Staff Paper

Project	**Insurance Activities in the Public Sector**	**Meeting**	AASB (M180)/NZASB April 2021
Topic	Risk adjustments for non-financial risk	**Agenda item**	AASB 10.3 NZASB 5.3
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		Decision-making	High
		Project status	Addressing specific technical issues for board deliberation

Objective of this paper

The objective of this paper is for the AASB and the NZASB to **decide** whether public-sector-specific modifications or guidance is needed in AASB 17/PBE IFRS 17 *Insurance Contracts* regarding:

(a) the requirement to include a risk adjustment for non-financial risk in measuring liabilities for incurred claims; and

(b) the disclosure requirements about those risk adjustments.

Structure of this paper

This staff paper is set out as follows:

Abbreviations used in this paper are referenced in full in Appendix A to this paper.

1 Staff do not consider that there is any particular significance in AASB 17/PBE IFRS 17 using the term 'risk adjustment' (rather than 'risk margin' under AASB 1023/PBE IFRS 4) other than (perhaps) to help distinguish it from the 'contractual service margin' (which applies under the general measurement model in AASB 17/PBE IFRS 17.

Section 1: Comparison of risk adjustments under AASB 17/PBE IFRS 17 versus AASB 1023/PBE IFRS 4

1.1 Table 1.1 compares the risk adjustment requirements in AASB 17/PBE IFRS 17 with the risk margin requirements in AASB 1023/PBE IFRS 4 and includes staff remarks on the comparison.

Table 1.1 – comparison of risk adjustment requirements

AASB 17/PBE IFRS 17	*AASB 1023/PBE IFRS 4*	*Staff comments*
Risk adjustment for non-financial risk: The **compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows** that arises from non-financial risk[2] as the entity fulfils insurance contracts [Appendix A]. **Notion of 'compensation':** The risk adjustment … 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 [B87].[3]	**Description of risk margin:** The outstanding claims liability includes, in addition to the central estimate of the present value of the expected future payments, a risk margin that relates to the **inherent uncertainty in the central estimate of the present value of the expected future payments** [5.1.6].	Effectively the same definition / description. AASB 1023/PBE IFRS 4 also distinguishes non-financial risk from financial risk. The main difference between the standards is that AASB 1023/PBE IFRS 4 has no equivalent to the AASB 17/PBE IFRS 17 notion of compensation – instead, the risks are regarded as being inherent in the cash flows. Conceivably, under AASB 17/PBE IFRS 17, an entity could have a risk adjustment of **zero** if the entity does not seek compensation for bearing non-financial risk. AASB 1023/PBE IFRS 4, assumes an entity includes a risk margin based on the inherent uncertainty around the cash flows.
Diversification and risk aversion: Because the risk adjustment … reflects the **compensation** the entity would require for bearing the non-financial risk arising from the uncertain amount and timing of the cash flows, the risk adjustment for non-financial risk also reflects: (a) the degree of diversification benefit the entity includes	**Characteristics of the business:** Risk margins are determined on a basis that reflects the insurer's business. Regard is had to the robustness of the valuation models, the reliability and volume of available data, past experience of the insurer and the industry and the characteristics of the classes of business written [5.1.7].	A risk adjustment of **zero** under AASB 17/PBE IFRS 17 would imply the entity is not risk averse, which seems unlikely for any entity. Although the AASB 1023/ PBE IFRS 4 commentary appears different from AASB 17/ PBE IFRS 17, in practice, 'characteristics of the business' relates to diversification and entities have regard to risk

2 Non-financial risks are all risks except 'financial risks', which are defined as: The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, currency exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract [Appendix A].

3 For example, the risk adjustment for non-financial risk would measure the compensation the entity would require to make it indifferent between fulfilling a liability that—because of non-financial risk—has a 50 per cent probability of being CU90 and a 50 per cent probability of being CU110, and fulfilling a liability that is fixed at CU100. 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 nonfinancial risk about the amount and timing of cash flows.

