



# icare response to ED319 on AASB17

June 2022



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## Executive Summary

This paper is in response to the Australian Accounting Standards Board’s (AASB) request for comments on the Exposure Draft 319 in respect of proposed modifications to AASB 17 *Insurance Contracts* for the public sector.

## Background

The AASB introduced the Australian Accounting Standard 17 Insurance Contracts (AASB17) in May 2017 with an effective date of 1 January 2023. It is not currently applicable for the public sector.

The Australian Accounting Standards Board (AASB) issued an Exposure Draft of proposed amendments to AASB 17 for comment by 8 June 2022 (Appendix A). The intent of the proposed amendments appears to be the uniform application of AASB 17 on all insurance and ‘insurance like’ public sector schemes.

We support AASB’s objective of uniform application of accounting standards where it is in the best interest of the economy and the cost of implementation is justified by the value provided to the users of the accounts. We also urge the AASB to consider the legislative construct of public schemes in applying the appropriate accounting standard.

As an example, the prudential framework that private sector insurance companies operate under in Australia is regulated by APRA. Federal legislation enables APRA to apply a uniform prudential framework across the country. Public sector insurance schemes are enabled by legislation enacted by each state. There are fundamental differences in the governance frameworks and enabling legislation across the various jurisdictions in Australia.

A comparison to icare’s counterparts in Victoria illustrates this:

Fund type	Self-Insurance		Lifetime Care and Support	
	NSW	VIC	NSW	VIC
Fund Name	Treasury Managed Fund	Victorian Managed Insurance Authority	Lifetime Care New South Wales	Transport accident commission
Description	The NSW government’s self-insurance scheme guaranteed by NSW Treasury.	VMIA is the Victorian Government’s insurer, covering the projects, workers compensation and general insurance.	The Lifetime Care and Support Scheme pays for treatment, rehabilitation and care for people who have been severely injured in a motor accident in NSW.	The TAC covers those who have been injured on our roads in Victoria.
Applicable accounting standard	AASB 137	AASB 1023	AASB 137	AASB 1023
Legislative requirement to apply a PoA	Not required under legislation as there is an explicit guarantee from the NSW Government	75% based on Victoria’s Prudential Standard	Not required under legislation	75% based on Victoria’s Prudential Standard

Is there a contract issued with a clearly defined contract boundary	No	Yes	No	Yes

**General matters for comment (Q12-16)**

**The Australian Accounting Standards Board has requested an indication of the costs and benefits of the application of AASB 17, modified as proposed, relative to the current requirements, whether quantitative (financial or non-financial) or qualitative?**

**In relation to quantitative financial costs, the Boards are particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements (AASB 1023).**

ED319 as it stands implies that there is a high likelihood that arrangements that are not classified as insurance will fall within the scope of the public sector equivalent AASB 17 standard. This will result in the implementation and ongoing costs of these public benefit schemes increasing significantly. This includes but is not limited to the ongoing cost of actuarial and audit services provided to the schemes - these have not been quantified.

The introduction of a risk margin for schemes currently accounted for under AASB137 would require funding to be increased to account for the higher level of assets that are required to be held. These requirements are indicatively: -

Scheme	Impact
Lifetime Care and Support Authority	\$1.7 billion at a PoA of 75%
Treasury Managed Fund	\$1.7 billion at a PoA of 75%
Workers Compensation Dust Diseases Authority	\$0.1 billion at a PoA of 75%
Motor Accident Benefits Fund	\$0.14 billion at a PoA of 75%

The inclusion of a risk margin will have an adverse impact on the funding required by the schemes which will result in either Government funding redirected that could be used for the betterment of the NSW economy or an increase in the levies imposed on motorists or employers being held in deposit to meet the requirements of the new accounting standard.

This \$3.64 billion could be used for essential services necessary for the ongoing running and development of the State, such as building more schools and hospitals. Locking this away to comply with an accounting standard could not reasonably be considered in the public interest or in the best interests of the Australian economy.

Our initial estimates suggest that CTP Insurers in NSW will have to increase the annual CTP levy by approximately \$425 per car to fund the risk margin should Lifetime Care have to comply with the requirements of AASB 17. The

above cost increase will put significant pressure on household budgets, particularly in an environment where inflation and interest rates are increasing relative to real wages. This will also significantly impact NSW communities ability to recover from the economic impacts of COVID.

icare is governed by a governing board. It is the board's responsibility to ensure the schemes can operate on a going concern basis. The directors may not be able to sign the accounts on a going concern basis if we introduce an increase in the liability by \$3.64 billion without appropriate asset backing.

