

28 February 2018

Ms K Peach  
Chair  
Australian Accounting Standards Board  
PO Box 204  
COLLINS ST WEST  
VIC 8007

Magoo Actuarial



John Walsh AM FIAA

Dear Ms Peach.

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

I welcome the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on its Discussion Paper (DP) *Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities*.

In principle I agree with the AASB's proposed objective of greater consistency of financial reporting across public sector entities engaging in insurance activities comparable to those provided in the private sector.

In my view the critical issue is in identifying those public sector monopoly schemes which are not and never have been underwritten in the private sector, and nor are capable of underwriting within reasonable and acceptable pricing. These schemes provide universal coverage and social benefits to citizens who become injured or sustain disability within the eligibility criteria of the statute, rather than indemnify a contracted policyholder. They provide entitlement to eligible citizens for lifelong social benefits, implying future cash flows of up to 100 years, far beyond any notion of immunised matched portfolios.

In the attachment to this covering letter I provide specific comments on some of the questions posed in the AASB discussion paper. I focus specifically on the NSW Lifetime Care and Support Scheme and the SA Lifetime Support Scheme. I deliberately do not mention the National Disability Insurance Scheme due to my position as a Board member of that scheme - this should not be taken to mean that I agree that the NDIS should fall within the scope of your recommendations.

I have also included for your information a brief bio introducing my qualifications to comment on these matters.

Please do not hesitate to contact me should you require further information - my contact details are in the footnote to this covering page.

Yours sincerely

John Walsh AM

## John Walsh AM Magoo Actuarial Consulting



Magoo Actuarial



John Walsh AM FIAA

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John Walsh spent over 20 years as a Partner in the Advisory practice of PricewaterhouseCoopers, before retiring from full-time employment in 2013. John's major client work was in the areas of social policy and funding of accident compensation, health and disability services. His ability to contribute to social policy is assisted by his own disability, traumatic quadriplegia.

In accident compensation, he is still peer review actuary to the SA Lifetime Support Scheme, having previously been actuary to the NSW Lifetime Care and Support Authority, the workers compensation insurance schemes of both NSW and South Australia and has conducted major reviews of several of Australia and New Zealand's accident compensation schemes and insurers.

In health he has been heavily involved in issues of funding design and resource allocation. In 2009 he was appointed Chair of the Independent Panel overseeing the implementation of *Caring Together: A Health Action Plan for NSW*. He was Deputy Chair of the National Health Performance Authority from 2011 to 2016, and is on the Board of the Australian Commission for Safety and Quality in Healthcare established as part of the COAG national health reforms.

In social policy he has advised the Commonwealth and NSW governments on future demand and funding requirements for disability services, homelessness services and Aboriginal disadvantage, and was heavily involved in the development of the *Stronger Together* funding and reform initiatives. He was a member of the Disability Investment Group established in 2008 to study options for increasing the investment opportunities in the disability sector and in 2010 was appointed to the Productivity Commission investigation which recommended the National Disability Insurance Scheme when it reported in July 2011.

John has been a board member of the NSW Motor Accidents Authority, the NSW Homecare Service, the NSW Paraquad Association, and is currently on the board of the National Disability Insurance Scheme, and chair of its Financial Sustainability subcommittee.

In 2001 he was named Australia's Actuary of the Year, and in 2011 was appointed a Member of the Order of Australia, and received the Prime Minister's Award for outstanding service to the disability sector. In 2015 John was appointed Australia's Patron for the United Nations International Day of People with a Disability.

John has an appointment as Adjunct Professor in the School of Medicine at University of Sydney.

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

### **Attachment - specific comments**

#### **1 Focus of my submission**

My submission focuses very much on Example 3A in the Discussion Paper (DP) – “Life care scheme operated by the DEF authority”. This example seems to refer specifically to the following schemes:

- NSW Lifetime Care and Support Scheme, and
- South Australia Lifetime Support Scheme.