Table 1.1 – comparison of risk adjustment requirements		
AASB 17/PBE IFRS 17	***AASB 1023/PBE IFRS 4***	***Staff comments***
when determining the compensation it requires for bearing that risk; and (b) both favourable and unfavourable outcomes, in a way that reflects the entity's degree of risk aversion [B88].	Risk margins adopted for regulatory purposes may be appropriate for the purposes of this Standard, or they may be an appropriate starting point in determining such risk margins [5.1.11].	aversion (see methodology in the next row of this table).
Methodology: An entity shall disclose the confidence level used to determine the risk adjustment … If the entity uses a technique other than the confidence level technique for determining the risk adjustment for non-financial risk, it shall disclose the technique used and the confidence level corresponding to the results of that technique [119].	**Methodology:** The financial statements shall disclose … (d) the probability of adequacy intended to be achieved through adoption of the risk margin; and (e) the process used to determine the risk margin, including the way in which diversification of risks has been allowed for [17.2]	Although terminology in AASB 17/ PBE IFRS 17 is different from that used in AASB 1023/PBE IFRS 4, the same confidence level (or probability of adequacy) approach is likely to apply under both. Also see paragraph 1.2 below.
Reinsurance: Instead of applying paragraph 37, an entity shall determine the **risk adjustment for non-financial risk so that it represents the amount of risk being transferred by the holder of the group of reinsurance contracts** to the issuer of those contracts [64].	There is no counterpart requirement on reinsurance	Although there is no counterpart requirement in AASB 1023/ PBE IFRS 4, current industry practice is to apply a counterpart risk margin to measure reinsurance assets and, in principle, achieve the same outcome as AASB 17/ PBE IFRS 17.

Industry benchmark

1.2 Prudential Standard GPS 320 *Actuarial and Related Matters* (2013) issued by the Australian Prudential Regulation Authority (APRA) includes an industry (minimum) benchmark that must be applied by registered private sector Australian general insurers. The same benchmark is also widely used among public sector entities in Australia and New Zealand for determining risk margins under AASB 1023/PBE IFRS 4 and, in some cases, under AASB 137/PBE IPSAS 19.

> 21. The valuation of insurance liabilities reflects the individual circumstances of the insurer. In any event, the minimum value of insurance liabilities must be the greater of a value that is:
>
> (a) determined on a basis that is intended to value the insurance liabilities of the insurer at a 75 per cent level of sufficiency; and
>
> (b) the central estimate plus one half of a standard deviation above the mean for the insurance liabilities of the insurer.[4]

4 https://www.apra.gov.au/sites/default/files/GPS-320-Actuarial-and-Related-Matters-January-2013.pdf

1.3 In practice, many public sector entities determine their risk margins as the amount that would be required to meet (or exceed) the actual claims liabilities 75% of the time – sometimes referred to as 75% 'probability of adequacy'. Private sector entities (APRA-registered insurers) use the 75% threshold as a minimum and typically their capital levels put them in the range of an 80% to 95% probability of adequacy.

1.4 APRA benchmarks tend to be widely applied in New Zealand due to the high level of common ownership of insurers that are registered in both jurisdictions.

The basis for AASB 17/PBE IFRS 17 risk adjustments and a public sector perspective

1.5 Table 1.2 outlines the IASB's thinking behind the way in which risk adjustments should be determined and includes staff remarks in a public sector context. Staff are not suggesting that the Boards should necessarily accept the IASB's conclusions on how risk adjustments are determined – in the spirit of transaction neutrality, we are attempting to assess whether there are public sector specific factors that might make those conclusions less relevant to public sector entities.

Table 1.2 – determining risk adjustments under IFRS 17

IFRS 17 Basis for Conclusions	*Staff comments*
The risk adjustment should be determined as the amount of compensation that the entity would require, not the compensation a market participant would require. Accordingly, it is not intended to measure the current exit value or fair value, which would reflect the transfer of the liability to a market participant [BC209(a)]	IFRS 17 uses a fulfilment cash flow model – that is the entity issuing the contracts will fulfil them, which seems as relevant in the public sector as it is for private sector registered insurers.
The risk adjustment should be an amount that would provide a high degree of certainty that the entity would be able to fulfil its contracts. This will help users of financial statements make decisions about providing resources to the entity [BC209(b)] by showing the entity's view of the economic burden imposed by the non-financial risk associated with the entity's insurance contracts [BC211(a)]	There may be a high degree of certainty among stakeholders that a public sector entity would be able to fulfil its contracts due to its government backing (whether or not there is an explicit government guarantee). Accordingly, it might be argued that this factor is less relevant as a reason for having a risk adjustment in a public sector context.