The proposals will potentially create audit and assurance challenges on the introduction of AASB17. We anticipate challenges and differences in interpretations between the scheme and the assurance team where the interpretation of the standard requires significant levels of judgement. We see this as a particular challenge with the ambiguity on guidance on scope.

In addition, the cost of implementing a AASB 17 compliant reporting solution for the schemes we believe should be within scope of the new standard is approximately \$18 million. NSW Treasury are the primary users of our financial statements. It is unlikely that the additional benefit from the new standard will exceed the cost of implementation. We have also highlighted other areas for consideration under Q11 (Other modifications).

### **Scope [paragraphs AusB16.1 to AusB16.25 and paragraphs BC123 to BC211] (Questions 7-9)**

Unambiguous guidance on the scope of AASB 17 is critical in ensuring uniform application of this standard. The proposed indicators do not provide a clear distinction between an insurance contract and a social benefit scheme.

icare acknowledges the challenges of attempting to achieve uniformity in applying this standard across multiple jurisdictions. However, it is also important to acknowledge the construct of the various schemes and legislative frameworks they operate under when accounting for what on face value appears to be schemes that provide similar benefits and cover similar risks.

- As an example, CTP Insurance is provided by private insurers in NSW. However, there are some risks that the private insurers are not willing to cover and benefits they do not want to provide as they are not regarded as insurable by the private sector. icare care schemes act as an insurer of last resort in providing these social benefits to the people of NSW. Those receiving the social benefits are referred to as participants (and not claims). The benefits are funded by a levy on motorists with no contract boundary. In contrast there are no private insurers in Victoria. The TAC issues insurance contracts that cover all risks as they are not the insurer of last resort. Hence it is appropriate for Victoria to account for the TAC as insurance and NSW to account for CTP Care and Lifetime Care as provisions.
- NSW self-insures its assets via the Treasury Managed Fund (TMF). The TMF is guaranteed by the NSW government and is not an insurance scheme. It is an administrative mechanism used to pay compensation on behalf of the NSW Government. The compensation payments are funded by the annual contributions from the agencies covered by the TMF. The agency contributions are largely funded by NSW Treasury. The short-fall/excess at the end of the year is funded by/returned to NSW Treasury. The TMF does not prepare separate financial statements but is consolidated within the Insurance for NSW accounts and the Total State Sector Accounts for NSW. It would not be appropriate to account for the TMF under AASB 17.

icare have proposed a list of indicators to be used in identifying those schemes that should be in scope of the new standard in response to question 8.

### **7. Scope [paragraphs AusB16.1 to AusB16.25 and paragraphs BC123 to BC211]**

The Boards propose that the public sector arrangements to which AASB 17 should apply would be identified based on a collective assessment of the following proposed indicators [paragraphs AusB16.1 to AusB16.25]:

- (a) similarity of risks covered, and benefits provided.
- (b) identifiable coverage;
- (c) enforceable nature of arrangement;
- (d) source and extent of funding;
- (e) management practices and assessing financial performance; and
- (f) assets held to pay benefits.

Do you agree with these proposed indicators?

If you disagree with the proposed indicators, which of them would you exclude?

Indicator		icare feedback
Similarity of risks covered, and benefits provided	Disagree	<p>icare disagrees with the proposal to use similar risks and benefits as an indicator that an insurance contract exists.</p> <p>Other private insurers cover similar risks and benefits in other jurisdictions not bound by the legislative framework of the NSW social benefit schemes is not indicative of whether there is an insurance arrangement in place.</p> <p>The requirement to identify arrangements outside of the Australian/New Zealand jurisdiction is not practical or feasible. In addition, there are fundamental differences between the legislation applicable in NSW vs other jurisdictions as highlighted in the comparison to Victoria above</p>
Identifiable coverage	Agree	<p>icare agrees that an identifiable coverage period is an indicator for an insurance contract.</p> <p>As noted in BC136/137 social benefit schemes are typically open ended and practical implementation of the standards would not allow for the determination of fulfilment cashflows.</p> <p>icare agrees that the annual levy for funding purposes is typically for practicality and not for the purposes of coverage (BC138).</p>
Enforceable nature of arrangement;	Agree	<p>The enforceable nature of the arrangement should be a prerequisite for identifying if the arrangement is an insurance contract or a social benefits arrangement.</p> <p>Arrangement that can be retrospectively changed (BC142) should not be accounted for under this standard. The standard requires the inclusion of a risk margin to account for volatility in claims. There is no need for a risk margin where claims volatility can be managed by changing benefits payable.</p> <p>Therefore, the arrangement would not be considered as insurance if the controlling government has the power to unilaterally</p>

