EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

NZASB Exposure Draft 2018-7

PBE IFRS 17 *Insurance Contracts*

(NZASB ED 2018-7)

Invitation to Comment

December 2018

PO Box 11250
Manners St Central, Wellington 6142
New Zealand
http://www.xrb.govt.nz

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Information for respondents

Invitation to Comment

The New Zealand Accounting Standards Board (NZASB)[1] is seeking comments on the specific matters raised in this Invitation to Comment. We will consider all comments before finalising a new PBE Standard based on IFRS 17 *Insurance Contracts*.

If you want to comment, please supplement your opinions with detailed comments, whether supportive or critical of the proposals, as both supportive and critical comments are essential to a balanced view.

Comments are most useful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for an alternative. Feel free to provide comments only for those questions, or issues that are relevant to you.

Submissions should be sent to:

Chief Executive
External Reporting Board
PO Box 11250
Manners St Central
Wellington 6142
New Zealand
Email: submissions@xrb.govt.nz
(please refer to *ED PBE IFRS 17* in the subject line)

We would appreciate receiving a copy of your submission in electronic form (preferably Microsoft Word format) as that helps us to efficiently collate and analyse comments.

Please note in your submission on whose behalf the submission is being made (for example, own behalf, a group of people, or an entity).

The closing date for submissions is **17 May 2019**.

Publication of submissions, the Official Information Act and the Privacy Act

We intend publishing all submissions on the XRB website (xrb.govt.nz), unless the submission may be defamatory. If you have any objection to publication of your submission, we will not publish it on the internet. However, it will remain subject to the Official Information Act 1982 and, therefore, it may be released in part or in full. The Privacy Act 1993 also applies.

If you have an objection to the release of any information contained in your submission, we would appreciate you identifying the parts of your submission to be withheld, and the grounds under the Official Information Act 1982 for doing so (e.g. that it would be likely to unfairly prejudice the commercial position of the person providing the information).

[1] The NZASB is a sub-Board of the External Reporting Board (XRB Board), and is responsible for setting accounting standards.

List of abbreviations

The following abbreviations are used in this Invitation to Comment.

AASB	Australian Accounting Standards Board
ED	Exposure Draft
IASB	International Accounting Standards Board
IPSASB	International Public Sector Accounting Standards Board
ITC	Invitation to Comment
NZ IFRS	New Zealand equivalents to International Financial Reporting Standards
NZASB	New Zealand Accounting Standards Board, a sub-Board of the External Reporting Board
PBE	Public benefit entity
PBE IPSAS	Public Benefit Entity International Public Sector Accounting Standard
RDR	Reduced Disclosure Regime

Questions for respondents

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		Paragraphs
9	Do you agree that there should be no RDR concessions in PBE IFRS 17 for Tier 2 PBEs? If you disagree, please explain why and identify the disclosures that should be identified as RDR concessions. It would also be helpful if you could include a description of any PBEs that are within the scope of the proposed PBE IFRS 17 and qualify for reporting in accordance with Tier 2 PBE Standards.	83
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1. Introduction

1.1 Purpose of this Invitation to Comment

1. The purpose of this Invitation to Comment (ITC) and associated Exposure Draft (ED) is to seek comments on the proposal to issue a PBE Standard based on IFRS 17 *Insurance Contracts*. The proposed standard would be applicable to Tier 1 and Tier 2 PBEs.

2. We are not seeking feedback on the underlying requirements of IFRS 17. However, we are interested in your comments regarding any PBE-specific issues with those underlying requirements.

1.2 Background

3. The NZASB is proposing to issue a new PBE Standard based on IFRS 17, which was issued by the International Accounting Standards Board (IASB) in May 2017 as a replacement for IFRS 4 *Insurance Contracts*.[2]

4. IFRS 17 establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts issued. It also requires similar principles to be applied to reinsurance contracts held and investment contracts issued with discretionary participation features. IFRS 17 does not apply to insurance contracts in which the entity is the policyholder, unless those contracts are reinsurance contracts held.

5. The current PBE Standard dealing with the accounting for insurance contracts is PBE IFRS 4 *Insurance Contracts*. PBE IFRS 4 is based on NZ IFRS 4 *Insurance Contracts*, which is based on IFRS 4. In addition, NZ IFRS 4 and PBE IFRS 4 contain two additional appendices:

   (a) Appendix C *Life Insurance Entities;* and

   (b) Appendix D *Financial Reporting of Insurance Activities*.

   These appendices carried forward existing insurance accounting requirements in New Zealand so that insurance entities would continue to apply their accounting for insurance contracts until the completion of the IASB's accounting for insurance contracts project, that is, the publication of IFRS 17.

