17 May 2019

Chief Executive
External Reporting Board
PO Box 11250
Manners St Central
Wellington 6142
New Zealand

Dear Sir/Madam

NZASB Exposure Draft 2018-7: PBE IFRS 17 Insurance Contracts

Thank you for the opportunity to comment on this Exposure Draft. We submit comments on specific matters from the Earthquake Commission in the attachment.

Yours sincerely

Chris Chainey

Chief Financial Officer, Earthquake Commission

Specific Matter #1 and 2:

No comment.

Specific Matter #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.

There is a lack of clarity about the role of the risk adjustment in a scheme underwritten by the government. We refer you to the commentary from The Treasury in relation to this.

In addition, the risk adjustment specified under PBE IFRS 17 is different from that under PBE IFRS 4, being specifically defined as the compensation that the entity would require to make the entity indifferent between the range of possible outcomes and a series of fixed cash flows with the same expected value. It is not clear how this will be determined/implemented in practice.

In some government-underwritten schemes, the government may be fairly neutral in regard to the uncertainty of scheme payments, thus requiring only a very small or even nil risk adjustment, we do not believe this is the case with EQC, because we cover catastrophic perils – our events by nature are both relatively rare and can be extremely large. Both of these key users of our financial statements prefer to understand more of a worst case scenario in relation to the events we cover.

We would appreciate more guidance on how the proposed form/role of the risk adjustment within the public sector would work.

Specific Matter #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.

The contract boundary provisions are not clear for PBEs that are funded through levies rather than through premiums and this leads to a significant issue for these PBEs. These levies are set through legislation and control over setting the levies sits with the Government rather than with the PBE. The legislation may not prescribe a timeframe for changing the levy or it may be set for a review period greater than one year that might then have the consequence of not allowing the PBEs funded through levies to apply the premium allocation approach.

Private insurers have an agency relationship with EQC and collect the levies set by the Government on our behalf. The levy is set by the Government and although EQC can make a submission on the levy and recommend a change, the final decision sits with the Government. The Act does not prescribe a specific timeframe for reviewing the levies which results in a judgement area when determining the contract boundary for EQC. The large majority of insurance contracts within the private sector are for terms of one year. We assume that under NZ IFRS 17, the private sector would therefore be eligible to apply the premium allocation approach without having to prove no material difference to the general approach. This would lead to a counter intuitive situation where the private insurers would likely account for the insurance contracts as a one year contract under the premium allocation approach (i.e. no CSM spreading) whereas the public sector could be required to

apply the general model when their purpose is social benefit and is not profit oriented. This could lead to differing presentations within financial statements for the same length of cover when public sector have no investors as such and one major aim of the project is to aid comparability. If EQC could not apply the 12month practical expedient then we would be required to go down the route of recalculating the measurement of insurance contracts under the general model to determine that the measurement would not differ materially if EQC had applied the premium allocation approach. This seems counter intuitive due to the cost involved in obtaining the resources necessary to make this determination.

Indeed, if the contract boundary were not one year, it would appear that it would then default to a combination of when the home or insurance was originally purchased and extend until the next planned review of the levy rate or when the home is sold. These parameters would make the calculations significantly more complicated, and indeed, perhaps impossible. In addition, we do not feel they add any value to the users of the financial statements.

Our recommendation would be to include in the Standard a practical expedient for PBEs that do not have direct control over setting levies to either:

- Apply the premium allocation approach when levies are not controlled by the PBE, i.e. set by the Government; or
- Adopt the contract term from the point of view of the policy holder, i.e. in this case it would be one year, or
- Specifically deem that the contract boundary is one year for PBEs which are funded by levies where the government could change the levy in this time.

Specific Matter #5:

No comment.

Specific Matter #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

The requirement to divide portfolios of insurance contracts into more granular groups of contracts should include modifications for PBEs that are funded by levies. (See also our comments on the assessment of whether the portfolio of insurance contracts is onerous.)

We also do not believe contract year is a useful grouping for EQC exposure.

Our recommendation would be to include in the Standard a practical expedient for PBEs that are funded by levies to allow the level of disaggregation to be limited to the same level at which levies are set by the Government. For EQC, this would currently be one group.

b) the discount rate?

We agree that risk free discount rates are appropriate. We believe the addition of a liquidity premium is problematic, primarily because it would be difficult to determine in the public sector context, and therefore suggest this is omitted. EQC is able to draw on funds from government and reinsurer's loss accounts with very little notice.