		<p>change the benefits (BC143/144). The reporting date is not relevant as a mitigant to this argument as noted in BC143 as legislative change can occur in less than 12 months if required.</p> <p>As an FYI, BC144 (b) and (c) should result in the same outcome for the analysis of whether an arrangement is insurance like or a social benefit scheme.</p>
<b>Source and extent of funding;</b>	<b>Agree</b>	<p>The source of funding is an identifier as to whether an insurance contract exists.</p> <p>A good indicator on the applicability of this standard is where the policy holder who stands to benefit from the coverage pays for insurance as noted in BC167.</p> <p>We disagree with BC169 if it refers to arrangement such as the NSW Governments Self Insurance entity.</p> <p>The funding from consolidated revenue is to pay for the claims of the previous year that exceeded our initial estimate of claims payments at the start of that year. If the initial estimate was higher, the funds are returned to consolidated revenue as this is an administrative mechanism to manage govt claims as opposed to an insurance arrangement</p>
<b>Management practices and assessing financial performance;</b>	<b>Disagree</b>	<p>A scheme does not have to be insurance related to have appropriate management practices and assessment of financial performance. B16.22(c) states that fair and prudent claims management. Whether the arrangements are under an insurance contract or a compensation benefit, the fund should apply fair and prudent claims management.</p>
<b>Assets held to pay benefits.</b>	<b>Disagree</b>	<p>In B16.24 a fund that is restricted in the use of funds to pay benefits would be an indicator of an insurance arrangement. This is a standard arrangement for establishment of any public sector scheme. This does not indicate the arrangements must be accounted for under this standard. Further the alternative in B16.24 that "public sector entity receives its funding from sources such as appropriations" is already considered an indicator under B16.19 and is not an alternative for asset held.</p>

**8. Whether or not you agree or disagree with some or all the indicators, do you have suggested alternatives or additional indicators? If so, please outline those indicators and provide supporting reasoning.**

<b>Indicator</b>	<b>Rationale for inclusion</b>
Guarantee provided by government	The key principles in AASB 17 are that an entity identifies as insurance contracts those contracts under which the entity accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

	<p>The standard requires providing for a risk margin to account for the volatility and uncertainty of claims payments.</p> <p>A government guarantee removes this uncertainty. Hence there is no significant insurance risk.</p>
The ability to change benefits	The ability to retrospectively change benefits for a beneficiary of the scheme is more akin to a social benefit rather than an insurance contract.

**9. The proposed paragraph AusB16.2 requires that the indicators outlined in paragraphs AusB16.3 to AusB16.25 are considered collectively so that a balanced judgement can be made.**

The Boards considered that the proposed indicators should not be ranked or be assigned a relative significance because their relative significance is expected to depend on the circumstances. Do you agree with not assigning a relative significance to the indicators or having any other form of ranking approach to indicators? If you disagree:

- (a) which indicators would you identify as being most significant, or how would you otherwise rank the indicators, and why?
- (b) would you identify some indicators as pre-requisites for applying AASB 17 and, if so, which ones, and why?

icare agrees that the indicators should be ranked and that there should be prerequisites as gateway requirements for the insurers to be in scope. The proposed indicators ranked in order of relevance:

Ranking	Indicator	Rationale
Prerequisite	Guarantee provided by government	<p>There is no transfer of risk where the scheme is backed by a government guarantee.</p> <p>An entity should consider all other indicators only when not covered by an explicit government guarantee</p> <p>A guarantee negates the need for a risk margin as required by the standard.</p>
Prerequisite	Enforceable nature of arrangement.	<p>A contractual arrangement between the public sector agency and the beneficiary or policy holder exists where rights and obligations are enforceable.</p> <p>Where the rights and obligations are not enforceable on the public sector agency then this is more akin to a social benefit arrangement.</p>



Prerequisite	An identifiable coverage periods.	Those schemes with defined eligibility entry criteria rather than a defined coverage period are social benefit schemes. BC57 (a) states that most public sector arrangements have coverage periods of one year. However, some social benefit schemes issue annual levy notices for administrative purposes only. This is not a proxy for the coverage period.
Relevant -Indicator	Insurer of last resort	Benefits provided by a government entity that the private sector are unwilling to cover in the same jurisdiction should not be considered as insurance.
Relevant -Indicator	The ability to retrospectively change benefits	The ability to unilaterally change benefits negates the need for a risk margin required by the standard.  The risk margin is aimed at ensuring that the value of the insurance liabilities is established at an appropriate and sufficient level. The ability to retrospectively change benefits provides public sector entities with an additional lever to manage the value of liabilities.
Relevant -Indicator	Funding source	The source of funding of an arrangement is a relevant indicator of an insurance like arrangement. Arrangements funded by the beneficiary of the arrangement is more likely to be insurance.  The arrangements are unlikely to be of an insurance where funding is through government appropriations (both direct and look through)

