



# AASB 1038 LIFE INSURANCE CONTRACTS

## FACT SHEET

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This fact sheet is based on existing requirements as at 31 December 2015 and it does not take into account recent standards and interpretations that have been issued but are not yet effective.

**IMPORTANT NOTE**

**This Standard is an Australian specific standard with no international equivalent. The application date included below is the effective date of the initial version of the Standard.**

## AASB APPLICATION DATE

AASB 1038 is applicable for annual reporting periods commencing on or after 1 January 2005.

## SCOPE

AASB 1038 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 cash of a life investment contracts that is reinsured, that it holds, and
- c. certain assets backing life insurance liabilities or life investment contract liabilities.

## OBJECTIVE

The objective of AASB 1038 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.

## RECOGNITION AND MEASUREMENT

### Premiums and claims

- insurance components of life insurance contract premiums are income.
- insurance components of life insurance contract claims are expenses.
- both components shall be separately recognised in the statement of comprehensive income.
- deposit components of life insurance contract premiums are not income and deposit components of life insurance contracts claims are not expenses and are recognised as changes in life insurance liabilities.

For life insurance contracts where unbundling of the deposit component is prohibited under paragraph 2.3.3 of AASB 1038, premiums shall be recognised as income and claims shall be recognised as expenses.

## Reinsurance

### Reporting by cedants

Reporting by cedants (e.g. life insurer) shall include the recognition of:

- 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.

### Reporting by reinsurers

Inwards reinsurance premiums and outwards reinsurance claims shall be recognised by the accepting reinsurer as for premiums and claims described above.

## Life insurance liabilities

### Present value and best estimates

Obligations arising from life insurance contracts (life insurance liabilities) shall be recognised as liabilities and shall be measured at the end of each reporting date as:

- i. net present value of future receipts from and payments to policyholders, including participating benefits, allowing for the possibility of discontinuance before the end of the insurance contract period, plus planned margins (based on the assumption of best estimates); or
- ii. 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 net present value approach in (i) above.

### Recognition of planned margins as revenues

Planned margins of revenues over expenses for life insurance contracts shall be recognised in the statement of comprehensive income 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.

### Assumptions

The effect of changes in life insurance liabilities resulting from a difference between actual and assumed experience during the reporting period shall be recognised in the statement of comprehensive income as income or expense in the reporting period which the change occurs. (*Note: This excludes the investment earnings rate assumptions.*)

Assumptions used for measuring life insurance liabilities shall be reviewed for each reporting period. Where the review leads to changes in assumptions, the changes shall be deemed to occur at the end of the reporting date. The only exception is with new business. Assumptions used for measuring new business may be deemed to have occurred at the beginning of the reporting period or date of commencement of the new business or at the end of the reporting period.

### Liability Adequacy Test

Life insurers shall perform a liability adequacy test. The test may be summarised as follows:

IF			THEN
<b>Situation 1:</b> Present value of estimated future expenses for a group of related products	Exceeds	Present value of estimated future revenues	Loss – recognised in the statement of comprehensive income in the period in which the assessment is made.
<b>Situation 2:</b> Present value of estimated future expenses	Less	Present value of estimated future revenues	Margin – recognised in the statement of comprehensive income in the period in which the assessment is made.

From one reporting period to the next, a planned margin may be eliminated and becomes a planned loss due to adverse future experience. The loss reflects a higher present obligation. While the losses are yet to occur, the justification for the accounting treatment is based on the entering into life insurance contracts; i.e. an event that gives rise to a present obligation to meet the expected future claims.

### Discount rates

The choice of discount rates is determined by whether the benefits under the life insurance contracts are contractually linked to the performance of the assets held.

**Scenario 1:** If the benefits under the life insurance contract (i.e. amount) are determined by the assets' performance, then the discount rate shall reflect the market returns on assets backing life insurance liabilities.

**Scenario 2:** If the benefits under the life insurance contract are **not** determined by the assets' performance, then the discount rate shall be the risk-free discount rate. The discount rate must be based on current observable, objective rates that relate to the nature, structure and term of the future obligations.

### Assets backing general insurance 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 and the fair value measurement approach for life investment contract liabilities required by AASB 1038.

