17 May 2019

Warren Allen
Chief Executive
External Reporting Board
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Dear Warren

NZASB Exposure Draft 2018-7 PBE IFRS 17 Insurance Contracts

Accident Compensation Corporation (ACC) welcomes the opportunity to provide comments to the New Zealand Accounting Standards Board on the ED PBE IFRS 17 Insurance Contracts.

We have attached our comments on specific questions asked.

Yours faithfully

John Healy

Chief Financial Officer

Specific Matter for Comment 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.

ACC agrees in principle to have the proposed scope modification to capture schemes that are eligible to apply the insurance approach under the IPSASB's forthcoming IPSAS dealing with social benefits. The type of schemes that are proposed to be included in the scope are those that are intended to be fully funded from contributions and levies and where there is evidence that the entity manages the scheme in the same way as an issuer of insurance contracts.

However, we still have some concern regarding the requirement that a scheme is intended to be fully funded and the meaning of fully funded. ACC uses a terminology for 'full funding' which relates to levies being regularly set to achieve a funding ratio over a specific timeframe (currently 105% over 10 years).

The proposed Application Guidance in the ED provides clarification on determining whether a Scheme is intended to be fully funded. In assessing whether a scheme is intended to be fully funded from contributions and levies, an entity considers substance over form. The example used is 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. In ACC's situation, whilst we recommend sustainable levies to achieve full funding of the Motor Vehicle, Earners' and Work Accounts, final levy rates are set by the Government. In addition, claims incurred before 1 July 2001 in the Non-Earners' Account are funded on a 'pay as you go' basis by the Government. Currently ACC holds the Outstanding Claims Liability (OCL) for these PAYG claims on the balance sheet.

Section 5 of the Accident Compensation Act 2001 binds the Crown, so claimants are entitled to cover under legislation. How and whether this is funded is a choice. For example, tourists to New Zealand are covered by the ACC scheme but levies are not collected directly from them (other than through the petrol levy for the Motor Vehicle Account).

It is unclear exactly why the scheme needs to be fully funded to be within the scope. The funding of the scheme does not impact whether an obligation to make a payment exists or not. ACC is concerned that some parts of our scheme are in scope and others may not be in scope. For example, would the PAYG claims for the Non-Earners' Account be excluded? Should there be requirement to apply different accounting treatment for different Accounts within the ACC scheme, the effort to this could be relatively onerous and potentially not provide better information for our users.

Specific Matter for Comment 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.

Currently, ACC adopts a risk margin to ensure that the OCL is sufficient to meet all the costs of future claim payments 75% of the time. This reflects the risk margins adopted for regulatory purposes

under PBE IFRS 4 which is accepted by our auditors as the Standard states that this may be appropriate in determining such margins.

However, ACC's view is that because we operate as a monopoly and have the power to recover cost overruns through future higher levies, there is no need for the inclusion of a risk margin when measuring our long-term liabilities or that the risk margin should be small.

ACC's funding policy explicitly ignores a risk margin for Non-Earners' Accounts (Non-Earners Account and Non-Earners' portion of Treatment Injury Account) i.e. the fully-funded target is 88%. The funding target indicates the level of assets each Account has available to cover its balance sheet OCL (which includes the risk margin). If the Government explicitly ignores the risk margin when it comes to non-earner Accounts, then the question for ACC is what the risk margin is trying to achieve. We consider that no risk margin is appropriate for ACC to align to underlying Government policy.

It appears that the concept of risk adjustment in the proposed PBE IFRS 17 is the same as risk margin in PBE IFRS 4.

We note 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. However, ACC considers that PBE-specific modification should be made to explicitly state that no risk adjustment or a small risk adjustment is appropriate for PBEs like us. Without this, we are concerned that we may get stuck in a debate with our auditors about applying a risk adjustment or not.

Specific Matter for Comment 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.

ED PBE IFRS 17 provides a safe harbour for contracts with a contract boundary of one year or less to apply a simplified measurement approach, referred to as the Premium Allocation Approach.

ACC's funding policy is set by the Government and ACC runs the levy consultation process every two years now and levy rates are set for a two-year period, rather than every year. However, we believe ACC can consult outside of the two-year timeframe if necessary. ACC can only ever recommend levy rates and the final decision is made by the Government, so there are some questions regarding ACC's "practical ability" to formally reassess the risks.

As a result, we are unclear whether we will be eligible to apply the Premium Allocation Approach. Without the ability to apply the simplified approach, we understand ACC would need to apply the general model which is likely to not differ materially but which could require significant cost and effort to do so.

ACC recommends the NZASB considers and provides guidance on the applicability of the Premium Allocation Approach for our above situation. An approach might be to explicitly state that Government social insurance agencies can apply the Premium Allocation Approach.