Table 1.2 – determining risk adjustments under IFRS 17	
IFRS 17 Transition Resource Group	***Staff comments***
May 2018 Agenda paper 2 *Determining the risk adjustment for non-financial risk in a group of entities* involved the IFRS 17 TRG discussing how the IASB envisaged that risk adjustments would be determined. In that paper [paragraph A.2], the IASB staff view (supported by the IASB members who were present) was that the insurer issuing the contract would determine the compensation required for bearing risk at the time the contract is priced. Accordingly, there is only one risk adjustment, not different risk adjustments at a subsidiary level versus a consolidated group level. The significance of this logic is that, in theory, an entity which does not consider[5] risk when it prices its contracts could have a risk adjustment of zero. Many of the Australian and New Zealand public sector entities that were the subject of staff research do not seek to price in risk. The alternative view, not supported by the IASB staff (or by the IASB members who were present), was that the view of risk at the original pricing point is not always relevant because the compensation an entity needs to bear risk would vary depending on the entity's circumstances. Hence, different risk adjustments might be calculated for the same contracts in different levels within a consolidated group.	The IASB staff logic around determining risk adjustments might seem to provide a neat solution for public sector entities applying AASB 17/PBE IFRS 17 – because it could allow some to have zero risk adjustment on the basis that they do not consider pricing risk into their arrangements. The IFRS 17 TRG members in general did not agree with the IASB staff logic and the Meeting Summary [paragraphs 15 & 16] for May 2018 records that a broader view of risk adjustments is acceptable (and there might be different risk adjustments at different levels in a consolidated group because risk appetites can be different depending on the context). One of the flaws in the IASB staff logic is that risk adjustments are not static – they change depending on the context, which can include (for example) the extent of diversification of risks, which can increase over time as more arrangements are entered into or can decrease as there are concentrations of similar risks. However, many of the relevant public sector entities with insurance arrangements have highly stable customer bases (because they are generally monopolies) and would have a predictable level of diversification (based on past experience). Accordingly, they might be better candidates for applying the IASB staff logic than most private sector insurers.

1.6 Table 1.3 outlines the reasons for the IASB concluding on the need for a risk adjustment in measuring insurance contact liabilities and includes staff remarks on that reasoning in a public sector context. Staff are not suggesting that the Boards should necessarily accept the IASB's reasoning – in the spirit of transaction neutrality, we are attempting to assess whether there are public sector specific factors that might make that reasoning less relevant to public sector entities.

Table 1.3 – reasons for requiring risk adjustments under IFRS 17	
Basis for Conclusions to IFRS 17	***Staff comments***
Requiring a risk adjustment provides a clear insight into the insurance contracts and distinguishes them from risk-free liabilities [BC211(a)]	This reasoning seems as relevant in the public sector as it is for private sector insurers.

5 Please note that considering the impact of risk when pricing contracts is different from actually pricing into a contract the relevant risk. For example, under IFRS 17, due to competitive pressures, an entity might issue a contract at a loss because it deliberately underprices for risk.

Table 1.3 – reasons for requiring risk adjustments under IFRS 17	
Basis for Conclusions to IFRS 17	***Staff comments***
Requiring a risk adjustment results in a profit recognition pattern that reflects both the profit recognised by bearing risk and the profit recognised by providing services [BC211(b)]	This reasoning would be less relevant in respect of public sector entities that are not seeking to profit from bearing risk (although, as previously discussed with the Boards, IFRS 17 specifically applies to not-for-profit mutual entities).
Requiring a risk adjustment faithfully represents circumstances in which the entity has charged insufficient premiums for bearing the risk that the claims might ultimately exceed expected premiums [BC211(c)]	This reasoning seems as relevant in the public sector as it is for private sector insurers.
Requiring a risk adjustment results in reporting changes in estimates of risk promptly and in an understandable way [BC211(d)]	This reasoning seems as relevant in the public sector as it is for private sector insurers.

1.7 Table 1.4 outlines the criticisms of risk adjustments from some stakeholders that the IASB considered in the process of concluding on the need for a risk adjustment in measuring insurance contract liabilities and includes staff remarks on those criticisms. Staff are not suggesting that the Boards should necessarily dismiss the criticisms – in the spirit of transaction neutrality, we are attempting to assess whether there are public sector specific factors that might make those criticisms more relevant to public sector entities.

Table 1.4 – criticism of risk adjustments considered in developing IFRS 17	
Basis for Conclusions to IFRS 17	***Staff comments***
There is no single well-defined measurement approach that would provide consistency and comparability of results [BC210(a)]	This criticism seems no more relevant in the public sector than it is for private sector insurers. As noted in paragraphs 1.2 and 1.3 (above), APRA benchmarks tend to be used by both public sector and private sector entities.
Some measurement techniques are difficult to explain to users of financial statements [BC210(b)]	This criticism may be more relevant in the public sector than it is for private sector insurers because the public sector users are likely to be relatively less familiar with actuarial techniques.
It is impossible to assess retrospectively whether a particular adjustment was reasonable, including whether (for example) a decision to set a confidence level at a particular percentile was appropriate [BC210(c)]	This criticism seems no more relevant in the public sector than it is for private sector insurers.
Developing systems to determine risk adjustments will involve costs that are not justified by the benefits [BC210(d)]	This criticism may be more relevant in the public sector than it is for private sector insurers because the public sector entities would probably not otherwise have to determine risk adjustments. In contrast, private sector entities must determine risk adjustments for prudential reporting purposes.
Including a risk adjustment in identifying any loss on initial recognition is inconsistent with IFRS 15 (on revenue) [BC210(e)]	This criticism seems no more relevant (and is possibly less relevant given the infrequent