Where the assets are not backing life insurance liabilities or life investment contract liabilities that arise under non-insurance contracts, life insurers apply the applicable accounting standards making use of any measurement choices available.

### Measurement

- Financial assets that:
  - are within the scope of AASB 139 *Financial instruments: Recognition and Measurement*;
  - back life insurance liabilities or life investment contract liabilities; and
  - are permitted to be designated as “at fair value through profit or loss” under AASB 139;
 shall be designated as “at fair value through profit or loss” under AASB 139 on first application of AASB 1038, or on initial recognition.
- Investment property within the scope of AASB 140 *Investment Property and that backs life insurance liabilities or life investment contract liabilities* are measured using the fair value model under AASB 140 and AASB 13 *Fair Value Measurement*.
- 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.
- Investments in associates that:
  - are defined by AASB 128 *Investments in Associates and Joint Ventures*;
  - back either life insurance liabilities or life investment contract liabilities;
  - are held by mutual funds, unit trusts and similar entities, including investment-linked insurance funds; and
  - are permitted to be designated as “at fair value through profit or loss” under AASB 139;
 shall be designated as “at fair value through profit or loss” under AASB 139, on first application of AASB 1038 or on initial recognition.

- Venturers' interests in jointly controlled entities that:
  - are defined by AASB 11 *Joint Arrangements*;
  - back either life insurance liabilities or life investment contract liabilities;
  - are held by mutual funds, unit trusts and similar entities, including investment-linked insurance funds; and
  - are permitted to be designated as "at fair value through profit or loss" under AASB 139;shall be designated as "at fair value through profit or loss" under AASB 139, on first application of AASB 1038 or on initial recognition.
- When preparing separate financial statements, those investments in subsidiaries, joint ventures and associates that:
  - are within the scope of AASB 127 *Separate Financial Statements*;
  - back life insurance liabilities or life investment contract liabilities; and
  - are permitted to be designated as "at fair value through profit or loss" under AASB 139;shall be designated as "at fair value through profit or loss" under AASB 139, on first application of AASB 1038 or on initial recognition.

## DISCLOSURES

Refer Appendix 1 for a checklist to assist with AASB 1038 disclosure requirements.

## DEFINITIONS

<b>Cedant</b>	The policyholder under a life reinsurance contract.
<b>Direct insurance contract</b>	An insurance contract that is not a reinsurance contract.
<b>Discretionary participation feature</b>	<p>A contractual right to receive, as a supplement to guaranteed benefits, additional benefits:</p> <ol style="list-style-type: none"> <li>a. that are likely to be a significant portion of the total contractual benefits;</li> <li>b. whose amount or timing is contractually at the discretion of the issuer; and</li> <li>c. that are contractually based on: <ol style="list-style-type: none"> <li>i. the performance of a specified pool of contracts or a specified type of contract;</li> <li>ii. realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or</li> <li>iii. the profit or loss of the company, fund or other entity that issues the contract.</li> </ol> </li> </ol>
<b>General insurance contract</b>	An insurance contract that is not a life insurance contract.
<b>Guaranteed benefits</b>	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.
<b>Guaranteed element</b>	An obligation to pay guaranteed benefits included in a contract that contains a discretionary participation feature.
<b>Insurance asset</b>	An insurer's net contractual rights under an insurance contract.
<b>Insurance contract</b>	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.
<b>Insurance liability</b>	An insurer's net contractual obligations under an insurance contract.
<b>Insurance risk</b>	Risk, other than financial risk, transferred from the holder of a contract to the issuer.
<b>Insured event</b>	An uncertain future event covered by an insurance contract and creates insurance risk.
<b>Insurer</b>	The party that has an obligation under an insurance contract to compensate a policyholder if an insured event occurs.
<b>Investment-linked</b>	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.
<b>Liability adequacy test</b>	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.

<b>Life insurance contract</b>	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.
<b>Life insurance liability</b>	A life insurer's net contractual obligations under a life insurance contract.
<b>Life reinsurance contract</b>	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.
<b>Policyholder</b>	A party that has a right to compensation under an insurance contract if an insured event occurs.
<b>Policy liability</b>	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 insurance contract.
<b>Reinsurance assets</b>	A cedant's net contractual rights under a reinsurance contract.
<b>Reinsurance contract</b>	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.
<b>Reinsurer</b>	The party that has an obligation under a reinsurance contract to compensate a cedant if an insured event occurs.
<b>Unbundle</b>	To treat the components of a contract as if they were separate contracts.

