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What is this paper about?

1. The purpose of this paper is to discuss the unit of account that would apply when:
   (a) determining the residual/single margin at initial recognition;
   (b) determining the residual margin subsequent to initial recognition [IASB only];
   (c) allocating the residual/single margin to profit or loss; and
   (d) performing the onerous contract test during both the pre-coverage period and under the premium allocation approach.
2. This paper should be read in conjunction with the "Definition of a portfolio of insurance contracts" paper (agenda paper 7A/77A) and the "Onerous contracts" paper (agenda paper 7D/77D).

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3. This paper does not discuss the unit of account for the onerous contract test for the single margin. An onerous contract test is not required for the residual margin in the IASB's model.

Staff recommendations

4. Staff recommends that:

   (a) the residual/single margin at initial recognition should be determined at the portfolio level.

   (b) the residual margin subsequent to initial recognition should be determined at the portfolio level [IASB only].

   (c) in allocating the residual/single margin to profit or loss of particular periods an entity should group contracts within a portfolio that have similar:

      (i) inception dates;

      (ii) expected end dates; and

      (iii) expected patterns of release of the residual/single margin.

   (d) the onerous contract test should be performed at the portfolio level both (i) during the pre-coverage period and (ii) under the premium allocation approach.

Background

5. In some areas, unit of account does not matter for measurement purposes (ie measuring groups of contracts does not give a different answer to measuring contracts individually). The same measurement results will be obtained irrespective of whether the unit of account is the individual contract or a grouping of contracts.

An example is the measurement of cash flows, because expected value is additive (ie the expected value from a portfolio of contracts equals the sum of the expected values of the individual contracts).

6. However, in some areas the unit of account does matter since the interrelationship between contracts and the manner in which contracts are grouped will affect measurement. Different measurement results will be obtained depending on the manner in which the unit of account is applied. This is the case when determining both the amount and allocation of the residual/single margin and in identifying and measuring onerous contracts.

7. In the comment letters to the Exposure Draft/Discussion Paper (ED/DP), some observed that the ED/DP specifies a number of different units of account:
   (a) portfolio level in general;
   (b) cohort level for the residual or composite margin; and
   (c) contract level for acquisition costs.

8. Some believed that the unit of account should be consistent throughout the standard because they believe that different units of account introduce unnecessary complexity. They believe that the portfolio is the appropriate unit of account. Accordingly, they would assess acquisition costs[1] and perform the onerous contract test at portfolio level[2], and they note this is consistent with the way that insurers manage the contracts.

9. This paper considers where and why the unit of account matters and considers its application to the residual/single margin and onerous contracts.

[1] At its June meeting, the boards tentatively decided that the acquisition costs to be included in the initial measurement of a portfolio of insurance contracts should be all the direct costs that the insurer will incur in acquiring the contracts in the portfolio. The IASB tentatively decided that no distinction should be made between successful acquisition efforts and unsuccessful efforts. The FASB tentatively decided that the acquisition costs included in the cash flows of insurance contracts will be limited to those costs related to successful acquisition efforts.

[2] Under current US GAAP, portfolio is used for the onerous contract test and amortisation of deferred acquisition costs.

Determining and allocating the residual/single margin

Background

10. The Exposure Draft/Discussion Paper proposed that the measurement of an insurance contract liability should include a residual/single[3] margin, calibrated as the difference between (a) the expected present value of the cash flows [IASB only: plus a risk adjustment] and (b) the expected premium. Consequently, under the approach proposed in the ED/DP there would be no day one gains. If however, there is a day one loss, the loss would be recognised immediately in profit or loss (ie the residual/single margin cannot be negative). These decisions were reconfirmed during the board meeting held in the week commencing 14 February 2011.

11. Furthermore, the ED proposed that insurers should determine the residual margin, both initially and subsequently, on a level that aggregates insurance contracts into a portfolio and, within a portfolio, by similar dates of inception and coverage period. The unit of account that aggregates insurance contracts within a portfolio by similar dates of inception and coverage period is sometimes referred to as a cohort.