**Sub-grouping of contracts [paragraphs Aus16.1 and Aus22.1 and paragraphs BC19 to BC45] (Questions 1 & 2)**

- 1. 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.**

Social benefit schemes such as the Lifetime Care scheme in NSW do not issue contracts and hence sub-grouping is not relevant.

icare supports 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 for those schemes that issue insurance contracts with a specific contract boundary.

Public sector insurance policies are typically priced at breakeven after considering investment earnings. (icare notes that 26(a) incorrectly suggests that this occurs prior to investment earnings). Therefore, public sector insurance contracts are onerous since inception.

**2. 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.**

icare supports the exemption from AASB 17.22. The focus of public sector insurance is on claims management as opposed to premium collections. An exemption allows us to report on these schemes similar to how they are currently managed.

**Initial recognition when contracts are onerous [paragraph Aus25.1 and paragraphs BC46 to BC50] (Question 3)**

**3. Do you agree with the proposal to amend the AASB 17 initial recognition requirements in a public sector context to not depend on when contracts become onerous? Please provide your reasons.**

icare supports the view that there should be an exemption from AASB17.25(c). Not having this exemption can result in future year losses being recognised in the current period.

**Determining contract boundaries, coverage periods and eligibility for the premium allocation approach (PAA) [paragraphs Aus34.1 to Aus34.3 and AusB64.1 and paragraphs BC51 to BC85] (Questions 4 & 5)**

**4. Do you agree with the proposed guidance on coverage periods, which would impact on applying the eligibility criteria for using the premium allocation approach (PAA) in a public sector context?**

The guidance provided on coverage periods does not address the concerns noted below.

The guidance on scope needs to be clearer before we address coverage periods. Without a clearer definition of scope there is potential for public sector schemes having perpetual coverage periods as noted in BC67 being incorrectly accounted for under this standard.

BC57 states that most public sector insurers would meet the requirements of stated coverage periods one year or less. For insurance like schemes the sourcing of funds by way of invoicing levies on an annual basis is an administrative function (BC170) and is not a coverage period. As per BC59 the coverage period will be different to the arrangements for funding of levies.

The calculation of the liability for remaining coverage is likely to be materially different between the PAA and GMM models for long tail schemes that do not issue insurance contracts with explicit contract boundaries. These schemes will not meet the eligibility requirements to adopt PAA under AASB17.

These schemes impacted include: -

- The Lifetime Care and Support Scheme
- The Motor Accidents Insurance Treatment and Benefits Funds
- Workers Compensation Dust Diseases Authority

Additional run off schemes may also be impacted by this requirement.

In addition, the guidance to date notes that the ability to reprice a contract will be based on: -

- The practical ability to fully reprice for risks/benefits under the existing or substantially enacted legislation BC71.
- The public sector pricing model is to have a medium to long-term view of the sustainability of the schemes and to minimise short term volatility in relation to pricing. BC81. This pricing model should not eliminate the eligibility of the scheme for PAA.

The proposal does not address the requirement to calculate the liability for remaining coverage under the general model for schemes that have coverage periods of greater than 12 months. eg:

- Construction Risk Insurance Fund
- Home Builders Warranty Insurance
- Reinsurance arrangements under those schemes.

Specific exemptions for these schemes are required to reduce the complexity of the implementation, and the considerable costs that would be associated with this as noted in BC53.

icare supports public sector insurers applying the Premium Allocation Approach without reference to the General Model. This will satisfy the needs of the users of the accounts without the costs and complexity of implementing a general model.

**5. Do you agree with the proposals to:**

**(a) require disclosure of information about the nature of the pricing process, including:**

- (i) the manner in which pricing/benefits are determined.**
- (ii) the timeframes for which they are typically determined; and**
- (iii) (any other relevant constraints under which an entity operates; when a public sector entity takes into account risks that relate to periods after the reassessment date based on having a policy of determining prices and benefits over a period longer than a single coverage period; and**

**(b) permit the disclosure to be located either:**

- (i) in the notes to the financial statements; or**
- (ii) by reference to an authoritative source that is available to users of the financial statements on the same terms as the financial statements and at the same time? Please provide your reasons.**

icare does not support the requirement to add commercially sensitive disclosures to the accounts of public sector insurers.

