



Staff Paper

Project:	Insurance Activities in the Public Sector	Meeting:	AASB September 2022 (M190) NZASB October 2022 (M103)
Topic:	Sub-grouping of insurance contracts	Agenda item:	AASB 4.2 NZASB 7.2
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		Project priority	Medium
		Decision-making	High
		Project status	Feedback on AASB ED 319 / NZASB ED 2022-3

Objectives of this paper

1. In respect of applying the sub-grouping of contracts requirements in AASB 17/PBE IFRS 17 *Insurance Contracts* to public sector entities, the objectives of this paper are to:
 - (a) CONSIDER comments received on questions 1 and 2 of AASB ED 319/ NZASB ED 2022-3 *Insurance Contracts in the Public Sector*; and
 - (b) CONFIRM whether to proceed with the proposals to exempt public sector entities from:
 - (i) sub-grouping onerous versus non-onerous contracts at initial recognition; and
 - (ii) sub-grouping contracts issued no more than a year apart.

Structure of this paper

2. This paper is structured as follows:
 - (a) The proposals in AASB ED 319/NZASB ED 2022-3
 - (b) Sub-grouping onerous versus non-onerous
 - The Boards' considerations when developing the ED
 - Respondents' feedback
 - (c) Sub-grouping contracts by issue date within one year period
 - The Boards' considerations when developing the ED
 - Respondents' feedback
 - (d) Explanation of terminology
 - (e) Staff recommendations
 - (f) [Appendix A](#): Collation of comments on questions 1 and 2 of AASB ED 319/ NZASB ED 2022-3



The proposals in AASB ED 319/NZASB ED 2022-3

3. The ED proposed to add paragraphs [Aus]16.1 and [Aus]22.1¹ to modify the requirements in AASB 17/PBE IFRS 17 paragraphs 16 and 22. Those paragraphs have been reproduced in the box below for the Boards' reference. Paragraphs 16 and 22 are not amended but are included to provide context.

Level of aggregation of insurance contracts	
...	
16	An entity shall divide a portfolio of insurance contracts issued into a minimum of:
	(a) a group of contracts that are onerous at initial recognition, if any;
	(b) a group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and
	(c) a group of the remaining contracts in the portfolio, if any.
[Aus]16.1	<u>Notwithstanding paragraph 16, a public sector entity is not required to sub-group a portfolio of contracts based on whether, at initial recognition, they are:</u>
	(a) <u>onerous; or</u>
	(b) <u>have no significant possibility of becoming onerous subsequently; or</u>
	(c) <u>are neither (a) nor (b).</u>
...	
22	An entity shall not include contracts issued more than one year apart in the same group. To achieve this the entity shall, if necessary, further divide the groups described in paragraphs 16–21.
[Aus]22.1	<u>Notwithstanding paragraph 22, a public sector entity is not required to sub-group insurance contracts within a portfolio based on when they are issued.</u>

Sub-grouping onerous versus non-onerous

The Boards' considerations when developing the ED

4. Existing insurance accounting practices in Australia and New Zealand do not require sub-grouping of onerous versus non-onerous contracts within a portfolio either at initial recognition or subsequently.
5. The sub-groupings under AASB 17/PBE IFRS 17.16 are established at initial recognition and are not subsequently changed, although new contracts would be added² to each group over an underwriting year. Accordingly, the discovery that contracts initially thought to be non-onerous which actually turn out to be onerous based on subsequent experience does not give rise to a new sub-grouping.

1 Both Boards have a policy of numbering paragraphs that are added to the IFRS text using the IFRS Standard paragraph number, following by a decimal point and unique consecutive numbering. The AASB also uses an 'Aus' pre-fix, while the NZASB has no prefix.

2 Except in the cases of public sector entities with a single fixed contract period for all contracts – such as 1 July to 30 June each year.



