

AC-2

June 2022

Ms April MacKenzie  
Chief Executive  
External Reporting Board  
PO Box 11 250  
Manners Street Central  
Wellington 6142

Dear April

**ED NZASB 2022-3 –INSURANCE CONTRACTS IN THE PUBLIC SECTOR**

Thank you for the opportunity to comment on ED NZASB 2022-3 –Insurance Contracts in the Public Sector.

Treasury is broadly supportive of the proposed standard, as are the entities we have discussed it with. In those discussions we considered three main issues:

- *Identifying Insurance in the Public Sector:* We have made some suggestions to refine the definition of an insurance contract, clarify the application guidance and ensure that the definition and the guidance hang together better.
- *Determining the coverage period:* We have made some suggestions to mitigate a risk that we observe with the current proposals.
- *Adjusting the measure of the insurance contract liability for risk:* We have provided our analysis of this issue, with two resulting options for the Boards to consider. We have indicated our preferred option but believe either option is superior to the split alternatives the Boards have presented.

Our response to NZASB's specific questions is provided in the enclosure.

We are very happy to discuss these suggestions with the NZASB and staff further.

Yours sincerely



Jayne Winfield  
Chief Government Accountant

## Treasury'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.

The Treasury agrees 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.

In addition to the basis for conclusions arguments in the exposure draft, the Treasury observes that insurance arrangements in the public sector are often established as a statutory scheme, comprising not a set of voluntary contracts that can be sensibly grouped, but rather a single 'social contract' in which the public sector reporting entity (or issuer) in return for the receipt of compulsorily levied premiums, accepts risk from a policyholder group by agreeing to compensate the individuals within that group if a specified uncertain future event adversely affects them. It is the performance of that social contract that is of interest to users of the financial statements, and that would not be enhanced (and in fact would be hampered) by requiring the sub-grouping of contracts based on whether they are onerous or non-onerous at initial recognition.

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.

The Treasury agrees 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.

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.

The Treasury agrees 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.

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.

Treasury agrees with the proposed guidance on coverage periods. However, we do not think it is sufficient.

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.

The Treasury agrees that these disclosures should be helpful to users

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.

The current risk adjustment for insurance liabilities in the Financial Statements of Government adds over \$6 billion to the government's liabilities. A similar number is likely to be calculated under the NZASB's proposal using a rebuttable presumption of a 75 per cent confidence level for a liability for incurred claims. Preparers, auditors, and users need to be

very clear about the purpose of the IFRS 17 risk adjustment in the public sector and the usefulness of such an adjustment to users of public sector financial statements.

Under the current proposed standard, the Treasury does not think that is the case.

Our analysis of the proposals suggests two conflicting rationales for the adjustment. That in turn leads to two different interpretations of risk adjustments for public sector insurance arrangements in the proposed ED.

Despite the benefit of lower cost, the NZASB proposal leaves unclear what the adjustment achieves. Neither interpretation would necessarily result in the application of a rebuttable presumption that a risk adjustment reflecting an amount that is estimated to achieve a 75% probability of liability for incurred claims.

The AASB proposal in our view is likely to lead to unnecessary and costly debates between preparers and auditors and confusion among users. We therefore believe the joint standard setters need to clarify the principle itself in respect of public sector insurance schemes because of the conflicting rationales we see in the proposed standard.

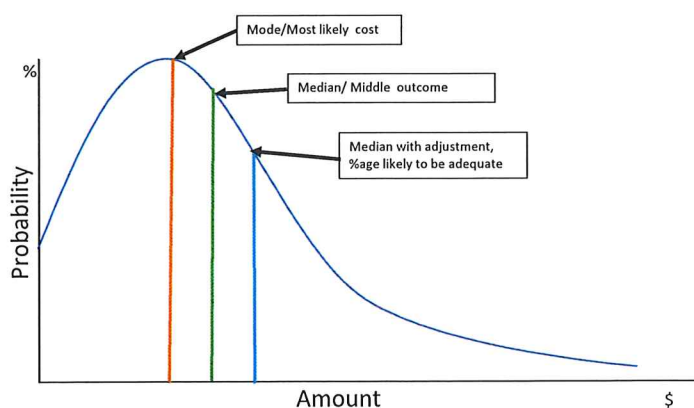
#### *First Rationale: Risk adjustment as an allowance for uncertainty*