12. Paragraph BC130 of the ED explains why the IASB decided that the unit of account for determining the residual margin should be the cohort:

> Paragraph BC120 explains that the risk adjustment should be determined at a portfolio of contracts level that groups together contracts subject to similar circumstances (ie contracts that are subject to similar risks and a managed together as a pool). However, because the residual margin is released over the coverage period, it is necessary to adopt a different level of aggregation for residual margins that group together only those contracts within the portfolio that have similar coverage periods. For this reason, the Board concluded that residual margins should be determined at a level that aggregates insurance contracts into a portfolio and, within each portfolio, by similar date of inception of the contract and by similar coverage period. An alternative would be to determine the release of the residual margin at an individual contract level, but the Board concluded that would be impracticable.

[3] The single margin was referred to as a composite margin in the DP.

13. The FASB DP proposed to release the single margin over the coverage period and the claims handling period (rather than just the coverage period). However, the FASB DP also proposed that the single margin should be determined and allocated at the cohort level.

Feedback received

14. The ED/DP did not ask a specific question about which unit of account should be used when determining and allocating the residual/single margin. However, a small number of respondents articulated their views on the unit of account to be used when determining the residual/single margin[4].

15. Some respondents agreed with the notion of determining the residual/single margin at the cohort level. However, of these respondents, some indicated that entities should be permitted to apply the phrase “similar date of initial recognition” in a flexible manner. These respondents expressed concern that calculating the residual/single margin at too granular a level would increase cost and complexity for preparers with little benefit to users.

16. Some respondents instead expressed a preference for determining the residual/single margin at the portfolio level. These respondents expressed concern that aggregation of contracts at the cohort level would be overly complex and burdensome with little benefit. Some of these respondents noted that the phrase “similar date of initial recognition” would not be interpreted consistently, which would lead to diversity in practice.

17. One respondent also stated that determining the residual/single margin at the cohort level would lead to the question of whether and to what extent the offset of negative and positive amounts should be permitted. This respondent noted that the economic basis of insurance is the pooling of risks, through which more profitable

[4] It is important to note that although the FASB’s tentative decision to recognise the single margin as the insurer is released from risk differs from the FASB DP proposal to recognise the single margin over the coverage period and the claims handling period, the comments received are still pertinent to the analysis in this paper.

contracts support less profitable contracts, and that determining the residual/single margin at too granular a level would distort the profitability of the portfolio.

18. Some respondents requested more guidance on whether calculating the residual/single margin on an individual contract level is acceptable because there may be practical advantages of calculating the residual/single margin at a contract level. Some insurers stated that the standard should not prescribe the level of measurement of the residual/single margin.

Determining the residual/single margin at initial recognition

19. At the start of the coverage period, an insurer must determine the residual/single margin. If the residual/single margin is positive, it will be released in profit or loss over the coverage period (IASB) or as the insurer is released from risk (FASB). If the residual/single margin is negative, the loss will be recognised immediately in profit or loss. If contracts are grouped together, then losses on some contracts will be offset by gains on other contracts leading to lower losses recognised on day one.

20. The following sections discuss the level at which the single/residual margin should be determined at initial recognition.

Determining the residual/single margin at the individual contract level

21. In theory it would be possible to determine the residual margin/single margin at initial recognition at an individual contract level[5]. This is because loss making contracts have not yet emerged. In general an insurer will price individual contracts to be profitable. However, there are a number of reasons why an individual contract might not be profitable at the start of the coverage period, for example:

[5] The staff note that to determine the residual margin at an individual contract level (or at any level other that the level at which the risk adjustment is calculated) it will be necessary to allocate the risk adjustment which will have been determined at a higher level of aggregation [IASB only].