Table 1.4 – criticism of risk adjustments considered in developing IFRS 17	
Basis for Conclusions to IFRS 17	***Staff comments***
	application of AASB 15/PBE IFRS 15) in the public sector than it is for private sector insurers.
If including a risk adjustment results in a loss, that loss will reverse in later periods as the entity is released from that risk, which may confuse some users of financial statements [BC210(f)]	This criticism may be more relevant in the public sector than it is for private sector insurers because many public sector entities would be aiming to break even over the long term, rather than earn profits or incur losses. In contrast, private sector entities would typically aim to profit from bearing risk.
A risk adjustment could be used to introduce bias into the measurement of insurance contracts [BC210(g)]	This criticism seems no more relevant in the public sector than it is for private sector insurers.

Section 2: Proposals regarding risk adjustments in AASB DP and NZASB ED 2018-7

2.1 AASB DP.E18 to E20 effectively emphasised applying the requirements of AASB 17 and did not propose any relief or additional measures to be applied (See Appendix A).

2.2 The Basis for Conclusions [AASB DP.BC8 to BC13] raised the possibility of a risk adjustment of zero based on a case of a public sector entity with a government guarantee and/or a monopoly position in which it can recoup current and past losses from its controlling government or via future contracts. However, the AASB concluded that, while the risk adjustment might differ from a for-profit private sector entity, it is unlikely to be nil because:

(a) the uncertainties associated with outstanding claims cash flows in respect of past transactions, that would be reflected in a risk adjustment are a characteristic of the claims liability; and

(b) in respect of the current (usually annual coverage) transactions, the entity is bearing risk for that period and an entity's monopoly position is not relevant [AASB DP.BC10].

2.3 NZASB ED 2018-7 proposed no additional PBE modifications in respect of risk adjustments.

Responses to AASB DP

2.4 Some respondents considered that there would be risk adjustments (above zero) and also noted various considerations, including:

(a) disclosures around the techniques used to determine risk adjustments should be required to help ensure transparency;

(b) if the AASB expects risk adjustments to be different from those in the private sector, the implication is that they would be lower (compared with the private sector) and guidance would be needed to help entities make those calculations; and

(c) whether it is appropriate to imply that risk adjustments in the public and private sectors should be aligned.

2.5 Other respondents consider that there would be circumstances in which a risk adjustment could be zero, such as:

(a) when there is absolute certainty around the government backing of the best estimate liability; and

(b) the liability cash flows are so long term that the volatility is mitigated by long-term investment returns.

2.6 Staff note that, in concept, a risk adjustment of zero does not mean there has been no transfer of insurance risk from a scheme participant to the entity. This is because the entity can have a risk-pooling function that involves accepting risk from each scheme participant and sharing the risk with other participants and, possibly, the government 'owner' of the scheme.

Responses to NZASB ED 2018-7

2.7 There was a strong theme among respondents to NZASB ED 2018-7 that risk adjustments may not be relevant to many public sector entities. Some respondents also considered that, regardless of whether a zero risk adjustment is considered appropriate in some or all circumstances, explicit guidance on determining risk adjustments in the public sector would be needed.

2.8 Some respondents advocated that the requirement for a risk adjustment should be removed, or for guidance that the Standard should specify that risk adjustments are zero for public sector entities. The reasons for this view included:

(a) risk adjustments are predicated on the liability being an estimated amount a third party would likely want to be paid to assume the risk of settling claims, which is akin to an exit price; however, the liabilities will be settled by the entity itself;

(b) if the entity seeks to fund a liability that includes a risk adjustment, in order to report a break-even result, the entity would need to set levies and other forms of income at amounts that (on average) would be higher than necessary; and

(c) if the entity is funded to meet a best estimate liability, including a risk adjustment in the liability would automatically result in reported losses, which may never eventuate.

Section 3: Current practices and recent stakeholder feedback

3.1 Table 3.1 outlines the practices of a number of Australian and New Zealand entities with respect to risk margins.

Table 3.1

Entity	*Risk margin*[6]	*Currently applying*
Accident Compensation Commission (NZ)	Yes – 75% PoA[7]	PBE IFRS 4
Earthquake Commission (NZ)	Yes – 85% PoA	PBE IFRS 4

6 Some entities refer to a 'prudential reserve'.

7 PoA = Probability of Adequacy. Some entities have a fixed percentage year-on-year; however, the PoA varies from year-to-year for others. In most cases, the PoA for 2020 annual reports is shown here.