AG89 states

“The purpose of the risk adjustment for non-financial risk is to measure the effect of uncertainty in the cash flows that arise from insurance contracts, other than uncertainty arising from financial risk.”

This purpose is further supported in the IASB’s basis of conclusions (BC211) which suggests the risk adjustment distinguishes risk-generating liabilities from risk-free liabilities. An explicit measurement of the non-financial risk associated with the entity’s insurance contracts that will provide a clearer insight into the entity’s view of the economic burden imposed by the non-financial risk.

That economic burden requires insurers to be prudent in the measurement of insurance liabilities. This suggests that the proposals mean that the amount that provides the fairest reflection of the liability would include a risk adjustment for the “uncertainty in the cash flows that arises”. We find the following chart helpful in explaining how we think about this idea.



Such a risk adjustment should be impacted by the extent of the uncertainty – liabilities with ‘fat tails’ where there are significant probabilities of extreme values, such as EQC’s

insurance liability, would have a higher risk adjustment than those that do not, such as ACC. This interpretation however would not be impacted by the risk appetite of the entity or degree of compensation the entity seeks.

Using this logic, public sector entities would report a risk adjustment similar to the approach that is currently used with PBE IFRS 4. We think it would be similar, rather than the same because, while a risk margin adopted for regulatory purposes is generally accepted under PBE IFRS 4, we doubt this would be the case under ED 2022-3, noting IASB's statement in BC209(b) that a regulatory approach is not compatible with the IASB's objectives.

If the boards think this approach is appropriate, we would suggest redefining the risk adjustment to something like the "the amount the public sector insurer would rationally expect to pay to be relieved of the risk that the ultimate fulfilment cash flows may exceed those expected". Preparers could be required to disclose how they have determined this amount, referring to the level of prudence required as a consequence of the nature of the uncertainties in the insurance liability. We suspect the result would not be significantly different to the current measures under PBE IFRS 4.

#### *Second Rationale: Risk adjustment as a compensation for uncertainty*

The actual definition of the risk adjustment in the proposed standard is

"the compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity fulfils insurance contracts"

and application guidance AG87 states:

"The risk adjustment for non-financial risk for insurance contracts measures the compensation that the entity would require to make the entity indifferent between:

- (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."

AG87 also advises:

"As a result, the risk adjustment for non-financial risk conveys information to users of financial statements about the amount charged by the entity for the uncertainty arising from non-financial risk about the amount and timing of cash flows"

Inevitably that brings the entity's risk appetite into the calculation. The Treasury observes that there is likely to be a significant difference in risk appetite between profit-oriented entities and public sector entities pursuing public benefit.

A profit-oriented entity will naturally require compensation for assuming the risk in the insurance contract; not to do so would be in conflict with its objectives. However, for public sector entities seeking to improve the wellbeing and resilience of insured groups, any compensation for the risk it is assuming is likely **to be in conflict** with those wellbeing and resilience objectives.

Consequently, for example, it is observable that with ACC and EQC, the pricing and funding of levies does not include an element to compensate for risk, but rather is more likely to

include a subsidy for accepting the risk. The entity is indifferent, in part because of the government guarantee, and the statutory ability to adjust future prices to make up for higher-than-expected past claims. At the whole-of-government level is indifferent because of its ability to spread the risk to the general tax base.

Applying this rationale, we conclude that public sector entities should only make a risk adjustment if we are prepared to charge for it, and in doing so, seek to be compensated for it. Using this logic, most NZ public sector insurers would not report a risk adjustment, or the risk adjustment would be deemed to be zero.