In general terms these two schemes meet the description in Example 3A of the DP:

*IE20 The DEF Authority (DEF) provides lifelong treatment, rehabilitation and care services to people catastrophically injured in a motor vehicle accident in the state, regardless of who was at fault. CTP insurance (provided by private sector entities) provides cover for third parties who suffer less serious injuries as a result of motor accidents.*

*IE21 DEF is funded by a levy paid by motorists when they purchase CTP insurance. The amount of the levy is determined by a different public-sector entity to the entity that accepts insurance risk (DEF). DEF is not obligated to fund any shortfall incurred by the private sector entities for the CTP element.*

#### **2 Clarification of statements in the Discussion Paper**

I believe the descriptive element of the DP contains misleading statements which lead to the direction of the conclusion ultimately found. I provide the following examples of these statements:

- *In IE22: “there is an element of voluntariness in that state residents can choose whether to own and register their vehicle...”*

While this statement is true, it is irrelevant in the context of the operation of the scheme. The required aggregate levy is estimated independently of the number of registered vehicles, and is apportioned accordingly. Coverage by the schemes is universal, and provides entitlement to anyone who meets the level of disability requirement and is injured through the use or operation of a motor vehicle in the relevant jurisdiction, including pedestrians - the entire population is protected. There is no notion of voluntary coverage.

- *In IE23: “the nature of what motorists received for paying DEF levies is somewhat unclear at time of payment (different private sector insurers may have different disclosure of what the scheme does)”*

Private insurers are not responsible for informing motorists or the public of their entitlements under the lifetime care schemes. These are prescribed by the statutes and are included in the guidelines and rules produced by the authorities. Some private insurers offer optional additional coverage in the event of severe injury, which may differ

between insurers; this is a private insurance matter and beyond the scope or responsibility of the lifetime care schemes.

- Paragraphs IE24 and IE25 correctly distinguish between (a) an insurance part of the CTP and registration transaction, which involves a contractual agreement by the policyholder to be indemnified by the insurer as to liability, and (b) a noninsurance part, which collects levies to fund an aggregate cost commitment, with no contractual agreement or policyholder or individual indemnity or liability.
- Nevertheless paragraph IE26 then attempts to force the transaction of the lifetime care scheme into a AASB 17 paradigm. It then incorrectly states:
  - in subsection (a) that in the absence of the lifetime care schemes the social benefits provided by these schemes would be the responsibility of the drivers. I will argue below that the benefits provided by lifetime care schemes have never been and are not able to be covered by private insurance. This section also errs by bringing compensation for loss of earnings within the coverage
  - in subsection (e) that, again, there is a transfer of risk from policyholders to the scheme. Policyholders have never been responsible for the type of no-fault whole of life liabilities covered by the lifetime care schemes.
- Paragraph IE27 provides an assessment of the extent to which the lifetime care schemes meet the requirements of ‘insurance-like arrangements’. I believe the following misunderstandings are contained in these arguments:
  - in subsection (b), the argument is incomplete by failing to acknowledge that the statute creates Rules/Guidelines which are regularly adjusted by the authorities and which effectively amend operations and implementation of the intention of the statute. In some cases these adjustments have implications for future scheme liabilities, including liabilities in respect of previously incurred years. Many of these changes would be challenged in a contractual insurance arrangement;
  - in subsection (g) it is argued that similar arrangements are entered into by for-profit entities and accounted for as insurance contracts. This is incorrect. The no-fault long-term cash flows provided under the lifetime care schemes have never been available in the private sector market; the previous CTP coverage differed on the fundamental bases of:
    - (a) coverage - only claimants who could establish liability of an insured policyholder were entitled to benefits,
    - (b) level of benefits - were not guaranteed but were subject to negotiation between the insurer on behalf of the policyholder and plaintiff lawyers on behalf of the injured party. There was almost always a negotiation rather than full retribution, and in many cases there was a reduction for alleged contributory negligence,
    - (c) there was no direct relationship between the settlement amount and the provision of lifetime care. Once the claimant received their agreed benefit they were free to dispose of that in any way they wished. The number of cases reverting to the Administrative

Appeals Tribunal having expended their benefits and applying for Social Security support is testament to the under provision of future care, and

(d) the benefits were not paid as a lifetime cash flow purchase of lifetime care, but rather as a lump sum. From an insurance accounting perspective this means that the term of the liabilities was very much lower than lifetime care schemes - typically in the order of four to five years, compared to a cash flow in lifetime care schemes of up to 100 years, and an inflated/undiscounted mean term of between 40 and 50 years, far beyond a reasonable projection of current complying investment returns.