6. IFRS 17 has been incorporated into the for-profit sector standards in New Zealand as NZ IFRS 17 *Insurance Contracts*. The effective date of IFRS 17 (and NZ IFRS 17) is annual reporting periods beginning on or after 1 January 2021.[3] Early application is permitted for entities that apply NZ IFRS 9 *Financial Instruments* and NZ IFRS 15 *Revenue from Contracts with Customers* on or before the date of initial application of NZ IFRS 17. Once NZ IFRS 17 becomes effective, there will be substantive differences between NZ IFRS and PBE Standards unless a similar change is made to PBE Standards.

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2 IFRS 4 includes only high-level requirements and essentially grandfathered existing national insurance generally accepted accounting practice (GAAP) in IFRS-compliant jurisdictions. Changes could be made to national GAAP provided they made the financial statements more relevant to the economic decision-making needs of users and no less reliable or more reliable and no less relevant to those needs. In contrast, IFRS 17 is a comprehensive standard which replaces IFRS 4.

3 The proposed deferral of the effective date of IFRS 17 is discussed later in this ITC.

The PBE Policy Approach

7. The NZASB applies the *Policy Approach to Developing the Suite of PBE Standards* (PBE Policy Approach)[4] when considering whether a new or amended IFRS® Standard should be incorporated in PBE Standards.

8. After due consideration of the factors outlined below, the NZASB has decided to issue an exposure draft (ED) of a PBE Standard based on IFRS 17.

   (a) PBE Standards currently include a standard for accounting for insurance contracts. This standard is based on IFRS 4, which is superseded by IFRS 17.

   (b) At this point in time the IPSASB has no plans to develop a standard on accounting for insurance contracts.

   (c) The introduction of new PBE requirements based on IFRS 17 would lead to higher quality financial reporting in the PBE sector.

   (d) The benefits of introducing those new PBE requirements would outweigh the costs.

   (e) IPSASB Exposure Draft 63 *Social Benefits* (ED 63) proposed to permit an entity to apply the insurance approach for some contributory social benefit schemes where:

      (i) those schemes are intended to be fully funded; and

      (ii) evidence exists that the entity manages the scheme in the same way as an issuer of insurance contracts, including assessing the financial performance and financial position on a regular basis.

   ED 63 did not include requirements for the insurance approach. Instead an entity applies the relevant international or national standard which contains substantially the same principles as IFRS 17.

   (f) Certain entities, both for-profit and public benefit entities (PBEs) that carry out insurance activities in New Zealand are required to be licenced by the Reserve Bank of New Zealand and are subject to regulation. It is, therefore, desirable that all licenced insurers apply the same requirements when preparing their financial statements.

1.3 Timeline and next steps

9. Submissions on NZASB ED 2018-7 are due by **17 May 2019**. Information on how to make submissions is provided on page 4 of this Invitation to Comment.

10. After the consultation period ends, we will consider the submissions received, and subject to the comments in those submissions, we expect to finalise and issue a PBE Standard based on IFRS 17.

[4] The XRB's PBE Policy Approach is available at https://www.xrb.govt.nz/reporting-requirements/policy-statements/

2. Overview of Invitation to Comment and ED

2.1 Summary

11. This Invitation to Comment seeks feedback on NZASB ED 2018-7 PBE IFRS 17 *Insurance Contracts* and identifies issues on which we are particularly keen to receive your comments.

12. The Invitation to Comment is organised as follows.

    (a) Approach taken to developing the ED.

    (b) Overview of the requirements of IFRS 17.

    (c) Proposed PBE-specific modification.

    (d) Issues considered by the NZASB.

    (e) RDR concessions.

    (f) Effective date and other comments.

2.2 Approach taken in developing the ED

13. In accordance with its usual approach to developing a PBE Standard based on an IFRS® Standard the NZASB has:

    (a) aligned terminology with that used in PBE Standards;

    (b) ensured coherence within PBE Standards by considering the existence of New Zealand specific standards or requirements; and

    (c) considered whether there is a need for any PBE-specific modifications to the requirements of the IFRS Standard.

14. In developing the ED, the NZASB consulted with some external parties that might be affected by the forthcoming standard to assist the NZASB in identifying any requirements in IFRS 17 that may not be appropriate for PBEs or that could require PBE-specific modifications. Issues considered by the Board are described in section 2.5 below.

15. Having considered the issues identified, the NZASB has proposed one PBE-specific modification to the scope of PBE IFRS 17 (see section 2.4 below). No PBE-specific modifications have been proposed to the recognition and measurement requirements of IFRS 17. This ITC seeks feedback on whether further PBE modifications are required in respect of certain issues (for example, in respect of the risk adjustment).

