSTRALIA**

Before making specific comments on the Exposure Draft, we have summarised some of the key features of the private health insurance environment in Australia that are relevant to our comments below. Private health insurance (also known as medical cover in some other countries) provides cover for hospital, medical and ancillary health services. The regulatory framework for the provision of private health insurance in Australia is set out in the *Private Health Insurance Act 2007*. The key features of this regulatory environment are:

**Community Rating** – price variation by risk is prohibited so that a single price must be offered for each product and family type (subject to the legislated Lifetime Health Cover premium loadings) in each state to current and prospective policyholders irrespective of age, claims history or other factors.

**Risk Equalisation** – to support community rating there is mandatory sharing of certain risks across all insurers, so that insurers with an older and less healthy membership are not disadvantaged. Through this method of sharing risks and costs between insurers, all Australian residents have equal access to private health insurance, and all insurers are able to operate within the industry and offer products at competitive prices.

**Guaranteed Acceptance** – private health insurers must accept all applicants for insurance without any underwriting. A maximum waiting period of 12 months for pre-existing ailments at the time of joining is permitted.

**Portability** – insured persons may transfer to an equivalent health insurance policy with another private health insurer without being subject to any underwriting or additional waiting periods.

**Premium Increases** – private health insurers may adjust premium rates by making application to the Federal Minister for Health and Ageing, who must approve the proposed changes unless they are deemed not to be in the public interest. It is extremely rare for this ministerial power to disallow premium increases to be exercised. Price changes generally take effect on 1 April each year.

**Contract Terms** - When a person purchases private health insurance in Australia, they sign a membership application form and agree to abide by the Fund Rules of the insurer. The Fund Rules are the basis of the contract between the insured and the insurer. The insurer has the right to vary the provisions of the contract that are contained in the Fund Rules, including premiums payable and benefits payable. There is no separate set of contractual terms entered into between the policyholder and the insurer, so no explicit contract term is specified. Instead, premiums are paid periodically (most commonly monthly and limited to a maximum duration of 12 months) to ensure that cover is maintained. Under the *Private Health Insurance Act*, insurers must accept future premium payments from policyholders but have no right to future premiums beyond those that have been paid, and insurers usually refund unearned premiums on policy termination.

**Short Term Liabilities** – health insurance in Australia has short term liabilities with up to 90% of claims notified within the first three months after an insured event and most claims notified within 6 to 12 months.

**Insurance Market**– about half of the Australian population has some form of private health insurance. There are 35 registered health insurers operating in the Australian market with the top 5 insurers collectively comprising over 80% of the market. Within the remaining 30 insurers there are a large number of smaller insurers who are either regionally based or offer insurance access to a restricted membership that focus on a particular market niche.

**QUESTION 9: CONTRACT BOUNDARY PRINCIPLE**

Question 9 contained in the Exposure Draft addresses the contract boundary principle:
*Do you agree with the proposed boundary principle and do you think insurers would be able to apply it consistently in practice? Why or why not? If not, what would you recommend and why?*

The Exposure Draft (paragraph 27) defines the proposed boundary of an insurance contract as the point at which an insurer either:

(a) is no longer required to provide coverage, or
(b) has the right or the practical ability to reassess the risk of the policyholder and, as a result, can set a price that fully reflects that risk.

Part (b) of this definition would lead to the conclusion that an Australian private health insurance contract is perpetual, as the insured has the right of renewal, and regulatory arrangements do not allow the insurer to reassess the risk or price at the individual policyholder level. Treating private health insurance contracts in this way would require projections to be made of future cash flows over the life of each policyholder, potentially resulting in a set of financial statements that do not reflect the economic manner in which private health insurance is operated and managed.

There are, however a number of features of Australian private health insurance that need to be considered in establishing the risk to which an insurer is exposed:

- the community rating requirements of the *Private Health Insurance Act* do not allow insurers to underwrite risks, refuse cover or set a price which reflects the risk of a particular policyholder;
- the risk equalisation arrangements provide individual insurers with significant protection from the claims costs of high risk policyholders through mandatory industry pooling;
- the policyholder's right of renewal extends to other insurers via the portability requirements of the *Private Health Insurance Act*, so does not have a value unique to a particular insurer; and
- health insurance contracts do not guarantee future premiums and/or benefits and insurers have the right to alter prices (unless deemed not to be in the public interest by the Minister for Health & Ageing) and/or benefits (subject to the requirements of the *Private Health Insurance Act*). Health insurers can unilaterally vary the contact terms and forcibly migrate policyholders from one product to another at any time.