## APPENDIX 1 – DISCLOSURE CHECKLIST

This checklist can be used to review your financial statements. You should complete the “Yes / No / N/A” column about whether the requirement is included. To ensure the completeness of disclosures, provide an explanation for “No” answers.

CODE		YES / NO / N/A	EXPLANATION (If required)
AASB 1038.14.1	Has the life insurer disclosed information that identifies and explains the amounts in its financial statements arising from life insurance contracts?		
AASB 1038.14.1.1	<p>To comply with paragraph 14.1, has the life insurer disclosed:</p> <ul style="list-style-type: none"> <li>a. its accounting policies for life insurance contracts and related assets, liabilities, income and expenses;</li> <li>b. the recognised assets, liabilities, income, expense and cash flows arising life insurance contracts, Furthermore, if the life insurer is a cedant, has it disclosed:               <ul style="list-style-type: none"> <li>i. gains and losses recognised in profit or loss at the time of buying reinsurance; and</li> <li>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.</li> </ul> </li> <li>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, has the life insurer also given quantified disclosure of those assumptions</li> <li>d. the effects 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 statements; and</li> <li>e. reconciliations of changes in life insurance liabilities and reinsurance assets?</li> </ul>		
AASB 1038.15.1	Has the life insurer disclosed information that enables users of its financial statements to evaluate the nature and extent of risks arising from life insurance contracts?		



CODE		YES / NO / N/A	EXPLANATION (If required)
AASB 1038.15.1.1	<p>To comply with paragraph 15.1, has the life insurer disclosed:</p> <ul style="list-style-type: none"> <li>a. its objectives, policies and processes for managing risks arising from life insurance contracts and the methods used to manage those risks;</li> <li>b. information about insurance risk (both before and after risk mitigation by reinsurance), including information about: <ul style="list-style-type: none"> <li>i. sensitivity to insurance risk</li> <li>ii. concentrations of insurance risk, including a description of how management determines concentrations and a description of the shared characteristic that identifies each concentration and</li> <li>iii. actual claims compared with previous estimates. 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;</li> </ul> </li> <li>c. information about credit risk, liquidity risk and market risk that paragraph 31 – 42 of AASB 7 would require if the life insurance contracts were within the scope of AASB 7. However, <ul style="list-style-type: none"> <li>i. the maturity analysis required by paragraphs 39(a) and (b) of AASB 7 is not required if the insurer discloses information about the estimated timing of the net cash outflows resulting from recognised insurance liabilities instead. This may take form of an analysis, by estimated timing, of the amounts recognised in the statement of financial position; and</li> <li>ii. if an insurer uses an alternative method to manage sensitivity to market conditions, it may use that sensitivity analysis to meet the requirement in paragraph 40(a) of AASB 7. Such a life insurer shall also provide the disclosures required by paragraph 41 of AASB 7; and</li> </ul> </li> <li>d. information about exposures to market risk arising from embedded derivatives contained in a host insurance contract if the life insurer if not required to, and does not, measure the embedded derivatives at fair value?</li> </ul>		

CODE		YES / NO / N/A	EXPLANATION (If required)
AASB 1038.15.1.3	<p>To comply with paragraph 15.1.1(b)(i), has the life insurer disclosed either (a) or (b) as follows:</p> <ul style="list-style-type: none"> <li>a. a sensitivity analysis that shows how profit or loss and equity would have been affected had changes in the relevant risk variable that were reasonably possible at the end of the reporting period occurred; the methods and assumptions used in preparing the sensitivity analysis; and any changes from the previous period in the methods and assumptions used;</li> <li>b. qualitative information about sensitivity, and information about 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?</li> </ul>		
AASB 1038.16.1	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, have the total premiums and total claims been disclosed?		
AASB 1038.17.1	<p>Have the following components of profit or loss been disclosed, separately between policyholder and shareholder interests:</p> <ul style="list-style-type: none"> <li>a. profit related to movement in life insurance liabilities;</li> <li>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;</li> <li>c. investment earnings on assets in excess of policy liabilities; and</li> <li>d. other items, separated into material components?</li> </ul>		