Moreover, not only were lifetime care schemes not previously insured by the for-profit sector, but when offered the opportunity to underwrite the NSW Lifetime Care Scheme during the political negotiations of 2005/2006 leading up to the introduction of the scheme, the collective insurance sector was prepared to underwrite only the frequency risk of the scheme, requiring to transfer the long-term liability risk back to the state after five years post injury. A similar arrangement was recently negotiated in the 2017 amendments to the NSW CTP scheme, which introduced a limited lifetime coverage for some benefits not covered by the lifetime care schemes.

In conclusion, I believe the statements in the DP relating to the lifetime care schemes are incorrect or misleading in a number of important and relevant areas.

### **3 Responses to specific matters for comment**

In response to the specific matters for comment introduced on p6 of the DP, I provide the following:

#### **General matters**

1. Do you agree with the objective of the proposed implementation guidance to achieve greater consistency of financial reporting across the public sector among entities engaging in insurance activities for the benefit of users of that information? Why or why not?

Yes, when all other considerations regarding the comparability of public and private arrangements are considered and agreed.

2. Do you agree with the proposed Implementation Guidance for determining when public sector entities should be required to apply AASB 17 *Insurance Contracts* and will the Guidance achieve its objective of greater consistency of financial reporting? Why or why not?

No. The specific public entities considered in my submission should not be included under the recommended implementation, for the reasons I have given above.

Compliance with the recommendations would potentially cause significant dislocation in the pricing and management of lifetime care schemes, to the

ultimate detriment of state coverage of social benefits - refer to my above responses.

3. Are there other forms of Implementation Guidance that would be more likely to achieve the objective of greater consistency of financial reporting for the benefit of users?

Yes, true clarification of the differences in arrangements between the schemes under consideration, acknowledging the practical reality of what can be provided by the private for-profit sector.

4. Do you agree the amendments to AASB 17 should apply to both for-profit and not-for-profit public-sector entities?

See above response

#### **Risk adjustment for non-financial risk**

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

Not specifically covered in my submission, but there should be additional guidance on the consideration of the combined forces of monopoly coverage, compulsory and universal insurance, state levy raising capability and state underwriting of liabilities.

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

Beyond the scope of my submission, but refer to my comment of the previous question.

#### **Determining the contract boundary**

7. 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?

No comment

8. 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.

No comment

#### **Captive insurance arrangements**

9. 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?

No comment

#### **Investment contracts with discretionary participation features**

10. Under a ASB 17 paragraph 3C an entity is required to apply a ASB 17 to investment contracts with discretionary participation features, if the entity also issues insurance contracts.
- a.
  - b.
  - c.
  - d.

No comment

#### **Other**

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

Refer to my comments above in Section 2 "Clarification of statements in the DP"

12. Over all other proposals for public sector insurance accounting in the best interests of the Australian economy?

No. Prior to the introduction of the lifetime care schemes, compensation for lifetime care costs under fault-based CTP were inadequate in coverage, long-term benefits and early access to rehabilitation. The current lifetime care schemes in NSW and SA provide a first step in extending support to people who sustain these major injuries in motor vehicle accidents. They are compulsory schemes, covering the full population and managed by a monopoly public sector entity. As I have pointed out they are uninsurable in the private sector and are not "insurance-like" within the definitions of AASB.

In 2011 the Australian Productivity Commission Inquiry into Disability Care and Support<sup>1</sup> (2011) ("the PC Report"), recommended the National Disability Insurance Scheme ("NDIS") and the National Injury Insurance Scheme ("NIIS").

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<sup>1</sup> Productivity Commission Inquiry Report: Disability Care and Support. No 54, 31 July 2011

The Productivity Commission clearly stated that the recommendations would provide a net benefit to the Australian economy.

In the case of lifetime care schemes, and ultimately the proposed NIIS, people who sustain a significant injury through whatever cause would have their lifetime care and support costs met by a separate state entity affiliated with the national injury insurance proposals. It was proposed by the PC that the existing lifetime care schemes be extended to include this more comprehensive coverage. The shortcomings of the prior CTP arrangements were clearly articulated in chapters 17 and 18 of the PC report.

In my view, imposing the recommendations of AASB 17 would severely compromise the orderly levy setting and financial management of lifetime care schemes, and as a result would compromise the orderly agreement and implementation of the National Injury Insurance Scheme.