6. When developing the ED, the Boards observed that there is no impact on the long-run overall results from taking different approaches to onerous contract units of account. The main impact of AASB 17/PBE IFRS 17 (relative to AASB 1023/ PBE IFRS 4) would be to recognise losses upfront that would otherwise have been recognised over the coverage period of the contracts.
7. Onerous contracts are a routine occurrence in the public sector because, in any given year, the entity prices to break even after expected investment returns and does not incorporate a risk margin into its pricing [Agenda paper 4.6/7.6 discusses possible zero risk adjustments]. Accordingly, public sector entity portfolios of insurance contracts are typically onerous as a whole, since the expected investment returns are usually higher than the risk-free discount rate applied to measure the insurance liabilities, and because the onerous contract testing would include any risk adjustment.
8. While there may be cross-subsidisation within the portfolio between onerous and non-onerous contracts, if these were to be disaggregated into separate groups, they would simply magnify the level of upfront onerous contract losses, which is unlikely to provide any beneficial information to users of the financial statements. Therefore, the IASB's objective of ensuring the up-front recognition of onerous contracts is largely irrelevant in the public sector.
9. In addition, the Boards noted [AASB ED 319.BC24 to BC37 / NZASB ED 2022-3.BC36 to BC49]:
 - (a) pricing decisions and the resulting onerous contracts would often be a consequence of broader policy decisions of government – for example, public sector entities are often required to take a long-term view to avoid volatility in premiums/levies, or to 'use up' surpluses or 'rectify' deficits;
 - (b) given that some public sector entities do not price differentially based on policyholder-specific risks, they do not monitor (and may not possess) the information necessary to differentiate between onerous versus non-onerous contracts at initial recognition;
 - (c) while for profit insurers use granular information to improve profitability and avoid adverse selection by policyholders – this is not relevant to public sector entities, which typically deliberately cross-subsidise across communities; and
 - (d) public sector entities do not choose their customers or seek to market their services to particular customers, and risks are usually community rated – accordingly, grouping by onerous/non-onerous arrangements is not relevant.
10. Accordingly, the Boards concluded that, in a public sector context, the sub-grouping between onerous and non-onerous contracts would add no information value for users, and proposed paragraph [Aus]16.1 in the ED.

Respondents' feedback

11. All respondents who commented on the proposal to exempt public sector entities from sub-grouping between onerous and non-onerous contracts were supportive. Their support was based on the reasons provided by the Boards. Some respondents particularly noted:
 - (a) the monopoly and community-wide nature of many public sector arrangements makes them unsuitable for sub-grouping based on profitability;
 - (b) there is no loss-leading in public sector arrangements that users might find interesting in a commercial context;
 - (c) performance at the portfolio level is generally a more relevant benchmark for public sector entities.

Sub-grouping contracts by issue date within one year period

The Boards' considerations when developing the ED

12. AASB 17/PBE IFRS 17.22 requires insurers to divide each portfolio of contracts into sub-groups of contracts issued no more than a year apart. These sub-groups are a key unit of account used in applying AASB 17/PBE IFRS 17. This contrasts with AASB 1023/PBE IFRS 4 under which successive generations of contracts are included in a single portfolio, which is the key unit of account used in applying AASB 1023/PBE IFRS 4. This has an impact on the potential for early recognition of onerous contracts with multi-year coverage periods.
13. Under AASB 1023/PBE IFRS 4, a profitable annual cohort of contracts can offset a loss-making annual cohort of contracts; whereas the loss-making annual cohort would be accounted for on a stand-alone basis and regarded as onerous under AASB 17/PBE IFRS 17.
14. Many public sector entities only issue contracts with one year of coverage and there would be little or no difference between the portfolio perspective versus sub-grouping by annual cohort. However, some public sector entities issue contracts that provide multi-year coverage – for example, in respect of domestic building risk coverage arrangements, which may result in a greater frequency of early onerous contract recognition.
15. The Boards noted that the IASB decided to require sub-grouping of contracts issued no more than a year apart because it considers annual grouping by the underwriting year to be important to ensure that trends in the profitability of a portfolio of contracts are reflected in the financial statements on a timely basis.
16. Given that trends in profitability are not a key matter for public sector entities, the Boards concluded that the sub-grouping by annual cohort would add no information value for users and added paragraph [Aus]22.1 in the ED. For further background, refer to AASB ED 319.BC38 to BC45 / NZASB ED 2022-3.BC50 to BC57.