16. Only limited changes were made to the requirements of IFRS 17 and the consequential amendments arising from IFRS 17, to ensure the coherence of the suite of PBE Standards. These changes were based on a consideration of:

    (a) the links between the proposed PBE IFRS 17 and those PBE Standards that differ from the for-profit equivalent standard (for example, references to IFRS 13 *Fair Value Measurement* and IFRS 15 *Revenue from Contracts with Customers*); and

    (b) forthcoming minor amendments to IFRS 17 approved by the IASB in June 2018 to reflect the IASB's intentions.[5]

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[5] These amendments will be included as part of the IASB's next *Annual Improvements to IFRS Standards Cycle.*

17. The NZASB also has some other active projects which could be affected by the proposals in PBE IFRS 17. It has dealt with the interaction between these proposals as follows.

    (a) *Financial Instruments*. The NZASB has not aligned the proposals in this ED with those in NZASB ED 2018-5 PBE IPSAS 41 *Financial Instruments*. That ED was issued in November 2018 and is still open for comment. However, the NZASB has shown how the proposals in this ED would affect the proposed PBE IPSAS 41 and any other PBE Standards amended by the proposed PBE IPSAS 41 (see Appendix D of this ED).

    (b) *PBE Combinations*. The NZASB has not aligned the proposals in this ED with those in NZASB ED 2018-4 PBE IPSAS 40 *PBE Combinations.* That ED was issued in September 2018 and is still open for comment. The NZASB plans to align the requirements as it finalises those standards. However, the NZASB has shown how the proposals in this ED would affect both PBE IFRS 3 *Business Combinations* and the proposed PBE IPSAS 40 (see Appendix D of this ED). (Once finalised, PBE IPSAS 40 will replace PBE IFRS 3.)

18. The NZASB's proposals would result in substantial alignment between NZ IFRS and PBE Standards on accounting for insurance contracts.

19. The ED includes proposed narrow scope amendments to IFRS 17 that were agreed by the IASB at its meeting in June 2018. These amendments do not change the requirements in IFRS 17 – they are intended to ensure that the wording of IFRS 17 is consistent with the decisions that the IASB made in the development of the standard. The IASB agreed to include the amendments in the next *Annual Improvements to IFRS Standards Cycle*.[6] [7] These proposed amendments are shown in the ED as blue shaded text, with new text underlined and deleted text struck through.

2.3 Overview of the requirements of IFRS 17

20. The recognition, measurement and disclosure requirements proposed in the ED are consistent with the requirements in IFRS 17. We have described the requirements in IFRS 17 below using the terminology from that standard. However, the ED has been updated for appropriate PBE terminology, such as replacing the term profit with surplus.

Scope

21. An entity applies IFRS 17 to insurance contracts, including reinsurance contracts, it issues, reinsurance contracts it holds, and investment contracts with discretionary participation features that it issues (provided the entity also issues insurance contracts).

22. Insurance contracts are identified in IFRS 17 as 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.

[6] The annual improvements cycle is limited to changes that either clarify the wording in a standard or correct relatively minor unintended consequences, oversights or conflicts between existing requirements of standards.

[7] The proposed IASB amendments to be included in the next *Annual Improvements to IFRS Standards Cycle* are set out in IASB agenda papers 2A and 2B from the IASB June 2018 meeting. These agenda papers are available at www.ifrs.org/-/media/feature/meetings/2018/june/iasb/ap02a-ic.pdf and www.ifrs.org/-/media/feature/meetings/2018/june/iasb/ap02b-ic.pdf

Separating components from an insurance contract

23. An insurance contract may contain one or more components that would be within the scope of another Standard if they were separate contracts. IFRS 17 requires that an entity separate specified embedded derivatives, distinct investment components and distinct non-insurance goods or services from insurance contracts.

Level of aggregation

24. IFRS 17 requires that an entity identify portfolios of insurance contracts. A portfolio comprises contracts subject to similar risks and managed together. IFRS 17 then requires an entity to divide the contracts in each portfolio on initial recognition into groups of contracts based on profitability. At a minimum an entity shall divide a portfolio of insurance contacts into:

    (a) a group of contracts that are onerous at initial recognition, if any;[8]

    (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.

25. An entity is prohibited from grouping contracts issued more than one year apart (except in certain circumstances when applying IFRS 17 for the first time).

26. Where contracts within a portfolio would fall into different groups only because law or regulation specifically constrains an entity's practical ability to set a different price or level of benefits for policyholders with different characteristics, IFRS 17 permits an entity to include those contracts in the same group.

Measurement

27. IFRS 17 contains two measurement approaches.

The general model

28. The general model is the primary approach in IFRS 17 for insurance contracts.

29. Under the general model, on initial recognition an entity measures a group of insurance contracts as the sum of:

    (a) the risk-adjusted present value of unbiased and probability-weighted estimates of future cash flows (the fulfilment cash flows); and

    (b) an amount representing the unearned profit in the group of contracts that the entity will recognise as services are provided (the contractual service margin).