These features and ability of the insurer to adjust the contract terms support the view that private health insurance is a short term contract, despite the guaranteed renewability available to the policyholder. This view is particularly so when we consider the fact that most health insurance claims are notified and settled within 6 to 12 months of the insured event.

We believe that Australian private health insurance should pass the test in paragraph 54 to be treated as short-duration contracts by meeting both of the following conditions:

(a) the coverage period of the insurance contract is approximately one year or less; and

(b) the contract does not contain embedded options or other derivatives that significantly affect the variability of cash flows, after unbundling any embedded derivatives in accordance with paragraph 12.

However, to avoid any doubt, we are of the view that the contract boundary definition should be altered to enable Australian private health insurance business to be treated as a short term contract with a contract term not longer than the next rate change date (1 April).

The economic management of Australian private health insurance business is based on premiums being reassessed annually for each product portfolio, rather than adjusted individually for each policyholder contract. Prices cannot be adjusted for each individual policyholder due to legislative community rating restrictions. This portfolio approach allows an insurer to respond to claims and profitability experience.

Treating Australian private health insurance as long term contracts does not reflect business reality. In practice, products (portfolios of similar individual contracts) are re-priced each year and terms and conditions are able to be changed as required to achieve required profitability. For example, with 60 days notice to the policyholder, a private health insurer can unilaterally change benefit structures and entitlements and alter policy excesses and/or co-payments to manage the profitability of the product.

We therefore propose that paragraph 27 of the Exposure Draft be amended as follows:

27. The boundary of an insurance contract is the point at which an insurer either:
    a) is no longer required to provide coverage, or

    **b)** has the right or the practical ability to reassess the risk of the particular policyholder **or portfolio of policyholders** and, as a result, can **adjust the** price **or other contract terms** so that **it** fully reflects that risk, **or**

    **c) has the right or the practical ability to set the price or other contract terms for existing policyholders equivalent to those applicable to new policyholders with similar risks.**

**QUESTION 19: BENEFITS AND COSTS**

- Question 19 contained in the Exposure Draft addresses the issue of benefits and costs from the proposal:

  *Do you agree with the Board's assessment of the benefits and costs of the proposed accounting for insurance contracts? Why or why not? If feasible, please estimate the benefits and costs associated with the proposals.*

- We believe that the Exposure Draft will have a significant impact on the way in which Australian private health insurers measure and report profit as a result of the change from accounting for these policies as long-term contracts rather than short-term contracts.

- Fund income statements would be exposed to significant volatility as future assumptions (many of which may well not have any historical factual base to be validated, or audited, against) underpinning projections of future cash flows (including membership growth, membership retention, membership movement between product types, premium increases, product drawing rates and risk equalisation experience) change over time. This would be inconsistent with the underlying economic management of the private health insurance risks undertaken by the insurer, which are clearly short term in nature. We do not believe that financial statements prepared under the proposed standard would provide useful information to users. We also believe that future pricing assumptions that would be applied in a projection of existing

- contracts would most likely be inconsistent with the community rating regulatory requirement that implicitly mandates cross subsidies between existing and new policyholders.

- If the current Exposure Draft is introduced it will have widespread information systems impacts. While many insurers maintain financial projection models these are unlikely to be at the level of detail required to support compliance with the new standard. Therefore insurers will have to change their systems, internal controls and processes to capture all future cash flows associated with insurance contracts. This will be a major exercise in terms of resources, cost and time. This would be particularly so for many of the smaller private health insurers in Australia.

We would welcome further opportunity to discuss our comments above as necessary. Please contact Greg Kovacs at greg@ahia.org.au or +61 2 6202 1000.

Yours sincerely

**HON DR MICHAEL ARMITAGE**
**CHIEF EXECUTIVE OFFICER**

11 November 2010