Specific Matter for Comment 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.

(a) ACC understands that these requirements are to provide more transparency and prevents profit-making contracts from subsidising loss-making contracts.

We question whether the rationale for these requirements is relevant for ACC. ACC provides cover for all accidents in New Zealand, including tourists. We do not 'choose' our customers.

ACC has five Accounts, three of which are fully community rated/funded being Earners', Non-Earners' and Treatment Injury. Work and Motor Vehicle Accounts both apply some class rating to the levy. There are ~540 industry classification units for the Work account and ~9 broad vehicle classes for Motor Vehicle. There are system limitations around collecting full information on accidents e.g. bicycle hit by car is a Motor Vehicle claim, but it is unlikely to define what class of vehicle hit them.

By virtue of the funding policy, all Accounts are expected to be "onerous" at the date of initial recognition, primarily due to different discount rates being applied to the levy/appropriation and the OCL (exacerbated in Non-Earner Accounts due to the funding target of only 88%). It would be challenging to determine onerous contracts at a more granular level for Motor Vehicle and Work for the underlying classes.

The funding policy looks at the funding position of each Account. In simple terms, when the Account has surplus assets, capital is given back to the levy payer by reducing the levy. If the Account has deficit assets, capital would be required by increasing the levy (as was the case when ACC was building assets to be fully funded).

The costs of collecting granular information and making an onerous assessment will be significant and we question what the benefit is for a scheme like ACC. In the absence of a sound rationale as to the benefit and relevance, ACC considers that a PBE-specific modification is required.

(b) With the discount rate, there is a question if this is directly observable in the market and may require judgement. NZ bonds currently only go to 2040, whilst ACC claims payments are projected to at least 2100. The shape of interest rates in the long-term will require some level of judgement.

We also question if an illiquidity adjustment is required and what it is trying to achieve (similar to the risk adjustment). ACC aims to match its liability with appropriate assets, including a large portion of inflation-linked bonds which better match the underlying liability. It should be noted that even small changes to the real discount rate (eg 15 basis points) is likely to increase ACC's OCL by around $1 billion.

Specific Matter for Comment 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.

As noted above, all accounts are expected to be onerous at outset. It does not seem to make sense to capitalise this at outset for ACC. Whether this is relevant to our financial information is also questionable. ACC considers the requirements regarding onerous contracts as not appropriate for us.

Specific Matter for Comment 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.

For-profit entities have had a couple of years' head start to digest IFRS 17 and their deferred effective date is the same as the proposed PBE IFRS 17. ACC considers that there will be a significant amount of work and therefore it would seem appropriate to be given the same lead-in time for PBEs.

Depending on the level of granularity required this could have large implications for OCL calculations, general ledger and claim and levy systems. We also believe there are some fundamental accounting concepts that need defining for Government social insurance agencies where individual contracts do not exist.

Specific Matter for Comment 11:
Do you have any other comments on the ED?

Assets backing insurance liabilities

Under PBE IFRS 4 assets backing insurance liabilities are required to be measured at fair value through surplus or deficit (FVTSD). PBE IFRS 17 does not contain an equivalent requirement. Currently ACC has used this requirement to measure our investment assets at FVTSD.

In the absence of this requirement, we will need to carry out an assessment under the 'solely payments of principal and interest' and 'business model' tests to determine the classification of our investment assets under PBE IFRS 9. Whilst it is likely that this will result in a similar outcome, having this requirement in PBE IFRS 17 gives certainty that we can measure our investment assets at FVTSD.

Gradual process claims

These claims are a result of injuries that have occurred due to prolonged exposure in the workplace to conditions that result in some form of harm. The most common examples of such claims are

asbestosis (due to prolonged exposure to asbestos dust in the atmosphere) and hearing loss (due to prolonged exposure to excessive noise).

Due to the nature of these injuries, many years can pass between exposure to the conditions that result in harm and the individual receiving treatment or suffering incapacity.

A gradual process claim can be made when a person is regarded as suffering personal injury caused by work-related gradual process, disease or infection which is in accordance with section 37 of the Accident Compensation Act 2001. The claim can be made at the earlier of either the date that the person first receives treatment or the date that the injury first results in incapacity.

ACC's accounting policy is to recognise a financial liability for gradual process injury only when a claim is made. The effect of the policy is that until the injury presents itself such that the person receives treatment or suffers incapacity and makes a claim, ACC does not record a liability in its OCL.

Under PBE IFRS 4, ACC discloses an IBNR liability for gradual process claims in the notes to the accounts, not in the balance sheet. This liability is also used by actuarial services to determine the Work account funding position and levy consultation. It is unclear how this liability is treated under PBE IFRS 17.