

## Appendix A to Agenda Item 8.2.2

### Insurance approach – scope and applicability

1. The definition of an insurance contract in the IASB's ED is given below. This definition is expected to remain the same in the forthcoming IFRS. Staff considers that the text in italics would need to be replaced by the text in square brackets when applying the IFRS by analogy to social benefits.  

"A *contract* [social benefit scheme] under which *one party (the issuer)* [a public sector entity] accepts significant insurance risk from *another party (the policyholder)* [the beneficiaries of the social benefit scheme] by agreeing to compensate *the policyholder* [the beneficiaries] if a specified uncertain future event (*the insured event*) [(the social risk)] adversely affects *the policyholder* [the beneficiaries]."
2. Implicit in the definition of an insurance contract is the notion that the policyholder provides consideration. This is because insurance contracts require performance by both parties. As such, insurance contracts are exchange transactions.
3. At its June 2016 meeting, the IPSASB agreed in principle that only schemes that are intended to be fully funded through contributions could appropriately apply the insurance approach. This is consistent with the view that insurance contracts are exchange transactions. Social benefit schemes that are not intended to be fully funded through contributions—in other words, those that are intended to be subsidized through taxation or other general revenues—will be by definition non-exchange transactions.
4. At the December 2016 meeting, the IPSASB discussed the nature of social benefit contributions in the context of the obligating event approach. An updated analysis is included in the discussion on the key participatory events obligating event in the Basis for Conclusions (paragraphs BC61–BC114) of the draft ED ([Agenda Item 8.3](#)). Staff proposed that the non-exchange nature of social benefits and the fact that many contributory benefits are subsidized through general taxation or other government revenues suggests that the contributions are a form of taxation, not consideration for the future receipt of a social benefit.
5. At that meeting, staff noted that if contributions are a form of consideration, this could provide the past event needed to recognize a legal obligation and therefore a liability; if considerations are a form of taxation, there is no past event that results in the recognition of a legal obligation.
6. Staff considers that, if the analogy to an insurance contract is to be applied, contributions would need to be considered as a form of consideration. As insurance contracts are exchange transactions, staff considers that only those social benefit schemes that are intended to be fully funded from contributions could satisfy that criteria. This is consistent with the IPSASB's in principle decision at its June 2016 meeting that only schemes that are intended to be fully funded through contributions could appropriately apply the insurance approach.
7. At its June 2016 meeting, the IPSASB also directed staff to consider other issues identified by IPSASB members as relevant to determining whether the insurance approach is appropriate - "commercial substance", "looks and feels" like insurance, and users' needs and accountability.
8. Staff considers that the first two issues will only be satisfied where a social benefit scheme is intended to be fully funded by contributions. A scheme which is intended to be subsidized by

taxation is unlikely to have commercial substance; nor will it look and feel like an insurance contract. Insurance contracts are exchange transactions between the insurer and the policyholder. Social benefits that are intended to be fully funded from contributions can be seen as arrangements between the public sector entity and the participants in the scheme; where social benefits are subsidized through taxation, this introduces additional parties into the arrangements.

9. Staff also considers that, for these issues to be satisfied, the public sector entity will need to manage the scheme in the same way as the issuer of an insurance contract manages insurance contracts.
10. This will be a matter of judgment for the preparer to determine. However, staff considers that the following factors will be relevant in making this determination:
  - (a) The entity considers it is bound by the scheme in a similar manner to an insurer being bound by an insurance contract. For example, there may be evidence that the entity considers that it can amend the terms of the scheme (such as where the entity has previously amended the terms of the scheme; or has proposed retrospective changes to the scheme). In such cases, the entity will not be bound in a similar manner to an insurer, and the social benefit scheme will not have commercial substance or look and feel like an insurance contract.
  - (b) Assets relating to the social benefit scheme are held in a separate fund, or otherwise earmarked to provide benefits to participants. If an entity does not separately identify amounts relating to social benefits, this will provide evidence that the entity considers the contributions as a form of taxation. The social benefit scheme will not have commercial substance or look and feel like an insurance contract. There will also be practical difficulties with applying the measurement requirements in the forthcoming IFRS on insurance if the assets associated with a social benefit scheme are not separately identified.
  - (c) The legislation that establishes the social benefit gives enforceable rights to participants in the event that the social risk occurs. Insurance contracts give such rights to policyholders. If the social benefit scheme does not also include such rights, then any benefits provided by the entity will have a discretionary nature. The social benefit scheme will not have commercial substance or look and feel like an insurance contract.
  - (d) There is a separate entity established by the government, which is expected to act like an insurer in relation to a social benefit. However, staff notes that the forthcoming IFRS will apply to insurance contracts, not just insurance companies. Consequently, staff considers that, while the existence of a separate entity will be an indicator that the insurance approach could be appropriate, this is not a requirement.
11. Staff considers that, where a social benefit is intended to be fully funded from contributions, has commercial substance and looks and feels like an insurance contract (as described above), users' needs could be met by the use of the insurance approach. In order to hold the entity accountable for the social benefit scheme, users will need information as to whether the contributions are sufficient to meet the expected liabilities. The insurance approach will provide that information.
12. Conversely, for social benefit schemes that are not intended to be fully funded from contributions, and where any contributions are therefore considered to be a form of taxation, the obligating event will best meet users' needs. For these social benefits, users are likely to need information regarding

the amount of future taxation (including future contributions) or other general revenue that will be required to discharge the entity's current liabilities.

13. Taking the above discussion into account, staff considers that social benefit schemes will only be analogous to insurance contracts where:
  - (a) They are intended to be fully funded from contributions; and
  - (b) There is evidence that the public sector entity manages the scheme in the same way as the issuer of an insurance contract manages insurance contracts.