30. The inclusion of the contractual service margin (CSM) in the initial measurement results in no gain arising from the initial recognition of the group of insurance contracts. The CSM is allocated to profit or loss over the period the entity provides insurance coverage and as the entity is released from risk. If a group of contracts is or becomes loss-making, the entity recognises the loss immediately in profit or loss.

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[8] An insurance contract is onerous at the date of initial recognition if the fulfilment cash flows allocated to the contract, any previously recognised acquisition cash flows and any cash flows arising from the contract at the date of initial recognition in total are a net outflow (paragraph 47 of IFRS 17).

31. Subsequent to initial recognition, the total liability of a group of insurance contracts is made up of the liability for remaining coverage and the liability for incurred claims.

32. The liability for remaining coverage is an entity's obligation under existing insurance contracts for insured events that have not yet occurred (i.e. the obligation that relates to the unexpired portion of the coverage period). The liability for remaining coverage is measured as the fulfilment cash flows under the contract, plus the remaining contractual service margin.

33. The liability for incurred claims is the entity's obligation for valid claims that have already occurred, including events that have already occurred, but which have not been reported. The liability for incurred claims is measured as the fulfilment cash flows for claims and expenses incurred but not yet paid.

34. The general model applies to all groups of insurance contracts in the scope of IFRS 17. However, simplifications or modification apply to groups of:

    (a) insurance contracts measured using the premium allocation approach (see below);

    (b) investment contracts with direct participation features; and

    (c) reinsurance contracts held.

Premium allocation approach (PAA)

35. IFRS 17 provides a simplified measurement approach (referred to as the premium allocation approach or PAA) for the liability for remaining coverage for groups of insurance contracts that are not onerous. This approach has some similarities to the existing approach in Appendix D of PBE IFRS 4 that some PBEs with insurance activities currently apply. However, there are differences.

36. IFRS 17 permits the use of the PAA where:

    (a) the coverage period of each contract in the group (including coverage arising from all premiums within the contract boundary) is one year or less; <u>or</u>

    (b) 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 general model.

37. Under the PAA, on initial recognition the liability for remaining coverage is equal to the premiums received less any insurance acquisition cash flows. The amount of premiums does not include any premiums due or expected.

38. At the end of each reporting period, the liability for remaining coverage is adjusted for premiums received during the period, insurance acquisition cash flows and insurance revenue recognised.

39. Insurance revenue for the period is the amount of expected premium receipts allocated to the period – typically on the basis of the passage of time, unless the expected pattern of release of risk during the period differs significantly from the passage of time.

40. Therefore, when measuring the liability for remaining coverage under the PAA an entity is not explicitly required to measure:

    (a) the present value of future cashflows;

    (b) a risk adjustment; and

    (c) the contract service margin.

41. However, when facts and circumstances indicate that a group of contracts is onerous, an entity calculates the liability for remaining coverage using the general model's fulfilment cash flows requirements, with certain simplifications if specified conditions are met.

42. The liability for incurred claims under the PAA is measured at the amount of the fulfilment cash flows relating to incurred claims, in a similar way as the general model. However, if the future cash flows are expected to be paid or received within one year or less from when they are incurred, then an entity may choose not to adjust the future cash flows for the time value of money.

Assets backing insurance liabilities

43. Under NZ IFRS 4 (and PBE IFRS 4) assets backing insurance liabilities are required to be measured at fair value through profit or loss (or fair value through surplus or deficit). IFRS 17 does not contain an equivalent requirement. IFRS 17 generally does not set requirements for other assets and liabilities of entities that issue insurance contracts, because those assets and liabilities fall within the scope of other IFRS Standards.

Presentation and Disclosure

44. IFRS 17 requires that an entity:

    (a) presents separately insurance revenue, insurance service expenses and insurance finance income or expenses.

    (b) discloses information to enable users of financial statements to assess the effect that contracts within the scope of IFRS 17 have on the financial position, financial performance and cash flows of an entity. To do this, an entity discloses qualitative and quantitative information about:

        (i) the amounts recognised in its financial statements from insurance contracts;

        (ii) the significant judgements, and changes in those judgements, made when applying the Standard; and

        (iii) the nature and extent of the risks from contracts within the scope of the Standard.

2.4 Proposed PBE-specific modification

45. IFRS 17 applies to insurance contracts.[9] Some PBEs that currently apply PBE IFRS 4 may have 'insurance-like' activities or schemes that arise from statute rather than contract. These entities may have elected to apply PBE IFRS 4 as an accounting policy choice.

46. The NZASB considered whether PBEs with 'insurance-like' activities that would be outside the scope of IFRS 17 should be captured within the scope of a PBE Standard based on IFRS 17.

47. At the date of publishing this ITC, the NZASB is aware that the International Public Sector Accounting Standards Board (IPSASB) has approved for issue an IPSAS dealing with social benefits.[10] IPSASB ED 63 *Social Benefits* proposed that entities with contributory social benefit schemes that met certain criteria could elect to apply IFRS 17 or national standards that have

[9] A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event) adversely affects the policyholder (paragraph 13.1 of the ED).