The Treasury is aware of arguments made to the *Transition Resource Group (TRG)*<sup>1</sup> that the recognition of the risk adjustment under IFRS 17 is not linked to what is actually charged when it comes to pricing. Pricing is influenced by other legal, commercial or regulatory factors than just risk analysis. Thus the definition of the risk adjustment centres on what “compensation that the entity would require ... for bearing non-financial risk” not what it actually requires. However, we do not think this changes our logic above – public sector entities seeking to accept risk, and therefore increase the resilience of their policyholder group, would not require compensation in the same way as profit-oriented entities.

#### *Implication for the proposed standard*

Our conclusion from the above logic is that a public sector amendment is appropriate for the proposed standard. The public sector difference arises because public sector entities seeking to improve wellbeing and resilience of policyholder groups do not require compensation for bearing the uncertainty related to insurance contract liabilities. The NZASB needs to clarify the principle between the first rationale and the second rationale described above. Both rationales, which are in conflict for public sector entities, appear valid under the proposals.

Illustrating the problem further, we note that in BC126 the AASB has observed ...

- under AASB 17, public sector entities might determine a zero risk adjustment on the basis that they are monopolies and can adjust future prices to make up for higher than expected past claims;
- under AASB 17, public sector entities might determine a risk adjustment based on a particular level of adequacy based on their facts and circumstances; and

... but doesn't provide clarity on when those very different alternatives would apply.

If the NZASB considers it appropriate for a risk adjustment for public sector entities to prudently make an allowance to represent the uncertainty in fulfilling the liability (as described in the first rationale above), the definition of the risk adjustment should be reworded in such cases to reflect that, and additional guidance provided to assist on its calculation. This is option one in our view.

Under the second option, if the risk adjustment is simply an expression of the compensation required due to the uncertainty in fulfilling the liability (as described in the second rationale above), additional application guidance should be provided to assist preparers who do not

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<sup>1</sup> The TRG is an IASB supported group of industry experts involved in IFRS 17 implementation, to respond to the implementation questions raised by constituents and share their views on the accounting analysis. , <https://www.ifrs.org/content/dam/ifrs/meetings/2018/may/trg-for-ifs-17/ap02-risk-adjustment-in-a-group-of-entities.pdf>

require compensation. The guidance should explicitly allow for a zero-risk adjustment and may include additional sensitivity disclosures, so the effect of the uncompensated uncertainty is made clear.

On balance Treasury prefers the second option. That seems to us to provide the cleanest and most understandable position for preparers, auditors and users. However, we would prefer the first option to the rebuttable presumption that is currently proposed in ED 2022-3, paragraph 37.1.

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?

The Treasury believes that guidance as to whether a public sector insurance scheme is and should be within the scope of the proposed standard is an area that needs more critical attention.

The proposed standard defines an insurance contract, and then provides proposed indicators for making a collective assessment whether a public sector arrangement will be assessed as an insurance contract. We agree that the structure is appropriate, but we think further work is needed on the definition, on the indicators, and the connection between them.

The proposed definition of an insurance contract is “a contract under which one party (the issuer) 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.” The challenge with this definition is that the essential elements of a contract may not be in place where the insurance scheme is statutorily defined, and the levies and compensation are regulated, and also when the party paying for the insurance is not the same as the policyholder group that is compensated. Despite the indicators we consider that the proposed definition needs to be widened to bring public sector insurance schemes appropriately into scope. Our proposed definition is:

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*.

To illustrate, currently ACC appropriately accounts for its activities as insurance. This is despite ACC being non-voluntary, and despite compensation not being dependent on a risk transfer payment (levy or premium) being paid. The definition in the standard is simply not



met, and the current application guidance with the proposed indicators does not change that fact.

If those adjustments are made to the definition, the application guidance on the proposed indicators, particularly (a.) and (d.) could be better connected to the definition.