Respondents' feedback

17. All respondents who commented on the proposal to exempt public sector entities from sub-grouping contracts issued no more than a year apart were supportive. Their support was largely based on the reasons provided by the Boards.

Explanation of terminology

18. Staff note that, assuming the Boards proceed with their proposals on sub-grouping, unless public sector entities chose to sub-group, they would have a portfolio of insurance contracts as their basic unit of account. However, AASB 17/PBE IFRS 17 includes references to the following:
 - 'group(s) of contracts'
 - 'group(s) of insurance contracts'
 - 'same group'.
19. In general, AASB 17/PBE IFRS 17 assumes most entities will be using a group of contracts as its main unit of account. Nonetheless, not all private sector commercial insurers would have groups of contracts – some would have only portfolios. This could include entities that have just commenced operating or that are in run off [in the process of settling 'old' claims]. Entities are expected to adapt the way they read the terminology in AASB 17/PBE IFRS 17 in light of their own circumstances.



Respondents' feedback

20. One respondent to the ED alluded to the terminology issue [KPMG]. They suggested revising the draft wording in paragraph Aus16.1 on the basis that the existing text is unclear on whether the Boards intend to provide relief from the requirements in AASB17/PBE IFRS 17.16 or if it is requiring to sub-group on another basis [such as on a basis other than profitability-based criteria]. In addition, stakeholders interviewed by staff [who did not subsequently make a formal comment on the ED] noted the Boards may need to identify how public sector insurers are expected to read requirements that apply to a 'group of contracts'.
21. The Boards are proposing to permit entities to use a portfolio as its main unit of account, not to prohibit public sector entities from accounting for groups of contracts under AASB 17/PBE IFRS 17.16 and 22. Accordingly, it would not be appropriate to change all the references in AASB 17/PBE IFRS 17, as they apply to public sector entities, from 'group' to 'portfolio'.
22. Nevertheless, there are cases when it might be particularly helpful to identify, for public sector entities, that portfolios are the relevant minimum unit of account, including:
 - (a) at the commencement of the section of AASB 17/PBE IFRS 17 that addresses 'Level of aggregation of insurance contracts'; and
 - (b) in the context of the criteria for determining eligibility for the premium allocation approach.

Staff recommendations

23. Based on the feedback received, staff recommend that the Boards proceed with the proposals to exempt public sector entities from:
 - (a) sub-grouping onerous versus non-onerous contracts at initial recognition; and
 - (b) sub-grouping contracts issued no more than a year apart.
24. Staff recommend that the Boards include background in the Basis for Conclusions that helps to explain the manner in which public sector entities that would have **portfolios of contracts** but need not have **groups of contracts** would be expected to interpret references in AASB 17/PBE IFRS 17 to the following terms:
 - 'group(s) of contracts'
 - 'group(s) of insurance contracts'
 - 'same group'.
25. In addition, in respect of clarifying the relevant level of aggregation to be applied by public sector entities, staff recommend that the Boards add the paragraphs to AASB 17/PBE IFRS 17 identified in the box below. Paragraphs 14 and 53 have been reproduced in the box below for the Boards' reference – they are not amended but are included to provide context.
26. **Please note:** if the Boards agree with the staff recommendation in Agenda paper 4.4/7.4 to provide public sector entities with an accounting policy choice to apply the premium allocation approach, the suggested paragraph [Aus]53.1 in the box below may not be needed or may need to be modified.