(a) The insurer may deliberately sell contracts at a loss in order to obtain other profitable contracts (ie the contract is sold as a loss leader).

(b) Regulatory constraints may limit an insurer's ability to price the contract to fully reflect the risk of an individual policyholder. This is the case in many health insurance contracts.

(c) There is some element of cross subsidisation between individual contracts (ie the insurer does not consider the risks of the individual policyholder when setting its prices, but instead considers the risk of a group of contracts as a whole).

(d) Events may have occurred between the pricing date and the start of the coverage period that result in the contract becoming loss making (for example, changes in the economic environment may increase expected costs). These events may or may not have been picked up by the pre-coverage onerous contract test.

22. It can be argued that recognising the losses on individual contracts provides better information to users of financial statements than grouping contracts together. In addition, staff observes that in many industries, reporting entities sell products at a loss in the expectation that customers will buy other services from the entity. Nevertheless, the reporting entity is in general required to recognise the losses arising on those loss making contracts.

23. However, staff believes that requiring an insurer to recognise a loss on an individual contract because it has been priced to reflect the risk of a group of contracts (whether it chooses that pricing or is required by the regulator to use that pricing) does not reflect the economics of insurance contracts which require the pooling of risk. In addition, requiring an insurer to determine the residual/single margin at an individual contract level would create a significant burden for insurers (who may have millions of individual contracts).

Determining the residual/single margin at a cohort level

24. The staff notes that the main reason for determining the residual/single margin at the cohort level was to achieve consistency with the unit of account used to allocate the residual/single margin to profit or loss. As noted above, the concept of a cohort was introduced to ensure that the whole of the residual/single margin was allocated to profit or loss by the end of the contract's coverage period.

25. However, many respondents to the ED/DP stated that determining the residual/single margin at the cohort level resulted in too little aggregation of contracts and did not reflect the way in which insurers manage their risks.

26. Staff agrees with those concerns and believes that the unit of account used for *determining* the residual/single margin should aggregate contracts at a level higher than the cohort.

Determining the single/residual margin at a line of business level

27. A few respondents to the ED/DP proposed that the residual/single margin should be determined at the line of business level.

28. The term "line of business" is frequently used to describe the contract groupings used under US GAAP for recoverability testing. Line of business is a general term for a set of one or more highly related products which service a particular customer transaction or business need. For example, life insurance contracts could be split into individual and group contracts, and further disaggregated as follows (not all inclusive):

    (a) traditional life contracts

        (i) whole life

        (ii) term life

        (iii) credit life

    (b) interest sensitive contracts

(i) universal life-type contracts

(ii) deferred annuities

(iii) variable and equity-based life and annuity products

(c) accident and health insurance contracts

(i) disability income

(ii) long-term care

(iii) medical expense insurance

29. Arguments for line of business as the unit of account for determining the residual/single margin are as follows:

(a) Line of business is a commonly understood method of aggregating contracts in some regulatory environments.

(b) Line of business groups contracts at a fairly granular level. This increases the usefulness of information provided to users of the financial statements.

(c) The same unit of account would be used for general purpose financial reporting and, in many cases for regulatory reporting.

30. However, staff does not support using a line of business as the unit of account for determining the residual/single margin for the following reasons:

(a) The “lines of business” to be applied are normally prescribed by the regulator (ie the description of a line of business is normally rules based). Consequently, grouping contracts in this way will not necessarily result in contracts with similar risks beings grouped together and dissimilar risks being disaggregated.

(b) Different regulators define a line of business in different ways and some regulators do not use the concept of a line of business at all. This will reduce the comparability of the financial statements.

Determining the residual/single margin at the portfolio level

31. The boards have tentatively decided that in general, the final standard should measure insurance contracts at the portfolio level.

32. Agenda paper 7A/77A *Definition of portfolio* proposes the following revised definition of a portfolio of insurance contracts:

    Insurance contracts that:

    (a) are subject to similar risks;

    (b) have similar expectations of profitability; and

    (c) are managed together as a single pool.