Table 3.1			
Entity		***Risk margin[6]***	***Currently applying***
iCare (NSW):	Dust Diseases Care	None	AASB 137
	Lifetime Care	None	AASB 137
	Insurance for NSW – various Funds	Some at 75% PoA – some have none	Some apply AASB 1023 and others AASB 137
	Home Building Compensation	Yes – 75% PoA	AASB 1023
	Workers' Insurance	Yes – 80% PoA	AASB 1023
	Sporting Injuries Scheme	Yes – 75% PoA	AASB 1023
	Building Insurers' Guarantee	None	AASB 137
WorkSafe (QLD)		Yes – 75% PoA	AASB 1023
WorkSafe (VIC)		Yes – 75% PoA	AASB 1023
WorkCover [RiskCover Fund] (WA)		Yes – 75% PoA	AASB 1023
ReturnToWorkSA (SA)		Yes – 75% PoA	AASB 1023
ComCare (Australia)		Yes – 75% PoA	AASB 1023
Victorian Managed Insurance Authority (VIC)		Yes – 75% PoA	AASB 1023
South Australian Finance Authority (SA) [SAicorp Division]		Yes – 75% PoA	AASB 1023
Insurance Commission (WA)	Risk Cover Fund	Yes – 75% PoA	AASB 137
	Third Party Insurance Fund	Yes – 75% PoA	AASB 1023
	Motor Vehicle Catastrophic Injury	Yes – 75% PoA	AASB 1023
Transport Accident Commission (VIC)		Yes – 75% PoA	AASB 1023
Motor Accident Insurance Board (TAS)		Yes – 75% PoA	AASB 1023
Nominal Defendant (QLD)		None	AASB 1023
National Injury Insurance Agency (QLD)		None	AASB 137
Lifetime Support Authority (SA)		Yes – 81% PoA	AASB 137
Australian Reinsurance Pool Corporation		None – currently has no claim liabilities	AASB 1023

3.2 Based on stakeholder feedback from interviews conducted by staff and through the review of financial statements, most public sector entities consider that:

(a) AASB 1023/PBE IFRS 4 requires a risk margin to be included in measuring liabilities for outstanding claims ('liability for incurred claims' in AASB 17/PBE IFRS 17 language); and

(b) AASB 137/PBE IAS 37 does **not require** a risk margin to be included in measuring provisions, **but permits** a risk/prudential margin to be included.

3.3 The stakeholder feedback also revealed that some public sector entities:

(a) chose to apply AASB 137/PBE IAS 37 (rather than AASB 1023/PBE IFRS 4) because they do not regard risk margins as appropriate to their circumstances;

(b) had assumed that their risk adjustments under AASB 17/PBE IFRS 17 would be the same as their risk margins under AASB 1023/PBE IFRS 4; and/or

(c) have yet to consider whether they would have a risk adjustment under AASB 17/PBE IFRS 17 and, if they did, whether it would be more or less than any risk margin they currently apply.

What 75% probability of adequacy means in practice

3.4 To provide the Boards with some context, Table 3.2 sets out information about the magnitudes of a range of public sector entities' risk margins (based on a % level of adequacy) disclosed in their (2019 or 2020) financial statements. The risk margins are generally in the range of 7% to 20% – that is, for example, a $100m best estimate of a claims liability is increased by $7m to $20m for risk. Accordingly, risk margins can have a material impact on the amounts of claims liabilities. In theory, the different percentages reflect the different levels of cash flow uncertainty.

3.5 Some of the entities that do not include risk margins in measuring their claim liabilities, nonetheless disclose the amount or percentage of those risk margins based on a particular percentage probability of adequacy (PoA).

Table 3.2

Entity		***Information***[8]	***Currently applying***
Accident Compensation Commission (NZ)		11.5% of claims liability at 75% PoA	PBE IFRS 4
Earthquake Commission (NZ)		21.5% of claims liability at 85% PoA	PBE IFRS 4
iCare (NSW):	Dust Diseases Care	None – but would have been 18.5% of claims liability at 75% PoA	AASB 137
	Lifetime Care	None – but would have been 16.5% of claims liability at 75% PoA	AASB 137
	Insurance for NSW – various Funds	Less than 1% on an aggregate of claim liabilities at 75% PoA	Some apply AASB 1023 and others AASB 137
	Home Building Compensation	Yes – 75% PoA	AASB 1023
	Workers' Insurance	15.1% at 80% PoA	AASB 1023
	Sporting Injuries Scheme	25% at 75% PoA	AASB 1023
WorkSafe (QLD)		11% at 75% PoA	AASB 1023
WorkSafe (VIC)		7.5% at 75% PoA	AASB 1023

8 Staff have calculated some of these percentages from publicly-available information and most are rounded – they should be regarded as indicative.

