



Project:	Insurance	Meeting:	AASB August 2016 (M153)
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Issues relating to AASB Interpretation 1047 *Professional Indemnity Claims Liabilities in Medical Defence Organisations*

1. This paper:
 - (a) notes background on Interpretation 1047 *Professional Indemnity Claims Liabilities in Medical Defence Organisations*;
 - (b) identifies reasons for retaining or withdrawing Interpretation 1047; and
 - (c) seeks the Board's views on whether Interpretation 1047 should be withdrawn.

Why the AASB issued Interpretation 1047

2. Medical Defence Organisations (MDOs) are mutual organisations that, prior to 1 July 2003 accepted subscriptions from members for professional indemnity cover and the membership rules generally included discretion for the MDO over whether or not to pay claims made by members.
3. This discretion was a key difference from the insurance contracts written by registered general insurers and MDOs were regarded as being outside the scope of AASB 1023 and AAS 26 *Financial Reporting of General Insurance Activities*.¹
4. There were different views concerning whether MDOs should recognise liabilities for claims by members prior to any formal exercise of discretion to assist a member with a claim or prior to notification of the claim by the member, as claims incurred but not reported. Concern was expressed that, in the absence of authoritative guidance, diverse or unacceptable liability recognition practices may continue in the industry, and that this would undermine the relevance and reliability of general purpose financial reports.
5. The AASB's Urgent Issues Group addressed that concern by issuing Abstract 47 *Professional Indemnity Claims Liabilities in Medical Defence Organisations* in June 2002. When Australia adopted IFRS, it was decided that the Consensus and associated text in the Abstract should be retained because the issues it covers were still relevant. Abstract 47 was reissued as Interpretation 1047 in 2004 and remains in substantially the same form today.

1 These standards were essentially the same as the current AASB 1023 *General Insurance Contracts*.

Interpretation 1047 Consensus and its impact

6. In essence, Interpretation 1047 says that liabilities arising in respect of outstanding claims must be recognised when the entity has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.
7. Interpretation 1047 also strongly implied that, if the discretion is essentially always being exercised in favour of claimants, the discretion itself has no substance from a financial reporting perspective.
8. The impact of Interpretation 1047 was to almost immediately cause MDOs to align their accounting with registered insurers and recognise claims liabilities as if requests for assistance were never refused by MDOs.

Changed legislative environment from 1 July 2003

9. After 1 July 2003, the *Medical Indemnity Act 2002* came into effect and regulatory arrangements allowed only authorised general insurers to offer medical indemnity insurance. To comply with the new arrangements the organisations established registered insurance subsidiaries to meet their members' ongoing needs.² All medical indemnity contracts of MDOs are now written through those subsidiaries.
10. The remaining business that includes discretion to refuse assistance is 'claims incurred' business sold by MDOs before 1 July 2003. For example, a medical practitioner who was insured on a claims incurred basis in the period 1 July 2002 to 30 June 2003 may be notified today of a patient action against them that relates to an event that occurred in the period of cover. Based on outreach conducted by AASB staff among industry stakeholders, there have been very few such claims in recent years and the current financial impact of new claims from business sold before 1 July 2003 regarded as being immaterial.
11. In some cases, business sold by MDOs before 1 July 2003, for which the MDO has already exercised its discretion in favour of the policyholder, may relate to currently recognised material liabilities. However, those liabilities would only be subject to the further exercise of discretion if new information became available that could enable an MDO to change its view. This is generally regarded as not being likely.

Reasons for retaining or withdrawing Interpretation 1047

12. Staff have identified the following benefits associated with retaining Interpretation 1047.
 - (a) There remains 'discretionary' business written before 1 July 2003 that is still in run-off and stakeholders might regard the withdrawal as a signal that the AASB does not support the accounting outcomes achieved under Interpretation 1047.

2 http://archive.treasury.gov.au/documents/965/HTML/docshell.asp?URL=03_state.asp

- (b) Interpretation 1047 is not creating any harm.
- (c) It is within the bounds of possibility that a form of insurance business will be written by a new type of entity that provides the entity with an ability to exercise discretion on whether to assisting claimants. That type of entity might only apply the appropriate accounting (by analogy) if Interpretation 1047 were retained.

13. Staff have identified the following benefits associated with withdrawing Interpretation 1047.

- (a) The remaining business subject to MDO discretion was written before 1 July 2003 has no material impact on the current financial statements of MDOs and there is ample evidence to support the view that it will have no material impact on future financial statements.
- (b) Interpretation 1047 is currently effectively part of IFRS because national insurance GAAP that is consistent with IFRS was grandfathered when IFRS 4 *Insurance Contracts* (and AASB 4 *Insurance Contracts*) was issued. However, once the forthcoming IFRS 17 is issued, the withdrawal of Interpretation 1047 would remove a potential ‘difference’³ from IFRS.
- (c) Some of the language in Interpretation 1047 is out of date, and will become more dated once the IASB’s revised *Conceptual Framework* is finalised.

Staff recommendation: On balance, staff consider that, assuming the Board votes to adopt the forthcoming IFRS 17, Interpretation 1047 should be withdrawn at that time. This is on the basis that:

- (a) the forthcoming IFRS 17 is intended to replace all aspects of national insurance GAAP in an IFRS-adopting jurisdiction, and the following could all be superseded at the same time by the forthcoming revised AASB 4:
 - (i) existing AASB 4 *Insurance Contracts*;
 - (ii) AASB 1023 *General Insurance Contracts*;
 - (iii) AASB 1038 *Life Insurance Contracts*; and
 - (iv) AASB Interpretation 1047; and
- (b) there is no need to withdraw Interpretation 1047 now and there is no convenient vehicle for its immediate withdrawal.

Does the Board agree with the staff recommendation?

³ Even though, in reality, it would merely be an addition to, not a difference from, IFRS.

Appendix A

Consensus in Interpretation 1047

- A1. The Consensus in Interpretation 1047 states:
7. Subject to paragraph 8, liabilities arising for medical defence organisations in respect of outstanding claims shall be recognised in relation to events that have occurred prior to the end of the reporting period that are alleged to be covered by discretionary medical indemnity arrangements of the entity, in the following cases:
 - (a) unpaid reported claims;
 - (b) incurred but not reported claims arising under claims-incurred indemnity arrangements;
 - (c) incurred but not reported claims arising under extended reporting benefit indemnity arrangements, death, disablement or retirement indemnity arrangements, or other run-off cover, in relation to:
 - (i) members for whom such arrangements are in effect as at the end of the reporting period; and
 - (ii) members expected to qualify in the future for such arrangements as a member of the organisation; and
 - (d) incurred but not reported claims arising under claims-made indemnity arrangements which are, in substance, claims-incurred indemnity arrangements.
 8. Liabilities arising in respect of outstanding claims shall be recognised when the entity has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.
 9. The following information shall be disclosed in relation to the determination of the liability for outstanding claims:
 - (a) the accounting policies and methods adopted, including the basis of measurement and key assumptions applied; and
 - (b) information about the nature and extent of the underlying indemnity arrangements, including significant terms and conditions that may affect the amount, timing and uncertainty of future cash flows.
- A2. The Consensus also includes Application paragraphs that are not now relevant.
- A3. The complete Interpretation 1047 is available on the AASB's website.

http://www.aasb.gov.au/admin/file/content105/c9/INT1047_11-04_COMPdec13_01-14.pdf