We comment further on the indicators, in response to question 8. below.

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

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?

Treasury does consider that some indicators represent essentially binary decisions – if the indicator is not present insurance accounting cannot be applied, a second group of indicators require greater judgement or assessment, with a rebuttable presumption that if the judgement is positive insurance accounting should be applied, and a third group that is useful to enhance the judgement from the first two set of indicators.

In the first category we would have b. (identifiable coverage period) and c. (enforceable nature of arrangement). These are necessary. If an identifiable coverage period cannot be determined and the rights and obligations are not enforceable it is not possible to apply insurance accounting sensibly.

In the second category we would have d. (source and extent of funding) and e.(management practices and assessing financial performance). If the judgement made of these indicators is positive, then there is likely to be user interest in the results of insurance accounting.

In the third category we would have a. (similarity of risks covered and benefits provided) and f. (assets held to pay benefits). While the presence of these indicators is supportive of the view that insurance accounting is appropriate, Treasury does not believe their absence would be fatal to the application of insurance accounting.

We suggest the Boards consider whether they agree with this assessment and clarify their position.

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

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

The Treasury sees no public-sector rationale for modifications to PBE IFRS 17 in respect of the topics considered by the Boards

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

No

## ANNEX

### SUGGESTED IMPROVEMENTS TO INDICATORS OF PUBLIC SECTOR INSURANCE STANDARDS

#### Identifying Insurance Contracts in a Public Sector Context

AG16.1 The guidance in paragraphs AG7 to AG16 on distinguishing between insurance risks and other risks applies equally to public sector entities. However, because public sector entities often undertake a much wider range of risk-bearing activities than private sector entities, and because these are often statutory arrangements to insure specified populations, additional guidance is needed to identify insurance contracts in a public sector context.

AG16.2 Governments often arrange to accept significant risk provide support as a result of events that adversely affect individuals and communities. Some of these arrangements involve transactions that are best accounted for as insurance contracts, while many of these arrangements relate to a government's role in providing services such as: social benefits, universal health care and disaster relief. In making the distinction between these types of arrangements, the indicators outlined in paragraphs AG16.4 to AG16.~~25~~ XX are considered collectively so that a balanced judgement can be made.

AG16.3 Some of the i-Individual indicators are Indicators of conditions that are necessary to apply insurance accounting. If the indicator is not met, insurance accounting is likely to be impossible. A second group of indicators is focussed on whether insurance accounting should be applied. If these indicators are met, insurance accounting is likely to be appropriate. The third group of indicators add qualitative considerations to the previous indicators. If these indicators are met, that would support the use of insurance accounting. However, absence of these indicators does not preclude insurance accounting being applied. would not necessarily be regarded as definitive in determining whether public sector arrangements would be accounted for as insurance contracts.

#### Indicators of conditions that are necessary to apply insurance accounting

##### ***Identifiable Coverage Period***

AG16.~~XX~~ An insurance contract or applicable statutory arrangement has an identifiable coverage period – either the period during which insured events occur (losses-occurring coverage) or the period during which claims become known (claims-made coverage). The coverage period might be explicitly stated in the contract or otherwise be determinable from the terms of the contract or statutory arrangement.

AG16.~~XX~~ An indicator that a public sector entity's arrangements would be accounted for as insurance contracts is the existence of an identifiable coverage period.

AG16.~~XX~~ Conversely, open-ended arrangements to provide benefits based on eligibility criteria would not be accounted for as insurance contracts.

##### ***Enforceable Nature of Arrangement***

AG16.~~XX~~ Under AASB Standards and NZ IFRS, a contract is an agreement between two or more parties that creates enforceable rights and obligations. An insurance contract is a contract or statutory arrangement under which one party or group (the 'insurer') accepts significant insurance risk from another party (the 'insured') by agreeing to compensate the

insured or other affected party if a specified future event adversely affects the insured or other affected party.