Specific Matter #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.

In considering the users of our financial statements, we believe it is important to identify if we do not believe our levy income will meet our expected costs. This is the case at present, due to enhanced seismicity from the Canterbury/Kaikoura earthquakes. We would prefer to avoid the concept of a "Contractual Service Margin" which has no place in a not-for-profit scheme – any levy income not used in the current year is invested in the Natural Disaster Fund to provide funds for future events. If, as we have requested, EQC is deemed to have a one year contract boundary and only one "group" of business, then it is appropriate to disclose whether the unexpired premium is onerous or not, as we do currently under PBE IFRS 4. As mentioned above, we do not believe a contract boundary of greater than one year is workable. We believe there are strong arguments against a greater disaggregation of EQC's book of business due to its nature as social insurance which take precedence over the role of accounting standards.

Specific Matter #8:

Are there any 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.

EQC is a Crown entity established under the Act. Our function is to provide natural disaster insurance for residential properties, administer the Natural Disaster Fund (including its investments and reinsurance) and fund research and education on natural disasters and ways of reducing their impact. EQC has an intergenerational outlook on natural disasters and its objective is not to earn a profit on our operations but to build up the Natural Disaster Fund for when a significant event occurs, such as the Canterbury sequence. EQC does not have any other investors other than the Government and as such many of the requirements in the proposed PBE IFRS 17 are not relevant to the users of our financial statements. Separating insurance contracts by level of risk (i.e. regions) is not beneficial as the Government sets levies nationwide.

In conjunction with the other comments made in this submission, we recommend that a practical expedient be introduced for PBE where the levy setting process is not within their control to apply premium allocation approach.

There are three transitions methodologies prescribed in the proposed Standard. It is a hierarchy with the 'catch-all' being the fair value approach. As we understand it, many insurers are falling into this category as they do not have the required data to undertake either the full retrospective approach or the modified retrospective approach. Given this, we have concern due to the following:

- There is no equivalent fair value Standard in the PBE suite which will lead to varying determinations and great difficulty when fair valuing the insurance contracts;
- There is currently no market data for buying and selling books of insurance contracts in the public sector which will lead to unobservable inputs determining the fair value; and
- We may have the additional factor of determining whether we could legally sell the insurance contracts which would impact the valuation.

We recommend that a simplified transition method be introduced to allow PBEs to prospectively apply PBE IFRS 17; with the comparatives being under PBE IFRS 4 and the transition year being disclosed under both PBE IFRS 4 and PBE IFRS 17. This will provide comparability to the users of the financial statements. This is an approach allowed recently with NZ IFRS 15.

Specific Matter #9:

No comment.

Specific Matter #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.

We do not agree with the proposed effective date of 1 January 2022. This timeframe is highly unusual considering it is the same effective date as NZ IFRS 17. In the past there has been a time lag between when the for-profit standard is effective and the equivalent PBE standard becoming effective, especially when the Standard brings about significant change. For example, NZ IFRS 9 was issued in September 2014 and is effective on 1 January 2019. The equivalent PBE IFRS 9 was issued in January 2017 and is effective on 1 January 2022; superseded by PBE IPSAS 41 which was issued in March 2019 and is effective on 1 January 2022.

The insurance standard is complex and is significantly different to its predecessor. This is shown in the timeframe for the implementation of the for-profit Standard. NZ IFRS 17 was issued in August 2017 and will be effective on 1 January 2022; and an extension has already been granted to the for-profit sector due to the complexity of the Standard. However, in the public sector we are currently only in the process of submitting on the exposure draft. Assuming that the submissions are acted on, this process is anticipated to bring about changes to the PBE Standard during 2020, just 2 years from the effective date. When issued, the new Standard is anticipated to require changes in systems and processes to ensure that the right data is captured to measure the insurance contracts. The current timeframe significantly disadvantages the PBE sector when considering the extent of these changes to be made.

Specifically for EQC, the public/ministerial inquiry which is currently ongoing is expected to result in changes to both EQC processes and the EQC Act. These are not yet known. Once known, the two year window mentioned above will be even less which is a significant concern.

We recommend that we are provided with the same lead-in time as the for-profit sector from when the Standard; being 5 years from the date the Standard is issued.

Specific Matter #11:

Do you have any other comments on the ED?

We note that currently there is a potential for mismatching of reinsurance and insurance assets in PBE IFRS 17 (and that this is under review). We would recommend the same amendment be included in PBE IFRS 17.