**Risk adjustment [paragraphs BC86 to BC122] (Question 6)**

**6. The AASB is proposing no modifications to the AASB 17 requirement for a risk adjustment that reflects the compensation the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.**

**In contrast, the NZASB is proposing a modification to require a risk adjustment that reflects an amount that is estimated to achieve a 75 per cent confidence level for a liability for incurred claims, which can be rebutted.**

**The proposed paragraph 37.1 in the NZASB's Exposure Draft states: 37.1 Notwithstanding paragraph 37, for a public sector entity, there is a rebuttable presumption that the compensation the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk**

is an adjustment to achieve a 75% confidence level (that is, a 75% probability of liabilities for incurred claims being adequate to meet actual claims).

(a) Do you support:

- (i) the AASB approach of not modifying AASB 17 regarding the risk adjustment requirement; or
- (ii) the NZASB approach of specifying a rebuttable presumption that a risk adjustment reflecting an amount that is estimated to achieve a 75 per cent confidence level is included when measuring a liability for incurred claims? Please provide your reasons.

(b) Do you have a suggested alternative approach? If so, please outline the approach and provide supporting reasoning.

icare supports not modifying AASB 17 re: PoA. This requirement would make it more onerous than the requirements of the private sector. In addition, icare's risk management is based on industry best practice and aligned to APRA Guidelines where practicable.

#### **Application date [paragraph AusC1.1 and paragraphs BC212 to BC215] (Question 10)**

**10. Do you agree with the proposed mandatory application date for public sector entities of annual periods beginning on or after 1 July 2025, with early application permitted?**

**If not, what alternative application date would you suggest? Please provide your reasons.**

An extension of time of at least one year is required if the scope of the public sector standard extends to those schemes that are not insurance although appearing to cover similar risks and benefits on the face of it. We anticipate the challenges and unintended consequences of attempting to force alignment between schemes that operate under varying legislative and governance framework to be significant.

Since for-profit public sector entities are currently required to apply AASB 17 for annual periods beginning on or after 1 January 2023, the AASB issued that consultation document to propose amendments to relevant Australian pronouncements so that for-profit public sector entities would be permitted to continue applying AASB 4 and AASB 1023 until a Standard making public sector-specific modifications to AASB 17 becomes effective.

#### **Other modifications**

**11. Do you consider there should be any further modifications to AASB 17 in respect of public sector arrangements?**

**If so, what modifications would you suggest and on what basis would you justify them? Please provide your reasons.**

**Please note that the Boards considered, but rejected, proposing modifications to AASB 17 in respect of public sector arrangements on the following topics:**

- (a) specifically exempting 'captive' public sector insurers from applying AASB 17 in their separate general-purpose financial statements [paragraphs BC215 to BC223].
- (b) discounting and inflating requirements applied in measuring insurance liabilities [paragraphs BC224 to BC246].
- (c) the measurement of investments backing insurance liabilities [paragraphs BC247 to BC252]; and
- (d) classification and presentation of risk mitigation program and other similar costs [paragraphs BC253 to BC260].

#### **Adverse Claims Development Cover**

If considered in-scope then consideration/guidance is required for those long tail schemes that are funded by levies where there can be a significant gap between the date of the incident vs. date of claim. This is referred to as adverse claims development coverage.

Guidance on the eligibility of these schemes for the Premium Allocation Approach is beneficial to the public sector.

### **Hindsight Adjustments**

Additional guidance on the treatment of premium adjustments for policies that are estimates at the inception of the policies is should not be treated as a direct participation feature under paragraph 45 of the standard and would not be accounted for under the Variable Fee Approach.

Eg: Workers Compensation premiums may be adjusted based on the performance of the policy holder in relation to claims experience and/or scheme performance. This is not an investment component. Guidance to this effect will be helpful.

icare does not believe that the use of this lever should result in the accounting for these adjustments under the Variable Fee Approach.

### **Captive Insurers**

Public sector governments create agencies to perform claims management on behalf of the state typically only providing services to other government sector agencies. These arrangements would be considered a captive insurer arrangement.

Requiring captive insurers to apply AASB17 without considering its enabling legislation would require a risk margin applied to the accounts of the agency, increasing the need for funding.

The users of the accounts of the captive insurer are the controlling government, and the application of the standard would provide no addition information to the users of the accounts, however, would require additional funding due to the application of the risk margin.

The AASB should revisit the requirement of Captive Insurers to account under AASB17.