33. Staff thinks that determining the residual margin/single margin at a portfolio level would maintain consistency between the unit of account used to determine the residual/single margin and the measurement of expected cash flows. This would reduce the cost and complexity associated with the determination of the residual/single margin.

34. In addition, the residual/single margin provides a measure of the insurer's expected profitability and the proposed revised definition of a portfolio requires insurers to group together contracts that have similar expectations of profitability. In general this will mean that contracts with different levels of expected profitability will not be grouped together.

35. Finally, the fact that the proposed definition of portfolio refers to the way in which the contracts are managed, means that the concept of a portfolio will reflect the manner in which an insurer conducts its operations.

Determining the residual/single margin at a level higher than portfolio

36. The staff also considered whether the residual/single margin should be measured at a level higher than the portfolio level (for example the level at which the risk adjustment is determined (IASB only) or an entity level). However, staff believes

that this could result in less information about losses and would thus be less useful to users of financial statements.

Staff recommendation

37. Staff believes that using the portfolio as the unit of account for determining the residual/single margin achieves a balance between giving consideration to the pooling effect and providing useful information to users. Consequently, staff recommends that for the purposes of determining the residual/single margin at inception, contracts should be grouped at a portfolio level for contracts (as defined in agenda paper 7A/77A *Definition of portfolio)*. We note that because the residual/single margin is determined at inception of the contract, this means that any residual/single margin determined at inception in effect also groups contracts with a similar inception date.

Question 1 – Level at which contracts are to be grouped?
Do the boards agree that for the purpose of initially determining the residual/single margin contracts should be grouped at the portfolio level?

Determining the residual margin after initial recognition (IASB only)

38. The IASB has tentatively decided that residual margin should be unlocked for changes in estimates of cash flows. An unlocked residual margin needs to be recalculated at each reporting period and allocated to profit or loss. Said differently, the amount of residual margin to be released will change continuously in an unlocked environment.

39. Whilst it would be possible to use a different unit of account for determining the residual margin at the start of the coverage period and determining it subsequently, similar considerations to those discussed in paragraphs 21-37 above apply. In addition, the staff believe that using the same unit of account would reduce complexity.

Question 2 – Determining the residual margin subsequently (IASB only)

Does the IASB agree that for the purpose of determining the residual margin subsequently contracts should be grouped at the portfolio level?

Allocating the residual/single margin

40. Staff notes that once the residual/single margin is *determined*, with losses arising from loss-making portfolios expensed, the residual margin for the remaining profitable contracts needs to be *allocated* to profit or loss. Because the IASB has decided to unlock the residual margin, the change in the residual margin in a reporting period will not equal the amount of residual margin allocated to the profit or loss in that period. In contrast the FASB single margin is locked in at inception of the contract.

Allocation of the residual margin (for the IASB)

41. The IASB has tentatively decided that the residual margin should be released over the coverage period. If contracts are aggregated for the purposes of releasing the residual margin, there is a risk that some of the residual margin associated with an individual contract will *not* be released in profit or loss by the end of the coverage period.

42. Furthermore, the IASB has tentatively decided that insurers should allocate the residual margin over the coverage period on a systematic basis that is consistent with the pattern of transfer of services provided under the contract. The residual margin will therefore not necessarily be released on a straight line basis, as was proposed in the ED. The staff believe using a pattern other than a straight line basis for releasing the residual margin will introduce operational and calculation complexities. Grouping together contracts with different patterns of service transfer could result in a) not all the residual margin associated with the individual contracts being recognised by the end of the coverage period or b) the residual margin

associated with the individual contracts not being released to the appropriate period. Insurers therefore need to consider whether the contracts to be grouped have the same profitability distribution and whether the contracts are at the same point on the profitability distribution. Using the portfolio as the unit or account will not achieve this objective.