AG16.XX When a public sector entity or its controlling government does not have the practical ability under existing or substantively enacted legislation to deny or change promised benefits, it is an indicator that an arrangement would be accounted for as an insurance contract. That is, the policyholder has enforceable rights under the arrangement and the public sector entity has enforceable obligations for promised amounts or for amounts based on agreed parameters.

AG16.XX Conversely, when a public sector entity or its controlling government has the practical ability under existing or substantively enacted legislation to retrospectively deny or change promised benefits or compensation, it indicates that an arrangement is not enforceable. For example, if an entity can retrospectively change the amount of benefits or compensation being paid to a beneficiary in relation to a past event under existing legislation, this is an indicator that the arrangement would not be accounted for as an insurance contract.

AG16.XX An arrangement that involves a public sector entity issuing documentation to another party, similar to an insurance contract issued by a private sector insurer, would be indicative of an agreement that creates enforceable rights and obligations. However, a substantive reliance on legislation or other regulation as a part of that arrangement would not necessarily be an indicator that the arrangement is unsuitable to be accounted for as an insurance contract. In common with the private sector, arrangements need to be interpreted within a regulatory framework and, when applying AASB 17/PBE IFRS 17, an entity is required to consider its substantive rights and obligations, whether they arise from a contract, law or regulation under paragraph 2.

### Indicators of conditions that indicate insurance accounting should be applied

#### ***Source and Extent of Funding***

AG16.XX Under an insurance contract, a policyholder usually pays premiums to an insurer. In most cases, the premiums are the primary source of funding the payment of any claims and the costs of operating the insurance business. Insurers usually also generate investment income and might sometimes receive supplementary contributions from governments, for example, such as those aimed at encouraging the use of private health insurance.

AG16.XX When a public sector entity receives 'premiums' under an arrangement in exchange for accepting risks from those who stand to benefit, it is an indicator that an arrangement would be accounted for as an insurance contract. The more direct the relationship between the participant or participant group that stands to benefit from an arrangement and the participant or participant group providing the funding, the more indicative this would be of a policyholder-insurer relationship and a transaction that would be accounted for as an insurance contract.

AG16.XX Conversely, when a public sector entity receives all of its funding from sources other than the 'premiums' from policyholders (that is, sources such as recurring funding from general taxation), it is an indicator that arrangements would not be accounted for as insurance contracts.

AG16.XX It is not necessary that the policyholder or policyholder group paying premiums or statutory determined levies is the same as the policyholder or policyholder group making claims for compensation. However, tThe lower is the proportion of a public sector entity's

funding to meet benefits-claims that is received in exchange for accepting risks from those who stand to benefit, the less likely is it that those arrangements would be accounted for as insurance contracts. For example, a co-payment that is intended to help ration services and is not intended to fully fund services is unlikely to indicate that arrangements would be accounted for as insurance contracts.

AG16.XX Under most general insurance contracts issued by private sector insurers, in the event that an insured cancels its coverage prior to the end of the coverage period, the policyholder would ordinarily receive a pro rata premium refund, possibly adjusted for administrative costs. Although not all contracts issued by private sector insurers allow for refunds, the practice is indicative of insurance contracts. Accordingly, a public sector entity arrangement that allows for a refund of premium when the policyholder terminates the arrangement early is an indicator that an arrangement would be accounted for as an insurance contract.

### ***Management Practices and Assessing Financial Performance***

AG16.XX An indicator that an arrangement would be accounted for as an insurance contract would be that the public sector entity has objectives, policies and processes for managing risks associated with those arrangements and has its financial performance assessed against those objectives and how successfully it applies those policies and processes. In that context, the entity would be expected to conduct the following activities (either itself or via outsourcing): (a) underwriting and risk assessment; (b) managing the entity's 'capital' based on the measurement of risks and uncertainties relating to coverage and incurred claims and their potential future impacts; and (c) fair and prudent claims management. The presence of all three of these factors is an indicator that those arrangements would be accounted for as insurance contracts. Conversely, the fewer of these three factors that are present, the less likely it would be for arrangements to be accounted for as insurance contracts.