Level of aggregation of insurance contracts

14 An entity shall identify portfolios of insurance contracts. A portfolio comprises contracts subject to similar risks and managed together. Contracts within a product line would be expected to have similar risks and hence would be expected to be in the same portfolio if they are managed together. Contracts in different product lines (for example single premium fixed annuities compared with regular term life assurance) would not be expected to have similar risks and hence would be expected to be in different portfolios.

[Aus]14.1 For a public sector entity applying the modifications in paragraphs [Aus]16.1 and [Aus]22.1, a portfolio of insurance contracts would be the main unit of account, not groups of insurance contracts.

...

53 An entity may simplify the measurement of a group of insurance contracts using the premium allocation approach set out in paragraphs 55–59 if, and only if, at the inception of the group:

- (a) the entity reasonably expects that such simplification would produce a measurement of the liability for remaining coverage for the group that would not differ materially from the one that would be produced applying the requirements in paragraphs 32–52; or
- (b) the coverage period of each contract in the group (including insurance contract services arising from all premiums within the contract boundary determined at that date applying paragraph 34) is one year or less.

[Aus]53.1 A public sector entity applying the modifications in paragraphs [Aus]16.1 and [Aus]22.1 assesses the criteria in paragraph 53 for each portfolio of insurance contracts:

- (a) on transition to this Standard; and
- (b) subsequently to any portfolio established after transition to this Standard at the inception of that portfolio.

Questions for Board members

Q1: Do Board members agree to confirm the AASB ED 319 / NZASB ED 2022-3 proposal to exempt public sector entities from:

- (a) sub-grouping onerous versus non-onerous contracts at initial recognition; and
- (b) sub-grouping contracts issued no more than a year apart?

If not, please provide your alternative views and reasons for those views.

Q2: Do Board members agree to include:

- (a) background in the Basis for Conclusions that helps to explain the manner in which public sector entities would be expected to interpret references in AASB 17/PBE IFRS 17 that relate to groups of contracts; and
- (b) the recommended additional paragraphs [Aus]14.1 and [Aus]53.1 in AASB 17/PBE IFRS 17 that refer to the portfolio unit of account? [potentially subject to change depending on the Boards' decisions on Agenda paper 4.4/7.4 in respect of having the premium allocation approach as an accounting policy choice.]

If not, please provide your alternative views and reasons for those views.



Appendix A: Collation of comments on questions 1 and 2 in AASB ED 319 / NZASB ED 2022-3

Sub-grouping – onerous versus non-onerous contracts

Q1: Do you agree with the proposal to not require the sub-grouping of contracts based on whether they are onerous or non-onerous at initial recognition in a public sector context? Please provide your reasons.

Respondent	Summary of comments
PwC	Agree – particularly when there are no private sector competitors, the entity is not profit-oriented and determines pricing with the aim to break even over the longer term. Since investment returns exceed risk free rates on an expected basis, most, if not all, groups of contracts will be onerous.
TSY NZ	Agree – in addition to the basis for conclusions arguments, the Treasury observes that insurance arrangements in the public sector are often established as a statutory scheme, comprising not a set of voluntary contracts that can be sensibly grouped, but rather a single ‘social contract’ in which the public sector reporting entity (or issuer) in return for the receipt of compulsorily levied premiums, accepts risk from a policyholder group by agreeing to compensate the individuals within that group if a specified uncertain future event adversely affects them. The performance of that social contract is of interest to users, and that would not be enhanced (and in fact would be hampered) by requiring the sub-grouping of contracts based on whether they are onerous or non-onerous at initial recognition.
iCare	Agree – schemes such as Lifetime Care NSW do not issue contracts and hence sub-grouping is not relevant. Public sector insurance policies are typically priced at breakeven after considering investment earnings.
HoTARAC	Members support the proposal for the reasons in paragraphs BC29, BC30 and BC34.
EQC	Agree for the following reasons: (a) have limited details on our exposure, and the modelling of the perils we cover is not well developed, so any judgements as to whether contracts are onerous or not is highly subjective (b) information on onerous contracts does not seem to align with the imperatives of a community rated scheme (c) it would be significant work for little return to the readers of the financial statements.
ACAG	Agree – the information obtained from sub-grouping would not be useful to users, compared to the effort required to gather the information (if even possible) and assess this. Some jurisdictions confirmed that insurers have pricing set for the whole portfolio based on ministerial decisions, or will use consistent pricing decisions and requirements for customers (with minor exceptions) that would not align well to a sub-grouping approach. There does not tend to be any deliberate ‘loss leading’ as the public sector insurers often cannot reject policyholders.