43. Other methods of grouping contracts and allocating an unlocked residual margin exist. The Australian Margin on Services (MoS) approach, which was discussed with the boards in June 2011, is one example (see agenda paper 3D/70D). Australian respondents believe that the objective to fully allocate the residual margin by the end of the coverage period can be achieved by other means than an aggregation on a cohort level. They stated that if the release pattern follows the services transferred under the contract, it is not necessary to allocate all the residual margin on a cohort level, and that even within an open portfolio it is possible to proxy a full release of the residual margin at the end of the coverage period of an individual contract when using a release pattern that follows the transfer of services.

Allocation of the single margin (for the FASB)

44. At its meeting in May 2011, the FASB tentatively decided:
    (a) The insurance contract measurement model should use a single margin approach that recognizes profit as the insurer satisfies its performance obligation to stand ready to compensate the policyholder in the event of an occurrence of a specified uncertain future event that adversely affects that policyholder.
    (b) An insurer satisfies its performance obligation as it is released from exposure to risk as evidenced by a reduction in the variability of cash outflows.

45. At its meeting on 7 September 2011, the FASB tentatively decided that an insurer should recognize the single margin in profit as the insurer is released from risk.

Specifically, an insurer is released from risk on the basis of reduced uncertainty in the timing of the insured event and/or as variability in the cash flows is reduced as information about expected cash flows becomes more known throughout the life cycle of the contract.

46. Because the single margin is to be recognized in profit as an insurer is released from risk, the unit of account to be used for allocating the single margin should be at least as low as the level at which contracts of similar risks are aggregated.

47. Because the single margin represents an insurer's potential profit, and an insurer's profitability is highly dependent on the manner in which the insurer prices its products, the unit of account for allocating the single margin should be at least as low as the level at which the profitability of the insurance contracts is assessed. Considering the relationship between pricing and profitability, then, the unit of account for allocating the single margin should be at least as low as the level at which insurance products are priced.

48. The definition of a portfolio proposed in agenda paper 7A/77A requires that contracts with similar risks and similar expectations of profitability are grouped together. However, the staff do not think that aggregating contracts on a portfolio level will achieve the objective of allocating the whole of the single margin to profit or loss by the end of the contract. The pattern of release from risk for a contract (i.e. the reduction in the variability of the expected cash flows) will not necessarily be on a straight-line basis. With some contracts risk may reduce more in the early years and less in the later years (and vice versa for other contracts). Similarly, the pattern of profitability of some contracts may not be on a straight-line basis. Consequently, grouping contracts together with different start and end dates could result in some of the available single margin not being allocated to profit or loss. Consequently, a lower level of aggregation needs to be considered.

Unit of account for allocation

49. Staff thinks that the most accurate way to ensure that the residual/single margin is fully allocated over the coverage period (IASB) or by the end of the contract (FASB) would be to calculate the release of the residual/single margin at an individual contract level. This approach will make the calculation independent from any form of aggregation.

50. However, staff notes that in developing the ED/DP the boards dismissed the idea of releasing the residual/single margin at an individual contract level on the grounds that it would be impracticable (refer to paragraph BC130).

51. In addition, the staff believe that determining the residual/single margin at the individual contract level would not reflect the economics of insurance contracts, because insurance contracts which will be priced with some element of cross subsidisation (ie the insurer does not consider the risks of the individual policyholder when setting its prices, but instead considers the risk of a group of contracts as a whole). For example, the life expectancy of every person with the same risk profile (gender, geography, life-style, etc.) might be, say, 88. In a portfolio of 10,000 policies of all 30-year olds with the same risk profile, the insurer will expect that five policyholders will die each year from the age 30-35; ten policyholders will die each year from the age 35-40; 25 policyholders will die each year from the age of 40-45 and so on. However, the insurer does not know which individual policyholder will fall into any of those categories.