Table 3.2			
Entity		***Information[8]***	***Currently applying***
WorkCover [RiskCover Fund] (WA)		20.5% at 75% PoA	AASB 1023
ReturnToWorkSA (SA)		12.5% at 75% PoA	AASB 1023
Victorian Managed Insurance Authority (VIC)		18% at 75% PoA	AASB 1023
South Australian Finance Authority (SA) [SAicorp Division]		16.5% at 75% PoA	AASB 1023
Insurance Commission (WA)	Risk Cover Fund	8% at 75% PoA	AASB 137
	Third Party Insurance Fund	7% at 75% PoA	AASB 1023
	Motor Vehicle Catastrophic Injury	12% at 75% PoA	AASB 1023
Transport Accident Commission (VIC)		10% at 75% PoA	AASB 1023
Motor Accident Insurance Board (TAS)		20% at 75% PoA	AASB 1023
Lifetime Support Authority (SA)		Yes – 81% PoA	AASB 137
Australian Reinsurance Pool Corporation		N/A – currently has no claims liability	AASB 1023

Section 4: Suggested approaches to risk adjustments in the public sector

4.1 No matter which of the following approaches might be adopted by the Boards, the approach would need to be explained and justified in a Basis for Conclusions.

Approach 1: Require each public sector entity to apply AASB 17/PBE IFRS 17 with no modifications or guidance

4.2 Table 4.1 sets out advantages and disadvantages of this approach.

Table 4.1			
	Advantages	***Disadvantages***	***Staff comments***
4.1.1	Consistent with the principle of only making modifications to the IFRS Standards if there is a strong case based on substantive differences in circumstances of public sector entities (compared with the entities for which IFRS Standards are developed).	IFRS 17 was designed to be applied by private sector entities. The public sector context is often different; in particular, due to entities holding a monopoly position and being driven by public policy objectives.	Any public sector specific changes might be either requirements or simply guidance. The IPSASB has not sought to create an IPSAS that is a modified IFRS Standard.

Table 4.1			
	Advantages	***Disadvantages***	***Staff comments***
4.1.2	Different public sector entities hold claim liabilities with different characteristics. The risk adjustment would usefully help reflect those differences. For example, very long-tail, relatively predictable claims (such as regular income support payments), would result in a relatively small risk adjustment. In contrast, claims subject to future legal judgements might result in a relatively large risk adjustment. Different public sector entities manage different types of risk.		Some stakeholders consider that benchmarking across different schemes in different jurisdictions is useful, while others do not. Virtually all the relevant public sector entities have long-tail claim liabilities, regardless of the different nature of the underlying risks they cover. However, the nature of the cash flows differs from risk to risk.
4.1.3	Different public sector entities hold different views on whether they should include a risk adjustment in measuring their claim liabilities. This approach would allow each entity to determine its position consistent with its own objectives, management philosophy, level of risk aversion, and the nature of their claim liabilities.	Different public sector entities may determine different outcomes even though they have similar operations. Accordingly, their reported financial position and financial performance would not be comparable.	Some stakeholders consider that benchmarking across different schemes in different jurisdictions is useful, while others do not.
4.1.4	A for-profit public sector entity could recognise a risk adjustment on the basis that it expects to profit from bearing risk. A not-for-profit entity might not recognise a risk adjustment because it does not seek to profit from bearing risk.		IFRS 17 does not distinguish between for-profit and not-for-profit entities. The pattern in which claim liabilities are reduced is based on the pattern of exposure to risk (regardless of whether the entity seeks to profit from bearing risk).