CODE		YES / NO / N/A	EXPLANATION (If required)
AASB 1038.17.2	<p>Have 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 been shown:</p> <ul style="list-style-type: none"> <li>a. planned margins of revenues over expenses;</li> <li>b. the difference between actual and assumed experience;</li> <li>c. the effects of changes to underlying assumptions;</li> <li>d. loss recognition on groups of related products or reversal of previously recognised losses required by paragraph 8.6; and</li> <li>e. other movements, separated into material components?</li> </ul>		
AASB 1038.17.3	<p>Have the restrictions attaching to assets held for the benefit of policyholders been disclosed?</p>		
AASB 1038.17.4	<p>Has the life insurer separately disclosed:</p> <ul style="list-style-type: none"> <li>a. in respect of contracts with discretionary participation features, the amount of policy liabilities that relates to the guaranteed element;</li> <li>b. in respect of investment-linked contracts, the amount of policy liabilities subject to investment performance guarantees; and</li> <li>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?</li> </ul>		
AASB 1038.17.5	<p>Have the following components of equity been disclosed:</p> <ul style="list-style-type: none"> <li>a. retained earnings wholly attributable to shareholders; and</li> <li>b. retained earnings where the allocation between participating policyholders and shareholders has yet to be determined?</li> </ul>		
AASB 1038.17.8	<p>Has the life insurer disclosed the regulatory solvency position of each statutory fund?</p> <p>If the entity is a group, has the entity disclosed the regulatory solvency position of each life insurer in the group?</p>		
AASB 1038.17.9	<p>Has the life insurer disclosed the nature and amount of the activities relating to managed funds and trust activities, and whether arrangements exist to ensure that such activities are managed independently from its other activities?</p>		

CODE		YES / NO / N/A	EXPLANATION (If required)
AASB 1038.17.10	<p>Has the following been disclosed in the notes:</p> <ul style="list-style-type: none"> <li>a. if other than the end of the reporting period, the effective date of the actuarial report on policy liabilities and solvency reserves;</li> <li>b. the name and qualifications of the actuary;</li> <li>c. whether the amount of policy liabilities has been determined in accordance with the requirements of the Life Insurance Act; and</li> <li>d. whether the actuary is satisfied as to the accuracy of the data from which the amount of policy liabilities has been determined?</li> </ul>		
AASB 1038.17.11	<p>Has the insurer disclosed the process used to determine which assets back life insurance liabilities or life investment contract liabilities?</p>		
AASB 1038.17.12.1	<p>Australian Accounting Standards and the Life Insurance Act differ in their requirements. Accordingly, life insurers are encouraged to disclose a reconciliation between:</p> <ul style="list-style-type: none"> <li>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</li> <li>b. the retained earnings at the end of the reporting period in accordance with Australian Accounting Standards and the retained earnings at the end of the reporting period in accordance with the Life Insurance Act?</li> </ul>		
AASB 1038.18.1	<p>For each statutory fund and for the shareholder fund, has the following been disclosed:</p> <ul style="list-style-type: none"> <li>a. investment assets;</li> <li>b. other assets;</li> <li>c. life insurance liabilities;</li> <li>d. life investment contract liabilities and assets or liabilities arising in respect of the management services element of life investment contracts;</li> <li>e. liabilities other than life insurance liabilities or life investment contract liabilities;</li> <li>f. retained earnings, showing the amount directly attributable to shareholders and other retained earnings;</li> <li>g. premium revenue split between life insurance contracts and life investment contracts;</li> <li>h. investment income;</li> <li>i. claims expense split between life insurance contracts and life investment contracts;</li> <li>j. other operating expenses;</li> <li>k. investment income paid or allocated to policyholders;</li> <li>l. profit or loss before tax;</li> <li>m. profit or loss after tax; and</li> <li>n. transfers to or from other funds?</li> </ul>		

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CODE		YES / NO / N/A	EXPLANATION <i>(If required)</i>
AASB 1038.18.2	Has the life insurer disclosed 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?		
AASB 1038.18.3	Have the disclosures required by paragraphs 18.1 and 18.2 included all imputed inflows and outflows as income and expenses where they can be reliably measured?		

## OTHER MATTERS

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