52. Staff agrees that tracking the release of the residual margin for each and every contract would place a significant burden on insurers. However, the staff believe it should be possible to retain the objective of releasing the residual/single margin on an individual contract level whilst permitting some form of aggregation.

53. The staff believe that grouping of contracts within a portfolio with similar:

    (a) inception dates;

    (b) expected end dates; and

(c) expected patterns of release of the residual/single margin;

will approximate the accumulation of individual contracts' results.

Staff recommendation

54. Staff recommends that in allocating the residual/single margin to profit or loss, an entity should group contracts within a portfolio that have similar:

    (a) inception dates

    (b) expected end dates; and

    (c) expected patterns of release of the residual/single margin.

Question 3 - Unit of account for allocating the residual/single margin
Do the boards agree that in allocating the residual/single margin to profit of loss an entity should group contracts within a portfolio that have similar a) inception dates b) expected end dates; and c) expected patterns of release of the residual/single margin?

Onerous contracts

Background

55. This section addresses the unit of account that should be used when applying the onerous contract test under the premium allocation approach and in the pre-coverage period.

56. The ED/DP proposed that for the purposes of determining and measuring onerous contracts under the premium allocation approach, an entity should aggregate contracts into a portfolio, and within a portfolio, by similar dates of inception. Because the ED/DP restricted the application of the premium allocation approach to

contracts with short coverage periods (approximately one year or less), the boards considered it unnecessary to require contracts with similar coverage periods to be aggregated together.

57. At its meeting on 14 March 2011, the boards tentatively decided that insurance contract assets and liabilities should initially be recognised when the coverage period begins. This decision means that no liability is recognised under the building blocks approach between the date the insurer becomes a party to the contract and the start of the coverage period (the pre-coverage period). Consequently, the boards have tentatively decided also to require the recognition of an onerous contract liability in the pre-coverage period. However, no decision was made about the unit of account that should be used when identifying or measuring onerous contracts.

Staff analysis

58. The onerous contract test (both in the pre-coverage period and under the premium allocation approach) is performed to identify insurance contracts that will not be profitable, ie a contract in which the future costs of fulfilling the contract are expected to exceed the future benefits expected to arise from that contract.

59. Staff assessed how other IFRSs and US GAAP guidance considers the interrelationship between items in grouping them together for measurement purposes. Staff observes that most standards require that the unit of account is the individual contract. However, in some situations it is not possible to measure at the individual contract level, because either:

    (a) it is not practically possible, for instance the measurement of stock, or

    (b) it will not reflect the economic substance of the situation, for instance when the interrelationship of individual assets is to be considered in determining a cash generating unit.

60. The staff considered whether the onerous test should be performed on an individual contract level. The staff does not believe that performing the onerous test at an individual contract level reflects the economics of insurance contracts, which inherently involve the pooling of risk and the law of large numbers. Said differently, contracts are priced and managed under the presumption that some contracts will be loss making and other contracts profitable. In general, an insurer will price individual contracts to be profitable. Before the claim is incurred, the insurer cannot determine which contracts will be loss making.

61. Furthermore, staff considers that after the start of the coverage period, some individual contracts will become loss making because of changes in assumptions used to price the contracts. If the onerous contract test is performed at an individual contract level after the start of the coverage period these contracts may be treated as onerous, which will not faithfully represent the pooling effect.

62. Most jurisdictions require insurers to perform an onerous contract test (also known as a recoverability, profitability, liability adequacy or premium deficiency test) on life and non-life insurance contracts. This test requires contracts to be grouped together in a way that is consistent with the enterprise's manner of acquiring, servicing and measuring the profitability of its insurance contracts.