Approach 2: Require public sector entities to have a zero risk adjustment

4.3 Table 4.2 sets out advantages and disadvantages of this approach.

	Table 4.2		
	Advantages	***Disadvantages***	***Staff comments***
4.2.1	All public sector entities would have a consistent approach, based on best estimate claim liabilities.	Many public sector entities hold strong views on the need to show their users that claim liabilities carry a level of uncertainty as to timing and amount. Consistency does not necessarily lead to comparability. There is no public sector specific basis for this modification.	Some stakeholders consider benchmarking across different schemes in different jurisdictions (and with private sector insurers) is useful, while others do not. Some public sector entities are required (via regulation imposed in that jurisdiction) to benchmark to APRA prudential requirements, which include a minimum risk margin.
4.2.2	Best estimates (with no risk adjustment) are relevant to user decision making because they provide a basis for determining how much levies or other charges need to be generated to sustain the entity in the long term.	There would be no information for users about the potential uncertainties in the cash flows, which may mislead government into making decisions on levies etc. that leave schemes, underfunded.	Some entities consider information about uncertainties in the cash flows are important, even in measuring provisions (under AASB 137).
4.2.3	All the relevant public sector entities are monopolies and/or have the power to adjust future levies and charges to meet any shortfalls in funding the existing claim liabilities. Accordingly, risk adjustments are not relevant because these entities have no reason to be risk averse.	There are often obstacles to exercising monopoly and other powers. For example, it might not be economically or politically feasible to increase levies in either the short, medium or long term to meet shortfalls in a timely manner. The accounting for existing arrangements should not necessarily be affected by possible future transactions. All entities are risk averse to varying degrees.	Most stakeholders interviewed by staff indicated that there are processes (including Ministerial decision-making) involved in changing levies and other charges that act as a constraint.
4.2.4	Would avoid misleading impact on the income statement – risk adjustments tend to create short term losses and longer-term gains as actual claims revert to the best estimate over the long term.	There would be no changes in risk adjustments to provide useful information about changes in the levels of uncertainty among cash flows over time.	Any tendency of risk adjustments to create short term losses and longer-term gains would generally be a 'once-off' impact and would not affect ongoing reported financial performance

	Table 4.2		
	Advantages	***Disadvantages***	***Staff comments***
4.2.5	Would reduce report preparation costs by removing the need for management (and auditors) to determine (and assess) risk adjustments and to make disclosures about risk adjustments.	It is normal commercial practice to determine risk adjustments and many managements would wish to have a risk adjustment for financial reporting purposes to match their management reporting.	Of itself, very little additional actuarial effort is likely to be needed to determine a risk adjustment – most of the relevant work would be performed to determine the best estimate. Some public sector entities have minimised the work involved in determining risk margins (under AASB 1023/PBE IFRS 4) by specifying the APRA minimum of 75% probability of adequacy.

Approach 3: Require a particular probability of adequacy for determining risk adjustments for all public sector entities

4.4 Table 4.3 sets out advantages and disadvantages of this approach.

Table 4.3			
	Advantages	***Disadvantages***	***Staff comments***
4.3.1	All public sector entities would have a consistent approach, using a best estimate of claim liabilities plus a risk adjustment based on a common probability of adequacy.	IFRS 17 was designed to have entities determine risk adjustments appropriate to each entity's circumstances. Consistency does not necessarily lead to comparability. There is no public sector specific basis for this modification.	Most public sector entities that have a risk margin (under AASB 1023/PBE IFRS 4) use the APRA minimum of 75% probability of adequacy.
4.3.2		If there is a general shift in expectations about the uncertainty surrounding cash flows, the required probability of adequacy might need to be updated by the Boards.	The APRA minimum of 75% probability of adequacy has not changed for at least a decade (through a wide variety of economic conditions).

Disclosure approaches

4.5 Each of the three approaches outlined above could be supplemented with disclosures.

Approach 1 – If each public sector entity applies AASB 17/PBE IFRS 17 with no modifications or guidance, the entity could also be required to disclose a risk adjustment for benchmark probability of adequacy (such as 75% probability of adequacy) to provide a point of reference for comparison.

Approach 2 – If each public sector entity recognises a zero risk adjustment, the entity could also be required to disclose what the risk adjustment would have been if AASB 17/PBE IFRS 17 were applied unmodified.

Approach 3 – If each public sector entity recognises a risk adjustment for a particular probability of adequacy, the entity could also be required to disclose what its risk adjustment would have been if AASB 17/PBE IFRS 17 were applied unmodified.

Staff views

4.6 Staff consider that Approach 1 would be the most relevant approach – require each public sector entity to apply AASB 17/PBE IFRS 17 with no specific public sector modifications. However, staff note that the Boards' Basis for Conclusions could include reasoning that might assist public sector entities in applying the requirements.

4.7 Staff support this approach on the basis of the following.

(a) Including a risk adjustment for the compensation the entity requires for bearing risk would mean the circumstances specific to each public sector entity can be taken into account in determining risk adjustments. Accordingly, the requirement itself can accommodate differences between:

(i) public sector entities and their particular insurance arrangements; and

(ii) public sector entities versus private sector entities, rather than having modified requirements for public sector entities to cater for differences from the private sector.

(b) Different public sector entities manage their levels of risk differently from others – for example, some are actively reinsuring their claims,[9] while others are retaining all the relevant risks – and the risk adjustment would reflect the impacts of those different management strategies.