Respondent	Summary of comments
ACC	<p>Agree – ACC’s levies and appropriations are set on a best estimate basis with no profit margin or allowance for risk/uncertainty. The Government has an on-going obligation to fund the ACC and funding policy is long-term in nature pursuant to the Accident Compensation Act. ACC can post-fund for prior years’ shortfalls or set levies intentionally lower if prior years are in surplus. This means the split between onerous/non-onerous contracts is not meaningful for users.</p>
ICWA	<p>Agree – unlike for-profit insurers where granular risk information is collected to inform premium setting for sub-groups of policyholders, which in turn contributes to insurer profit margins, this granular level of information is less relevant in the public sector. In the public sector, pricing is often performed at a portfolio level with limited information captured in internal systems on the risk profile of sub-groups within the portfolio. Premium cross-subsidisation or community-based pricing is generally applied across a portfolio.</p>
KPMG	<p>Agree for the following reasons:</p> <ul style="list-style-type: none">• objectives of many public sector arrangements are to manage long term financial viability from investment returns or other funding rather than via periodic repricing to issue profitable contracts• Identification of non-onerous versus onerous contracts unlikely to affect pricing decisions as these decisions are not usually driven by profitability considerations.• Allowing the unit of account to be at a portfolio level would be more compatible with current practice and therefore less burdensome for entities already applying the Liability Adequacy Test under AASB 1023. <p>For clarity, recommend revising paragraph Aus16.1 to be consistent with AASB 17.16 wording. As drafted, it is not clear whether paragraph Aus16.1 is intended to provide relief from the requirements in AASB17.16 (which we understand to be the boards’ intent) or if it is requiring sub-grouping on another basis, i.e., other than on profitability stipulated in AASB 17.16.</p>

Sub-grouping – annual cohorts

Q2: Do you agree with the proposal to not require the sub-grouping of contracts based on whether they are issued more than a year apart in a public sector context? Please provide your reasons.

Respondent	Summary of comments
PwC	Agree – the key risks of a public sector entity are ensuring ongoing viability and funding, with less of a focus on an individual product or individual year group profitability.
TSY NZ	Agree – follows logically from response to Q1.
iCare	Agree – the focus of public sector insurance is on claims management as opposed to premium collections – the exemption aligns reporting with the way these schemes are currently managed.
HoTARAC	Members support the proposal for the reasons in paragraph BC45.
EQC	Yes, for the following reasons: (a) do not currently have reliable exposure data clarifying coverage periods (b) levies are repriced infrequently (c) this would require significant work for little return to the readers of the financial statements.
ACAG	Agree – annual cohorts are not considered overly relevant for the majority of public sector insurance entities for the reasons outlined in paragraph BC45.
ACC	Agree – follows logically from response to Q1.
ICWA	Agree. ICWA’s motor injury insurance and government self-insurance arrangements are issued with a maximum of one year of coverage. Sub-grouping of contracts issued more than one year apart are therefore not as relevant when compared to for-profit insurers who issue multi-year coverage and wish to identify trends in profitability.
KPMG	Agree – for the reasons noted in Q1. We do not expect the loss of information on the development of profitability to be a cause of concern in a public sector context. As per our comment on paragraph Aus16.1, we recommend revising the draft wording in paragraph Aus22.1 to be consistent with AASB 17.22, i.e., an entity is permitted to include contracts issued more than one year apart in the same group.