63. For non-life insurance contracts (those likely to be within the scope of the premium allocation approach as tentatively proposed) insurers may track data at the line of business level (eg ocean marine, workers' compensation, automobile (physical damage and bodily injury), etc). However, many insurers group non-life insurance contracts into personal and commercial contracts for the purposes of performing a premium deficiency test since that is the level at which contracts are acquired and serviced and for which profitability is managed. Also, it can be argued that personal and commercial contracts have different risk distributions but within those groupings contracts have similar risk distributions (i.e. personal auto and homeowners). However, others would argue that some types of contracts

listed above may have dissimilar risk distributions (i.e., commercial auto, workers compensation and surety).

64. In addition, these contracts are typically written with very different profit margins based on the risk type, competitiveness in the market, and the payout pattern. Appendix A shows the industry combined loss ratios for non-life insurance lines of business from 1996 through 2010. Using 2010 data, the overall commercial lines of business reported an undiscounted loss ratio of 103 percent. However, within commercial, undiscounted loss ratio of 116 percent, 97 percent and 75 percent were reported for workers compensation, commercial auto and surety lines of business, respectively. Staff believes that combining lines of business with such different combined loss ratios/profit margins for determining the unit of account to perform the onerous contract test would lead to insurers not recognizing losses in a timely manner.

65. Staff believes also that similarities exist between testing for impairment and performing an onerous test of insurance contracts. As the guidance in Appendix B indicates, impairment testing should be performed at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. Staff believes the same general principle should guide the unit of account for determining onerous contracts.

66. The onerous contract test is performed under the premium allocation approach to identify insurance contracts that will not be profitable. Since the unit of account for determining profitability under the building block approach is the portfolio level (as discussed herein), it follows naturally that the unit of account for applying the onerous test under the premium allocation approach would also be the portfolio level. Also, because the single/residual margin provides a measure of an insurers' profitability, staff believes that losses related to that profit should be recognized at the same level. Therefore, staff believes that the unit of account for the single/residual margin should be the same as the unit of account for the onerous contract test–the portfolio level.

67. In addition, staff believes, from a consistency and operational perspective, that a single unit of account should be applied in performing the onerous contract test during all "phases" of an insurance contract. Therefore, the same unit of account should be used in determining whether contracts are onerous during both the pre-coverage and under the premium allocation approach. Using different units of account during different "phases" of an insurance contract will be operationally challenging and produce results that may not be easy to interpret.

Staff recommendation

68. Staff recommends that the unit of account for measuring onerous contracts should be the portfolio level.

Question 4 - Unit of account for the onerous contract test
Do the boards agree that the onerous contract test should be performed at the portfolio level during both the pre-coverage and under the premium allocation approach?

Appendix A: US industry combined loss ratios for non-life insurance lines of business

