Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Insurance**	**Meeting:**	AASB August 2016 (M153)
Contact:	Angus Thomson athomson@aasb.gov.au +61 3 9617 7618		Agenda paper 4.7 23 August 2016

Insurers and the Tier 2 disclosure regime

Objective of this paper

1. The objective is to confirm, or otherwise, the Board's existing position of not having differential Tier 2 disclosure requirements in the insurance standards.

Position adopted in existing insurance standards

2. None of the existing Australian insurance standards[1] explicitly contemplate there being Tier 2 entities that sell material levels of insurance contracts. However, in theory, an insurer (including a captive insurer) could identify as a Tier 2 entity and take advantage of the reduced disclosure requirements in other standards (such as AASB 7 *Financial Instruments: Disclosure*).

3. In finalising AASB 1053 *Application of Tiers of Australian Accounting Standards*, the Board concluded that there may be certain general insurers, such as some captive insurers, that do not have public accountability. Appendix A to this paper includes relevant extracts from AASB 1053.

Position adopted in Exposure Drafts

4. There have been two EDs and one Supplement to an ED in the course of progressing the insurance project:

   ~ ED 201 *Insurance Contracts* (August 2010), incorporating IASB ED/2010/8;

   ~ Tier 2 Supplement to ED 201 *Insurance Contracts*; and

   ~ ED 244 *Insurance Contracts* (June 2013), incorporating IASB ED/2013/7.

1 AASB 4 *Insurance Contracts*, AASB 1023 *General Insurance Contracts* and AASB 4 *Life Insurance Contracts*.

5. In the Preface to ED 244, the AASB noted:

> In the Tier 2 Supplement to ED 201 *Insurance Contracts* the AASB outlined its view that entities with material insurance activities that prepare general purpose financial statements would be publicly accountable. Accordingly, they would be required to comply with Tier 1. In forming this view the AASB considered feedback received from constituents in response to a specific question in AASB ED 201 about Tier 2. The AASB has not changed its view and it is not intended that a separate consultative document outlining Tier 2 disclosure requirements would be issued. However, the AASB would reconsider its view if the responses to this Exposure Draft indicate that Tier 2 requirements would be relevant.

Feedback received – captive insurers

6. One respondent (PwC) raised issues concerning Tier 2, commenting that:

> … we generally agree with the AASB's approach of not specifying Tier 2 disclosures for insurance contracts, based on the assumption that entities with material insurance activities would generally be publicly accountable. However, this does not have to be the case. For example, a captive insurer who is a wholly-owned subsidiary without external stakeholders would not normally be publicly accountable. Under the current differential reporting regime, these entities can reduce their disclosure burden by preparing special purpose financial reports. However, should the Board decide in the future to change the application focus of Australian Accounting Standards from 'reporting entity' to 'general purpose financial statements', all entities with insurance contracts would be required to apply the proposed insurance contracts disclosures regardless of whether they are publicly accountable or not, and whether users of the financial statements would require this kind of information. This would be an additional burden for entities such as captive insurers.
>
> We therefore recommend that the Board reviews the application of the proposed disclosures to nonpublicly accountable insurers using the Tier 2 Disclosure Principles should the reporting entity concept be revised at a future point in time.

Other background

7. A captive insurer is an entity that provides risk-mitigation services for its parent or for a group of related companies. Many larger non-insurance companies have captive insurers that buy insurance cover for all or many of the entities within the group. This is usually designed to facilitate risk management across the group and coordinate group buying power to obtain cost-effective insurance cover. Australian-registered insurers often also have captive insurers to coordinate the purchase of reinsurance for the group.

8. In the public sector, each state government and some local governments have captive or largely[2] captive insurers (such as the Victorian Managed Insurance Authority).

9. Other than the state-level captive insurers, most of the captives are registered offshore, which can be for various reasons, including the relative regulatory burden in those offshore jurisdictions compared with Australia.

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2 State-level captives often have some contracts relating to unrelated insureds, such as builders' warranty.

10. Australian insurers can be considered to fall within four categories with the following characteristics.

		Main objective	Registered insurer	Identify as reporting entity
1	Private sector insurers selling to unrelated parties	Profit	Yes	Yes
2	Public sector insurers selling to unrelated parties	Administrative and cost efficiency	No	Yes
3	Captive private sector insurers of commonly-controlled entities	Administrative and cost efficiency	Yes	Sometimes$^{\Omega}$
4	Captive public sector insurers of commonly-controlled entities	Administrative and cost efficiency	Sometimes$^{\beta}$	Usually$^{\psi}$

Ω If they are registered as insurers in foreign jurisdictions, they report based on the relevant foreign requirements and usually lodge financial information with the foreign regulator. That information may include financial statements and may be lodged publicly, depending on the jurisdiction. Australian-based entities usually prepare special purpose financial statements.

β The Commonwealth, States and Territories legislate to create their insurance entities. Local government captives register as insurers, usually in foreign jurisdictions.

ψ Some are effectively reported only as a segment of the relevant department.

Staff comments

11. Staff consider that the level of financial statement requirements captive insurers should meet is not a Tier 1 versus Tier 2 issue, but an issue of whether they are entities that should be required to report at all.[3]

12. The most relevant context in which to consider this reporting entity issue would be as part of the research topic ‘Information on entities within a group (includes considering information on parents, subsidiaries and administered items)’. This topic is on the AASB’s existing research work program as part of the Australian Financial Reporting Framework project.

Staff recommendation: Staff consider the reporting obligations of insurers that do not have public accountability (including captive insurers) should be dealt with in the context of the Australian Financial Reporting Framework project. In particular, the research topic ‘Information on entities within a group (includes considering information on parents, subsidiaries and administered items)’ would be relevant.

Does the Board agree with the staff recommendation?

3 There may be information on which the taxation authorities would want captives to report, but that is not a general purpose financial reporting matter.

Appendix to agenda paper 4.7
Extracts from AASB 1053 *Application of Tiers of Australian Accounting Standards*

A1. The IASB's definition of 'public accountability', which is included in Appendix A of AASB 1053, means:

> accountability to those existing and potential resource providers and others external to the entity who make economic decisions but are not in a position to demand reports tailored to meet their particular information needs.
>
> A for-profit private sector entity has public accountability if:
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> (a) its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
>
> (b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.

A2. The Basis for Conclusions to AASB 1053 notes:

> BC27 In relation to identifying entities that should be deemed to be publicly accountable in the Australian context, some respondents to ED 192 questioned whether captive insurers should be classified as publicly accountable since, in their view, there is unlikely to be a broad group of outsiders involved. The Board noted that the nature of captive insurers varies. Some only provide insurance to subsidiaries within their group while others also insure joint venture businesses. Some captive insurers, such as association captive insurers, can insure a wide range of members. Those that provide insurance to subsidiaries within groups may also deal with outsiders. For example, they may offer products that have public beneficiaries (such as public or product liability, or professional indemnity).
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> BC28 The Board concluded that, whilst it expects that most insurance companies will be publicly accountable, there may be certain general insurers, such as some captive insurers, that may not be publicly accountable. Accordingly, the Board did not deem all regulated insurance entities as publicly accountable.