### **Indicators of conditions that enhance the view that insurance accounting should be applied**

#### ***Similarity of Risks Covered and Benefits-Compensation Provided***

AG16.XX Under an insurance contract, significant insurance risk is transferred from an insured to an insurer. Private sector insurers accept a wide range of risks. These include risks relating to, for example: property loss, loss of income, professional and trade indemnity, public and legal liability, medical costs, mortality and disability. In the event that an insured event occurs, to the extent required under an insurance contract, the insurer would typically provide a benefit-compensation commensurate with the loss. Compensation would not typically exceed the loss, nor would the compensation payment be unrelated to the amount lost.

AG16.XX Many of the risks covered by private sector insurers are also the subject of social benefits provided by governments. Accordingly, judgement needs to be applied to determine the relevance of this indicator.

AG16.XX It is an indicator that a public sector entity's arrangements would be accounted for as insurance contracts when they involve accepting risks and providing benefits compensation that are the same as, or similar to, those offered by private sector insurers. In some cases, public sector entities operate alongside private sector insurers to accept risks and provide benefits that are the same, for example, in respect of employer liability for workers' compensation risks.

AG16.XX In some cases, public sector entities are monopolies in their jurisdictions, and there are no relevant counterpart arrangements of private sector entities to consider. In other cases, public sector entities may provide insurance cover as a 'protection gap' for risks that for fat-tail insurance that exceed the risk appetite of private insurers in their jurisdiction. In these cases, consideration is given to whether a public sector entity's arrangements involve accepting risks and providing benefits-compensation that are the same as, or similar to, those offered by private sector insurers in other, similar, jurisdictions. In relation to other jurisdictions, only information that is 'readily available' need be considered. That is, public sector entities need not conduct an exhaustive search for counterpart arrangements.

AG16.XX In some cases there will be a clear similarity between the risks being accepted and the compensation benefits being provided by a public sector entity and private sector insurers, and this is an indicator that a public sector entity's arrangements would be accounted for as insurance contracts.

AG.16.XX In other cases public sector entities will provide complementary insurance in addition to private sector insurers, accepting risks and providing compensation that otherwise would not be offered by the market, or would otherwise be considered unaffordable by the desired group to be insured. The complementarity of such arrangements is an indicator that a public sector entity's arrangements would be accounted for as insurance contracts.

AG16.XX Conversely, the greater the level of dissimilarity between the risks accepted and compensation benefits provided by a public sector entity and those offered by any relevant counterpart private sector insurer, the more likely it would be that the public sector entity's arrangements would not be accounted for as insurance contracts.

### ***Assets Held to Pay Benefits***

AG16.XX Consistent with the guidance above on 'Management practices and assessing financial performance', the existence of a separate fund, or earmarked assets, that are restricted to being used to pay benefits-compensation can be regarded as evidence that a public sector entity is operating and being managed as an insurer. The existence of a separate fund, or earmarked assets is also consistent with the guidance above on 'Source and extent of funding' because it would generally involve investing funds raised via premiums or levies received in exchange for accepting risks from those who stand to benefit.

AG16.XX While the existence of a separate fund, or earmarked assets, that are restricted to being used to pay benefits is a feature of some public sector arrangements that are not in the nature of insurance, the feature is still regarded as an indicator, in conjunction with other indicators, that those arrangements would be accounted for as insurance contracts. The alternative would be when a public sector entity receives its funding from sources such as general taxation, which is an indicator that arrangements would not be accounted for as insurance contracts

AG16.XX To be relevant, the separate fund, or earmarked assets need not be managed by the public sector entity itself. It is the existence of a separate fund, or earmarked assets, that is indicative, not the performance of investing activities.