Combined Ratio by Line of Business (%) (annual only)	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Major Segment - Personal	105.05	100.02	103.03	104.79	111.40	110.35	104.85	97.81	93.91	96.12	93.84	97.44	104.37	102.45	102.66
Major Segment - Commercial	106.88	102.90	108.72	111.76	110.70	123.95	110.29	102.34	103.34	106.06	90.52	93.11	105.84	98.45	102.72
Major Segment - Accident & Health	98.06	103.60	101.91	105.42	101.30	106.18	97.68	84.48	87.29	90.26	96.54	95.87	91.10	95.19	102.76
Home / Farmowners Multi-Peril	121.62	101.22	109.63	108.34	111.19	121.23	109.10	98.09	94.37	100.23	89.51	95.77	116.68	105.95	107.07
Private Auto	101.16	99.71	101.40	103.87	111.44	107.41	103.65	97.68	93.74	94.77	95.24	98.01	99.97	101.16	100.96
Fire and Allied Lines Combined	96.28	93.08	106.42	106.91	109.46	125.57	90.88	80.12	88.09	105.12	79.04	70.09	99.29	80.72	83.23
Cmcl Multi-Peril Combined	118.27	111.09	119.71	118.09	114.78	117.54	105.00	99.57	100.54	97.19	93.05	92.22	103.96	97.15	100.59
Fin. / Mtg. Guaranty Combined	74.38	64.87	59.63	49.80	45.37	45.28	49.18	52.58	63.34	58.36	60.51	138.99	301.57	164.03	205.31
Marine Lines Combined	95.00	97.10	99.98	104.76	94.42	100.36	87.72	86.00	86.24	96.87	82.60	88.22	95.61	89.61	88.83
Medical Malpractice	109.52	112.55	117.64	128.41	132.28	152.82	140.14	138.54	109.89	99.95	90.65	84.72	79.21	85.51	88.85
Workers Comp	100.18	100.12	108.57	119.40	119.41	120.72	110.24	108.88	105.88	101.83	96.46	100.52	100.90	107.96	115.81
Other Liability	122.34	110.61	114.59	109.57	111.85	137.16	134.49	115.53	116.75	112.33	95.42	99.28	95.16	105.62	109.75
Commercial Auto	111.91	112.94	115.89	120.62	119.92	122.55	108.11	98.99	96.64	93.46	94.09	95.33	97.40	100.22	96.98
Aircraft	111.20	100.84	120.69	116.60	123.73	83.65	76.30	72.58	71.75	62.51	81.89	80.84	97.00	94.45	94.10
Fidelity / Surety Combined	84.55	86.63	90.26	85.43	88.26	116.93	113.33	108.04	109.37	97.71	82.87	73.16	70.31	84.42	75.17
A&H Lines Combined	98.06	103.60	101.91	105.42	101.30	106.18	97.68	84.48	87.29	90.26	96.54	95.87	91.10	95.19	102.76
Other Commercial	106.34	91.51	103.18	104.66	110.80	112.27	91.95	89.42	94.82	81.11	88.37	99.78	106.25	96.73	96.89
Non Proportional Reinsurance	104.11	100.63	100.18	113.77	107.07	161.88	125.99	109.77	123.12	256.70	88.26	77.63	97.79	69.43	79.56

The data above is from SNL Financial LC and is on an undiscounted basis.

Appendix B: IFRS and US GAAP guidance regarding impairment

1. Impairment of assets

    (a) IAS 36: An asset's cash-generating unit is the smallest group of assets that includes the asset and generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Identification of an asset's cash-generating unit involves judgement. If recoverable amount cannot be determined for an individual asset, an entity identifies the **lowest aggregation of assets that generate largely independent cash inflows** [emphasis added].

    (b) ASC 360-10-35-23: For purposes of recognition and measurement of an impairment loss, a long-lived asset or assets shall be grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities [emphasis added]. However, an impairment loss, if any, that results from applying this Subtopic shall reduce only the carrying amount of a long-lived asset or assets of the group in accordance with paragraph 360-10-35-28.

2. Evaluation of impairment of financial assets

    (a) **AG87 of IAS 39**: For the purpose of a collective evaluation of impairment, financial assets are **grouped on the basis of similar credit risk characteristics** [emphasis added] that are indicative of the debtors' ability to pay all amounts due according to the contractual terms (for example, on the basis of a credit risk evaluation or grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). The characteristics chosen are relevant to the

estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. However, loss probabilities and other loss statistics differ at a group level between (a) assets that have been individually evaluated for impairment and found not to be impaired and (b) assets that have not been individually evaluated for impairment, with the result that a different amount of impairment may be required. If an entity does not have a group of assets with similar risk characteristics, it does not make the additional assessment.

(b) ASC 310-10-35-21: Some impaired loans have risk characteristics that are unique to an individual borrower, and the creditor shall apply the measurement methods described in paragraphs 310-30-30-2; 310-10-35-22 through 35-28; and 310-10-35-37 on a loan-by-loan basis. However, some impaired loans may have **risk characteristics in common with other impaired loans** [emphasis added]. A creditor may aggregate those loans and may use historical statistics, such as average recovery period and average amount recovered, along with a composite effective interest rate as a means of measuring impairment of those loans.