[10] IPSAS 42 *Social Benefits* was approved by the IPSASB at its meeting in December 2018. The IPSASB plans to issue IPSAS 42 at the end of January/beginning of February2019.

adopted substantially the same principles as IFRS 17 (referred to as the "insurance approach").

48. The NZASB considered the proposals in ED 63 and commented on them to the IPSASB. In its comment letter to the IPSASB on ED 63, the NZASB (i) broadly supported the criteria proposed by the IPSASB for a social benefit scheme to be able to apply the insurance approach, and (ii) was of the view that the insurance approach should be mandatory rather than optional for contributory social benefit schemes that met the criteria.

49. The NZASB is, therefore, proposing to amend the scope of PBE IFRS 17 to capture schemes that are eligible to apply the insurance approach under IPSAS 42 *Social Benefits*.

50. The types of schemes that are proposed to be included in the scope of PBE IFRS 17 are those:

    (a) that are intended to be fully funded from contributions and levies; and

    (b) where there is evidence that the entity manages the scheme in the same way as an issuer of insurance contracts, including assessing the financial performance and financial position of the arrangement on a regular basis.

51. Some respondents to IPSASB ED 63 expressed concerns regarding the requirement that the scheme is intended to be fully funded from contributions and levies. These respondents considered that there would be cases where the requirements in IFRS 17 would be appropriate when a scheme was *substantially* funded from contributions and levies rather than *fully* funded from contributions and levies. A particular concern is that contributions made by a controlling entity to a controlled entity within the group would be classified as "fully funded" in the controlled entity's financial statements but not in the consolidated financial statements.

52. The IPSASB has considered these comments and has agreed that where another entity made contributions on behalf of those who could not afford to do so, these should be treated as contributions and the scheme classified as being fully funded from contributions and levies. The IPSASB agreed to include Application Guidance to clarify this point in the forthcoming standard on Social Benefits.

53. The ED includes Application Guidance from the forthcoming IPSAS on social benefits on determining:

    (a) whether a scheme is intended to be fully funded from contributions and levies; and

    (b) whether a scheme is being managed in the same way as an insurer would manage an insurance portfolio.

54. The proposed Application Guidance in the ED on determining whether a scheme is intended to be fully funded clarifies:

    (a) where an entity may be required to make contributions to a scheme on behalf of those individuals and/or households who could not afford to do so (e.g. a public sector entity that may be required to make contributions to a scheme for those individuals who are unemployed) and the contributions relate to specified individuals and/or households, the contributions made by the entity are to be treated as contributions for the purposes of determining whether a scheme is intended to be fully funded;

    (b) the contributions in (a) may be made by the entity administering the scheme itself or by some other entity; and

(c) in assessing whether a scheme is intended to be fully funded from contributions and levies, an entity considers substance over form. For example, where a scheme is in deficit for a period but the scheme has an ability to adjust the future contribution rates and/or benefits payable such that the deficit is addressed.

55. The ED does not propose any further PBE-specific modifications to the requirements of IFRS 17. Issues considered by the NZASB to determine whether additional PBE-specific modifications were needed to the requirements of IFRS 17 are discussed in section 2.5 below.

Questions for respondents

1. Do you agree with the proposed scope modification in the ED to capture schemes that are eligible to apply the insurance approach under the IPSASB's forthcoming IPSAS dealing with social benefits? If you disagree, please explain why.

2. Are there any schemes that the proposed scope modification would capture, for which the requirements of proposed PBE IFRS 17 are not appropriate? If so, please identify those schemes and explain why the requirements of PBE IFRS 17 are not appropriate.

2.5 Issues considered by the NZASB

56. The NZASB considered the following issues in determining whether PBE-specific modifications were needed to the requirements of IFRS 17.

(a) Whether the scope of a PBE Standard based on IFRS 17 would need to be modified to capture PBEs with 'insurance-like' activities that are created by statue, rather than contract (see section 2.4 above).

(b) Whether a risk adjustment is appropriate for PBEs.

(c) Whether the contract boundary is sufficiently clear for PBEs that are funded through levies.

(d) Whether the requirements of IFRS 17 to divide portfolios of insurance contracts into more granular groups of contracts and assess onerous contracts at that granular level are appropriate for PBEs.

(e) Whether the discount rate described in IFRS 17 is appropriate for PBEs, specifically the need for the discount rate to factor in liquidity.

(f) Whether the onerous contract requirements of IFRS 17 are appropriate for public sector PBEs with 'insurance-like activities' where funding is determined on a different basis to how the insurance liability is measured.

