ACC’s Response to Questions in Invitation to Comment on NZASB ED 2022-3

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.

ACC agrees with this proposal.

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 Scheme and its funding policy is long-term in nature pursuant to the Accident Compensation Act. We are able to post-fund for prior years’ funding 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 of our financial accounts.

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.

ACC agrees with this proposal. This view logically follows from our response to Question 1.

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

ACC agrees with this proposal.

This view logically follows from our response to Questions 1 and 2.

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? In particular, do you agree with the Boards’ proposals to provide guidance that:
   (a) assessing a public sector entity’s practical ability to fully price for risks or benefits would include assessing the ability of its controlling government, and any relevant Minister(s), to decide on pricing or benefits;
   (b) a public sector entity’s monopoly position in providing coverage for risks in a particular community, of itself, would not affect the entity’s practical ability to fully price for risks or benefits;
   (c) any legislated obligation for a public sector entity to stand-ready to insure future policyholders, of itself, is not an obligation that would affect the practical ability to fully price for risks or benefits;
   (d) arrangements would not be regarded as failing to meet the criterion in PBE IFRS 17.34(b)(ii) simply because premium pricing for coverage up to the date when the risks are reassessed takes into account:

(i) risks that relate to periods after the reassessment date based on having a policy of determining prices and benefits using a medium to long term view; and/or
(j) a broad government policy framework that includes considering general economic circumstances and community needs.

ACC agrees with the proposed guidance on coverage periods. But like Treasury we believe more guidance should be provided.

Our feedback is consistent with the feedback given in the Treasury response:

Our understanding of the principle, that the guidance is intended to support, is that the boundary when a coverage period ends is when the entity has the practical ability to reassess the risks and, as a result, can set a new price or level of benefits that fully reflects that reassessment. Treasury agrees that this is a sensible principle.

What we are observing in practice is that while the government has the ability to set a new price or level of benefits on an annual basis in accordance with constitutional and budgetary conventions, as a matter of good policy, we are tending towards institutionalising two-to-five year funding/pricing reassessments. On the one hand this provides certainty on levies to the affected constituency and the consultation process is too costly to do annually, but on the other hand a medium-term planned reassessment promotes good stewardship. An example of this trend can be seen in the Natural Hazards Bill currently before the Parliament which institutes a five-year funding review.

*However, while the **practice** of multi-year pricing assessments may be becoming the norm, the **practical ability** to do an annual assessment remains. Under the current guidance Treasury can foresee that there may be significant challenge for preparers (and opportunities for protracted disagreement with auditors) in debating and proving whether the practice of multi-year pricing assessments constrains the practical ability to do annual assessments. We do not think such debate is helpful, nor should the standard add further to the transaction costs of insurance accounting.*

We therefore propose an additional guidance proposal on coverage periods, that:

- *The practice of multi-year funding/pricing assessments does not, of itself, constrain the practical ability of a public sector entity to more frequently change prices and benefits of insurance arrangements.*

Subsidiary guidance could explain that where there is some legislative constraint on public sector entities reviewing prices, then that will be relevant to the determination of the coverage period, but in the absence of such constraint, then constitutional and budgetary norms would apply.

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.

ACC agrees with the proposals that information is publicly available about the pricing process. We also agree that this disclosure should not be required to be in the notes to the financial statements.

Currently ACC's levy setting process is only performed every three years although prices are set for each year as part of this. For instance, in 2021 levies were set for each levy year from 2023-2025. As part of the levy setting process various reports are publicly released which set out the detail of the pricing process. However, like the levy setting process these reports are only produced every three years.

These reports contain significant amounts of detail about the pricing process including each of points noted above. This process remains unchanged over the multi-year levy setting period. We believe this information is what this proposal intends to be available so our preference would be for these reports to cover the disclosure under b)ii above. Even though our pricing reports would be available prior to the financial statements, and would be applicable for the financial statement year, we are not convinced it meets the above definition due to the fact the reports are only produced every three years.

Instead, we suggest either b)ii changes to:

by reference to an authoritative source that is available to users of the financial statements for the period covered by the financial statements and available earlier or at the same time as the financial statements

Or else, additional guidance is added to note that the reports from a multi-year pricing process are sufficient to cover this disclosure in each year covered by the pricing process.

6. 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 of PBE IFRS 17 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 reflect a 75% confidence level (that is, a 75% probability of liabilities for incurred claims being adequate to meet actual claims).

   In contrast, the AASB is proposing no modification 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.

a) Do you support:
   i. 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; or
   ii. the AASB approach of not modifying AASB 17 regarding the risk adjustment requirement?

   Please provide your reasons.

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

ACC's view is that the requirement of a risk adjustment should be based on a principles approach with the goal being to improve information for the users of public sector financial statements.

ACC's funding policy is based on best estimate assumptions with no pricing for additional risk. The Government has an on-going obligation to fund the ACC Scheme and its funding policy is long-term in nature pursuant to the Accident Compensation Act. ACC is able to adjust future levies to make up for higher-than-expected past claims. Our view is that our balance sheet should be consistent with our funding policy and no risk adjustment should be included.

