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Kris Peach
Chair, Australian Accounting Standards Board
Podium Level 14, 530 Collins Street,
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Dear Kris

AASB Discussion Paper
Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities

Thank you for the opportunity to comment on the DP.

This submission addresses DP questions 5, 6, 7, 8, 9, 11 and 13.

The views expressed in this submission are mine and do not necessarily reflect the views of any of my employers or clients.

Q5 & Q6 Risk adjustment

Do the proposals provide sufficient guidance to determine the risk adjustment factor for non-financial risk? If not, what additional guidance is needed?

Are there any situations where there might be a risk adjustment factor of zero (refer paragraph BC11)?

I agree that:

~ in respect of annual contracts, the existing transactions should be considered on a stand-alone basis – that is without reference to likely future transactions (consistent with DP.BC9);

~ public sector entities should incorporate risk adjustments in measuring claim liabilities (consistent with DP.BC10).

This is on the basis that financial statements should recognise and measure existing transactions and any information that might be provided about future transactions should be included in disclosures only.

The measurement of risk adjustments is entity specific, being based on the compensation the entity requires for bearing the uncertainty about the amount and timing of insurance cash flows [AASB 17.37] and, as the DP acknowledges, public sector entities could have minimal risk adjustments due to having a high tolerance for risk.

I agree that those risk adjustments would be greater than zero because the uncertainty would not be completely eliminated even for the most risk tolerant entity.

Q7 & Q8 Contract boundary

When determining the contract boundary, are there any other instances apart from those illustrated in the examples, where there is no premium or the contract boundary is longer than 12 months, but it would still be permitted to apply the simplified approach under AASB 17? If so, do you agree that all public sector entities should be given an exemption to apply the premium allocation approach (the simplified approach) under AASB 17?

Do you agree with the following interpretation? If the funding can only be changed with a corresponding change in legislation, then the presumption exists that the simplified approach is not available for application. However, if the funding can be changed at will, then the presumption that the contract boundary is less than 12 months can be supported and the simplified method will be available for use.

The illustrative examples are comprehensive and well-explained.

Question 7 – Yes.

Question 8 – No.

The Board's goal of consistency in accounting for insurance risks and insurance-like risks across the public sector in applying the insurance standards and AASB 136 *Provisions, Contingent Liabilities and Contingent Assets* is appropriate and will help achieve greater comparability across jurisdictions. However, the Board should permit public sector entities to apply the premium allocation approach to all their insurance liabilities for remaining coverage, regardless of the length of the coverage period and the funding situation.

The general model[1] in AASB 17 is relevant to all claim liabilities, but the contractual service margin element of the model affecting liabilities for remaining coverage is complex, costly to learn, implement and maintain, as is a system for assessing eligibility for the premium allocation approach. The general model is also largely unsuitable for the liabilities for remaining coverage arising from most insurance and insurance-like arrangements in the public sector for the following reasons.

(a) The arrangements that might result in contract boundaries greater than a year are usually schemes catering to community expectations and fill a gap that private sector insurers are reluctant to fill. They often intersect with the public health system, which does not give rise to insurance-like arrangements. An example is cover provided for serious injury relating to transport accidents, which intersects with the wider health system. If insurance and insurance-like arrangements in the public sector were to change significantly – for example, multiple premium products with long coverage periods – the Board could re-consider the application of AASB 17 at that time.

(b) The main focus for public sector insurers and their financial statement users is on claim liabilities rather than liabilities for remaining coverage.[2] Accordingly, requiring application of the general model to liabilities for remaining coverage, with all its complexities, would impose a reporting burden that is disproportionate to any minor benefit that might be obtained.

1 The 'general model' is the measurement model required/described in AASB 17.32 to 52.

2 Of the $29b of Victoria's insurance liabilities as at 30 June 2016 identified in the DP on page 3, $27b relates to the Transport Accident Commission and WorkSafe, of which more than $26b (96%) is in outstanding claims.

(c) The AASB 17 general model was created to help achieve a level of consistency of profit recognition (contractual service margin allocation) among for-profit insurers for contracts with long coverage periods. The motive for public sector insurers is either to break even or, for those that are for-profit oriented, any margin is a function of the exercise of monopoly power, not profit in a marketplace.[3]

(d) Given the lack of relevance of the general model in the public sector, it would be simpler to have only one measurement model for liabilities for remaining coverage to avoid having to set criteria for distinguishing between arrangements with one-year or greater-than-one-year contract boundaries, which would be an added complexity and subject to interpretation. The suggested criteria in DP.E21 (based on the time it might take to change a funding arrangement) are potentially problematic in that entities would need to gauge the efficiency of the parliamentary process.

Q9 Captive insurance arrangements

Where subsidiaries apply AASB 17 to insurance and insurance-like contracts in the subsidiary's separate financial statements, but at the consolidated group level such contracts are regarded as self-insurance and consequently outside the scope of AASB 17, should such arrangements be scoped out of AASB 17 for the subsidiary's separate financial statements?

I agree with providing an optional exemption from applying AASB 17 to captive insurance arrangements for the reasons outlined in DP.BC84.

Q11 Other

Are there other matters raised by the requirements of AASB 17 that you consider should be addressed in respect of public sector entities?

As the AASB is aware from discussions at its Insurance Transition Resource Group, the premium allocation approach appears to involve a cash receipts basis [AASB 17.55].

For an insurer that offers premium payment choices (for example, annual and quarterly) for contracts providing annual coverage, the amount of the liability for remaining coverage would vary depending on the choices made by policyholders. This would provide a potentially misleading view of public sector entities' obligations to provide insurance coverage.[4]

The payment choices exercised by policyholders should not impact on the liability measure because those choices do not affect the extent of an insurer's obligations. In addition, in the context of a public sector insurer occupying a monopoly position, a policyholder who pays quarterly premiums for a contract with an annual coverage period has no less of a commitment to a full year's coverage than a policyholder who paid an annual premium. Although a policyholder of a monopoly public sector insurer has the option to cancel a policy; they have no option to enter a substitute contract with another insurer. For example, anyone wanting to register and drive a motor vehicle in Victoria must have a contract with VicRoads (and through VicRoads with the Transport Accident Commission).

3 Some might view the margins as pseudo taxes.

4 Despite the assertion in the second sentence of IFRS 17.BC35.

Regardless of the direction that this issue might take at the IASB in respect of IFRS 17, I would urge that AASB 17 require public sector insurers to:

(a) accrue any unpaid premiums for a current coverage period as receivables; and

(b) incorporate them in measuring the liability for remaining coverage.

Q13 For-profit private sector entities

AASB 1023 and AASB 1038 included some regulatory disclosure requirements that have not been carried forward into AASB 17. Do you agree with the AASB's recommendation that these disclosure requirements should not be carried forward to either AASB 17 or AASB 1054 Australian Additional Disclosures?

Subject to consultation with the New Zealand Accounting Standards Board, I agree these disclosures are not needed in accounting standards. They are more in the nature of regulatory information that might be set and maintained by other regulators, such as a prudential regulator.

Please contact me if you need any clarification of the above.

Yours sincerely

Angus Thomson