57. The Australian Accounting Standards Board (AASB) considered the suitability of the requirements of IFRS 17 for private not-for-profit entities when developing of AASB 17 *Insurance* Contracts. AASB 17 was issued in July 2017 and is applicable to for-profit entities and not-for-profit private sector entities. No changes were made to the recognition and measurement requirements in IFRS 17 when AASB 17 was developed. The AASB subsequently sought feedback on the appropriateness of the requirements for public sector entities.

58. In November 2017 the AASB issued AASB Discussion Paper *Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities.*[11] This Discussion Paper proposed that the scope of AASB 17 be expanded to include 'insurance-like' arrangements that are created by

[11] Available at www.aasb.gov.au/admin/file/content105/c9/ACCDP_Aus_Specific_Insurance_Issues_11-17.pdf

statute, rather than contractual arrangements. Additional guidance on determining whether an arrangement is insurance-like was also proposed to be added to AASB 17.

59. The AASB is currently considering feedback received from constituents on the Discussion Paper and is undertaking further work on some issues raised by respondents.[12]

Whether a risk adjustment is appropriate for certain PBEs

60. ED PBE IFRS 17 requires that a risk adjustment be included in determining the liability for remaining coverage under the general approach and the liability for incurred claims under both the general model and the PAA.

61. Currently PBEs applying Appendix D of PBE IFRS 4 are required to apply a risk margin in determining outstanding claims liabilities. PBE IFRS 4 does not prescribe a fixed margin or the level of adequacy required, but states that risk margins adopted for regulatory purposes may be appropriate for the purposes of the standard, or as a starting point in determining such margins.

62. Some PBEs with insurance activities, particularly public sector PBEs, may have the power to recover cost overruns in any given period by increasing premiums/levies in future periods. The NZASB acknowledges existing concerns that, for PBEs with such power:

    (a) at a broader level, some disagree with the inclusion of a risk adjustment when measuring long-term liabilities for public sector entities, including liabilities arising from insurance contracts and 'insurance-like' schemes (see further discussion in paragraph 66 below); and

    (b) even if the inclusion of a risk adjustment is appropriate, it may not be appropriate for the risk adjustment for these public sector entities to reflect the risk margins adopted for regulatory purposes by for-profit insurers without such powers.

63. On the point in paragraph 62(b) above, the NZASB noted that ED PBE IFRS 17 explicitly requires that the risk adjustment for non-financial risk reflect an entity's own perception of its degree of risk aversion. Paragraph 87 of ED PBE IFRS 17 states that:

> "The risk adjustment for non-financial risk for insurance contracts measures the compensation that <u>the entity</u> would require to make <u>the entity</u> indifferent between [emphasis added]:
>
> (a) fulfilling a liability that has a range of possible outcomes arising from non-financial risk; and
>
> (b) fulfilling a liability that will generate fixed cash flows with the same expected present value as the insurance contracts."

64. The IASB concluded in paragraph BC209 of IFRS 17 that:

> "…a risk adjustment for non-financial risk <u>should not</u> represent [emphasis added]:
>
> (a) the compensation that a market participant would require for bearing the non-financial risk that is associated with the contract. As noted in paragraph BC17, the measurement model is not intended to measure the current exit value or fair value, which reflects the transfer of the liability to a market participant. Consequently, the risk adjustment for non-financial risk should be determined as the amount of compensation that the entity—not a market participant—would require.
>
> (b) an amount that would provide a high degree of certainty that the entity would be able to fulfil the contract. Although such an amount might be appropriate for some regulatory purposes, it is not compatible with the Board's objective of providing information that will help users of financial statements make decisions about providing resources to the entity."

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[12] The Action Alert from the AASB meeting in September 2018 is available at www.aasb.gov.au/admin/file/content102/c3/194-ActionAlert.pdf

65. The NZASB noted that the requirements in ED PBE IFRS 17 are explicit that the risk adjustment is determined from the perspective of the entity issuing the insurance contract. ED PBE IFRS 17 does not require an entity to adopt a risk adjustment that reflects the risk margins adopted for regulatory purposes. Accordingly, for public sector entities, the risk adjustment under ED PBE IFRS 17 for a public sector PBE could be small, and even potentially immaterial.

66. The above discussion focuses on determining the amount of the risk adjustment. However, as noted in paragraph 62(a) above, the NZASB acknowledges that some hold a broader view that, as a general principle, in the public sector it may not be necessary to include a risk adjustment for the measurement of longer-term liabilities. This issue relates not only to liabilities arising from insurance contracts and 'insurance-like' activities, as it also relates to other types of long-term liabilities. The NZASB is interested in receiving feedback on this point.

67. The proposals in ED PBE IFRS 17 reflect the NZASB's preliminary view that although PBEs with the ability to recover cost overruns by increasing premiums/levies in future periods might have a less risk averse approach to an equivalent entity which does not have such ability, such PBEs are still expected to have a risk adjustment (subject to materiality), albeit lower than that of an equivalent entity without such powers.