From the perspective of users of the financial statement it is important for them to understand the uncertainty in large balance sheet items like insurance liabilities. Rather than including the risk adjustment on the balance sheet we suggest that a sensitivity is included for the risk adjustment. Sensitivity analysis generally includes individual changes in assumptions. A sensitivity for risk adjustment would provide additional information in that it considers all assumptions at once. Such a sensitivity disclosure would provide better transparency than embedding a risk adjustment into the balance sheet.

If we are required to include a risk adjustment on the balance sheet, then we are comfortable with the modification above. We note that the proposed wording differs slightly from the current risk margin approach in IFRS 4 in that it explicitly mentions timing and non-financial risk. In PBE IFRS 4 D5.1.6 states:

The outstanding claims liability includes, in addition to the central estimate of the present value of the expected future payments, a risk margin that relates to the inherent uncertainty in the central estimate of the present value of the expected future payments

We would appreciate if additional guidance was included as to if/how the methodology proposed modification differs from the current risk margin approach.

7. The Boards propose that the public sector arrangements to which PBE IFRS 17 should apply would be identified based on a collective assessment of the following proposed indicators [paragraphs AG16.1 to AG16.25]:
   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?

ACC agrees broadly with the proposed indicators.

Under the source and extent of funding additional guidance there is a differentiation made between premiums received from policyholders and funding from other sources (e.g. recurring funding from general taxation). ACC's Non-Earner's account funding is sourced from an appropriation that is paid from general taxation. However, the appropriation amount is calculated in a consistent way with ACC's levied accounts in that it is an estimate of the lifetime costs of the new year of claims. There are also publicly available reports that set out the process for calculating the appropriation released annually.

It is our view that the fact it is funded by general taxation is less of an indicator of insurance than how the amount has been calculated. We suggest that additional guidance is included that differentiates between funding directly out of general taxation and an actuarially calculated appropriation (which aligns better with insurance).

We agree with the Treasury in their suggestion of changing the proposed definition of an insurance contract to:

An insurance contract is a contract or statutory arrangement under which one party (the issuer) accepts significant insurance risk from another party or group (the policyholder or policyholder group) by agreeing to compensate policyholders or other affected parties if a specified uncertain future event (the insured event) adversely affects policyholders or those other affected parties.

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

We agree with the feedback from Treasury and also their recommendations on *Similarity of Risks Covered and Compensation Provided* included in the annex to their feedback:

On indicator (a.) Treasury considers this could be better connected to the definition if the word compensation was used. Treasury also notes that this indicator seems to have two elements:

- *Similarity or comparability between the risks and the benefits*
- *Similarity with comparable private sector insurance contracts.*

We believe these two facets could be better explained in the application guidance. We note that often a feature of public sector insurance contracts is that they fill a 'protection gap' that would otherwise not be met by insurance markets. In our view, this is a rationale for inclusion rather than exclusion from the standard.

Treasury has a number of recommendations to improve the discussion of the indicators consistent with our earlier recommendations. These are included in the annex to this submission.

9. The proposed paragraph AG16.2 requires that the indicators outlined in paragraphs AG16.3 to AG16.25 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 PBE IFRS 17 and, if so, which ones, and why?

ACC has the view that some indicators should be given more weight than others.

There are some indicators that we believe are a pre-requisite and need to be met. These are b (identifiable coverage period) and c (enforceable nature of arrangement).

The indicator *f* (assets held to pay benefits) should have a lower weight than other indicators. Our view is that having assets held to pay benefits is not a key requirement of defining an insurance contract, particularly in the public sector where solvency is not such a big issue.

We consider the remaining indicators to be of equal importance with flexibility in how many of these indicators are needed to be met.

10. Do you agree with the proposed mandatory application date for public sector entities of annual periods beginning on or after 1 January 2025, with early application permitted? If not, what alternative application date would you suggest? Please provide your reasons

We agree with the feedback given by Treasury:

If the standard is issued prior to 1 January 2023, improved in accordance with our recommendations, we would agree with the proposed mandatory application date for public sector entities of annual periods beginning on or after 1 January 2025, with early application permitted. If however those conditions are not met, Treasury would suggest deferring the standard application date.

11. Do you consider there should be any further modifications to PBE IFRS 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 PBE IFRS 17 in respect of public sector arrangements on the following topics:
    a. specifically exempting ‘captive’ public sector insurers from applying PBE IFRS 17 in their separate general purpose financial statements [paragraphs BC228 to BC236];
    b. discounting and inflating requirements applied in measuring insurance liabilities [paragraphs BC237 to BC259];

c. the measurement of investments backing insurance liabilities [paragraphs BC260 to BC265]; and
d. classification and presentation of risk mitigation program and other similar costs [paragraphs BC266 to BC273]. 38 to 39 12

ACC does not see it being necessary to make any further modifications to the standard.

12. Do you have any other comments on the ED?

No