Question for respondents

3. Do you agree that no PBE-specific modifications are needed to the requirements of IFRS 17 in respect of the risk adjustment? If you disagree, please explain why.

Whether the contract boundary is clear for PBEs that are funded through levies

68. Concerns have been raised, primarily by public sector PBEs, that there is a lack of clarity around the contract boundary for PBEs with 'insurance-like' activities that are funded by levies (or some other means other than by way of premiums). This can make it difficult for such entities to determine their obligation for insured events related to the remaining coverage period and to determine whether a contract is onerous. Any lack of clarity around the contract boundary could also make it difficult for entities to determine their eligibility to apply the PAA.

69. The NZASB noted the requirements in IFRS 17 that cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the entity can compel the policyholder to pay the premiums or in which the entity has a substantive obligation to provide the policyholder with services. A substantive obligation to provide services ends when:

(a) the entity has the practical ability to reassess the risks of the particular policyholder and, as a result, can set a price or level of benefits that fully reflects those risks; or

(b) both of the following criteria are satisfied:

(i) the entity has the practical ability to reassess the risks of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio; and

(ii) the pricing of the premiums for coverage up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date.

70. The NZASB considered the requirements in IFRS 17 for determining the boundary of an insurance contract for a PBE that is funded through levies rather than premiums. The NZASB is

of the view that the requirements are sufficiently clear for such a PBE to determine the contract boundary.

Questions for respondents

4. Are the provisions regarding the contract boundary clear enough for PBEs that are funded through levies rather than through premiums? If not, please explain how these provisions could be improved.

5. Are you aware of any PBEs within the scope of the ED:

   (a) that are funded by levies (or some means other than by way of premiums) but which would not be eligible to apply the premium allocation approach; and

   (b) for which the requirements of the general model would not be appropriate?

   If you are aware of such PBEs, please explain why the requirements of the general model would not be appropriate.

Whether the requirement of IFRS 17 to divide portfolios of insurance contracts into more granular groups of contracts and assess onerous contracts at that granular level are appropriate for PBEs.

71. IFRS 17 requires that portfolios of insurance contracts are divided into groups considering differences in the expected profitability of the contracts (only contracts issued in the same year can be included in the same group).

72. For contracts that at initial recognition are expected to be loss-making (i.e. onerous) an entity will recognise losses immediately.

73. These contracts may previously have been offset against profit-making contracts. This offsetting will no longer be permitted.

74. However, the grouping requirements in IFRS 17 include an exemption for economic differences that arise as a result of regulatory restrictions. For example, regulation might restrict an insurer from charging different premiums to policyholders because of specific characteristics, such as gender or age.

75. When the reason for the difference in profitability arises from such regulations, paragraph 20 of IFRS 17 allows the entity to include such contracts in the same group – even though expected profitability is different.

76. The NZASB noted that similar concerns have been expressed by for-profit insurers and did not believe that this was an issue specific to PBEs. Therefore, the NZASB has not proposed any amendments to the requirements in IFRS 17 in respect of this issue.

Discount rate

77. IFRS 17 specifies that the discount rates applied to the estimates of the future cash flows shall:

    (a) reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts;

    (b) be consistent with observable current market prices (if any) for financial instruments with cash flows whose characteristics are consistent with those of the insurance contracts, in terms of, for example, timing, currency and liquidity; and

(c) exclude the effect of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts.

78. Concerns have been raised regarding whether it is appropriate for a public sector PBE to apply a discount rate that includes an adjustment for liquidity.[13] It was also noted that the discount rate approach in PBE IPSAS 39 *Employee Benefits* does not include a requirement for a liquidity adjustment.

79. The NZASB noted that inconsistencies in the application of discount rates is a wider issue. Therefore, for the purposes of PBE IFRS 17 the NZASB has not proposed any amendments to the requirements of IFRS 17 in relation to discount rates. However, the NZASB is interested in receiving feedback on this issue.

Question for respondents

6. Do you agree that no PBE-specific modifications are needed to the requirements of IFRS 17 in respect of:

   (a) the requirements to divide portfolios of insurance contracts into more granular groups of contracts and assess onerous contracts at that granular level; and

   (b) the discount rate?

   If you disagree, please explain why.

Onerous contracts

80. Onerous contracts are grouped separately from contracts that are not onerous. An insurance contract (or group of insurance contracts) is onerous at the date of initial recognition if the fulfilment cash flows allocated to the contract, any previously recognised acquisition cash flows and any cash flows arising from the contract at the date of initial recognition in total are a net outflow. A loss is recognised in surplus or deficit for the net outflow for the group of onerous contracts. This results in the carrying amount of the liability for the group being equal to the fulfilment cash flows and the CSM of the group being zero.

81. In the public sector, for broader policy reasons, it is possible contributions or levies charged are determined on a different basis to how the fulfilment cash flows allocated to insurance contracts are measured under IFRS 17. For example, a levy charged by a public sector scheme may have been reduced for the current financial year or an annual levy may be held at the same level for a fixed number of years. This could result in the relevant fulfilment cash flows reflecting a net cash outflow and thus reported at the date of initial recognition as being onerous. This could be the case even when the wider public sector considers the overall scheme is adequately funded.

82. The NZASB is aware of a view that the requirements regarding onerous contracts may not be appropriate in such situations. The NZASB is interested in receiving feedback on this view.

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[13] The IASB's rationale for including an adjustment for liquidity in the discount rate is discussed in the IASB's Basis for Conclusion on IFRS 17, paragraphs BC193–BC197. The IASB's Basis for Conclusions on IFRS 17 is available on the XRB website at www.xrb.govt.nz/accounting-standards/for-profit-entities/nz-ifrs-17/ for constituents that have a New Zealand-assigned IP address.

Questions for respondents

7. If you are of the view that the requirements regarding onerous contract contained in PBE IFRS 17 are not appropriate for schemes where funding is determined on a different basis to how the insurance liability is measured, please explain why, and what alternative approach the NZASB should consider for such schemes.

8. Are there any other requirements in the proposed PBE IFRS 17 that may require modification for PBEs? If, there are, please explain the requirement, the reason why the requirement needs to be modified for application by PBEs and how the requirement should be modified.

2.6 RDR concessions

83. The NZASB is not proposing any RDR concessions for Tier 2 PBEs. PBE IFRS 4 does not contain any RDR concessions for Tier 2 PBEs and there are no RDR concessions in NZ IFRS 17 for Tier 2 for-profit entities.

Question for respondents

9. Do you agree that there should be no RDR concessions in PBE IFRS 17 for Tier 2 PBEs? If you disagree, please explain why and identify the disclosures that should be identified as RDR concessions. It would also be helpful if you could include a description of any PBEs that are within the scope of the proposed PBE IFRS 17 and qualify for reporting in accordance with Tier 2 PBE Standards.

2.7 Effective date and other comments

84. The proposed effective date in the ED is 1 January 2022. Earlier adoption is permitted as long as an entity applies forthcoming PBE IPSAS 41 *Financial Instruments* on or before the date of initial application of PBE IFRS 17. This date is tentative and would be reviewed prior to issuing the standard.

85. At its meeting in November, the IASB tentatively decided to defer the mandatory effective date of IFRS 17 to annual reporting periods beginning on or after 1 January 2022 (from 1 January 2021). This means that, subject to due process, the effective dates of IFRS 17, NZ IFRS 17 and PBE IFRS 17 would be aligned.

86. The ED does not include the non-integral illustrative examples that accompany NZ IFRS 17. These illustrative examples are available in the additional material for NZ IFRS 17 on the XRB website at www.xrb.govt.nz/accounting-standards/for-profit-entities/nz-ifrs-17/ for constituents that have a New Zealand-assigned IP address.

Questions for respondents

10. Do you agree with the proposed effective date of 1 January 2022, with early adoption permitted as long as an entity also applies PBE IPSAS 41 *Financial Instruments* at the same time? If you disagree, please explain why.

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

2.8 Current developments regarding IFRS 17

87. At its meeting in December, the IASB will consider some of the concerns and implementation challenges with IFRS 17 discussed by the Transition Resource Group and other stakeholders and decide whether amendments are needed to the standard.[14]

88. At its October meeting, the IASB agreed that any proposed amendments must meet specified criteria and will be subject to normal due process, with an ED being issued at some point in the future.[15] The specified criteria include a stipulation that any amendments would not unduly disrupt implementation already under way or risk undue delays in the effective date of IFRS 17.

89. In order to provide PBEs with enough time to consider the proposals in ED PBE IFRS 17, and to plan for its implementation, the NZASB wishes to seek feedback on the requirements in the proposed standard as soon as possible. Despite potential amendments to the requirements of IFRS 17, the NZASB considers that it is still appropriate to issue ED PBE IFRS 17 for comment given that any amendments would be limited to those that would not lead to undue disruption to the implementation of IFRS 17.

90. In the event that the IASB proposes amendments to IFRS 17, the NZASB expects to issue an ED in New Zealand and seek feedback from both for-profit entities and PBEs at the same time.

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[14] The concerns and challenges being considered by the IASB at its December meeting are outlined in agenda paper 2, available at https://www.ifrs.org/-/media/feature/meetings/2018/december/iasb/ap2-insurance-contracts.pdf. Agenda papers 2A–2F discuss the issues in more detail.

[15] The criteria that any proposed amendments to IFRS 17 must meet are outlined in the October IASB Update, which is available at https://www.ifrs.org/news-and-events/updates/iasb-updates/october-2018/#4