(c) Each entity's level of risk aversion would be affected by the extent to which it might have the power to manage its cash flows and has access to additional funding from government and scheme participants. The interviews that staff conducted with stakeholders from the potentially affected entities revealed that different entities have different levels of risk aversion. For example:

(i) the more constrained the entity is in pricing its services and in being able to access additional government funding, the more risk averse the entity tended to be – these entities were generally in favour of recognising a risk adjustment to reflect that the entity itself (including its board of management) is responsible for managing risk; and

(ii) those entities that were structured more along the lines of a compensation scheme for which there is a close involvement of policymakers from wider government and an ability to adjust pricing and benefits to meet a budget tended

9 IFRS 17 TRG April 2019 Agenda paper 2 *Reporting on other questions submitted* notes: "The risk adjustment for non-financial risk reflects the degree of diversification benefit the entity includes when determining the compensation it requires for bearing that risk. Therefore, if an entity considers reinsurance when determining the compensation it requires for bearing non-financial risk related to underlying insurance contracts, the effect of the reinsurance (both cost and benefit) would be reflected in the risk adjustment for non-financial risk of the underlying insurance contracts" [page 17].

to be less risk averse – these entities were generally not in favour of recognising a risk adjustment or favoured only a minimal risk adjustment).

(d) The level of diversification reflected in each entity's claims liabilities and the characteristics of the cash flows would be reflected in the level of the risk adjustment. The interviews that staff conducted with stakeholders from the potentially affected entities and staff reviews of their financial statements revealed that different entities have different levels of risk diversification and different levels of inherent uncertainty about their cash flows.[10]

(e) There is potentially useful information for users of the financial statements in knowing the impact on a risk adjustment of a change in benefit arrangements, particularly those that might affect existing claims. Such changes might make the cash flows associated with claims more or less certain.

(f) A considerable amount of literature is being developed on determining risk adjustments under IFRS 17, including guidelines published by local and international actuarial associations. By having unmodified requirements for risk adjustments, public sector entities can take advantage of that literature in preparing their financial statements.

4.8 Staff do not consider the different circumstances of public sector entities would justify mandating a zero risk adjustment (Approach 2). However, it might be feasible for a public sector entity to have a risk adjustment that is zero or close to zero (within the bounds of materiality). An uncontroversial example might be a public sector scheme that manages a 'closed book' of claims in run off that, therefore, have highly certain cash flows.

4.9 Staff do not consider the different circumstances of public sector entities would justify mandating a particular probability of adequacy for public sector entity risk adjustments (Approach 3). However, public sector entities might continue to apply available industry benchmarks, such as those set by the APRA.

4.10 Staff do not consider there is a need for additional disclosures about risk adjustments for public sector entities – staff consider there are already sufficient disclosures required by AASB 17/PBE IFRS 17. Also see Section 5 below.

Question R1

4.11 Do Board members agree that Approach 1 would be the most relevant approach – to require each public sector entity to apply AASB 17/PBE IFRS 17 with no specific public sector modifications?

10 AASB 17.B92/PBE IFRS 17.B92 notes that a risk adjustment has the following characteristics:
(a) risks with low frequency and high severity will result in higher risk adjustments than risks with high frequency and low severity;
(b) for similar risks, contracts with a longer duration will result in higher risk adjustments than contracts with a shorter duration;
(c) risks with a wider probability distribution will result in higher risk adjustments than risks with a narrower distribution;
(d) the less that is known about the current estimate and its trend, the higher will be the risk adjustment; and
(e) to the extent that emerging experience reduces uncertainty about the amount and timing of cash flows, risk adjustments will decrease and vice versa.

5. Other issues relating to risk adjustments in the public sector

Group versus subsidiary level risk adjustments

5.1 Some entities in the public sector report on a number of different insurance activities that are often the subject of different schemes that each have their own enabling legislation.

5.2 If those financial statements are regarded as being a consolidation of those different insurance activities, a decision may need to be made about whether the risk adjustment for consolidated claims liabilities is:

(a) a simple aggregation of the risk adjustment for each scheme; or

(b) a different amount (probably lower) based on the greater level of diversification at the consolidated level.

5.3 As noted in Table 1.2 in this paper, the IASB has conducted a process via its IFRS 17 Transition Resource Group that means either approach is regarded as acceptable. Accordingly, staff do not propose that the Boards develop a public sector specific requirement on this matter, but suggest that the Boards' Basis for Conclusions might usefully reference the outcome of the TRG process.

Question R2

5.4 Do Board members agree that there is no need for public sector specific guidance on consolidated group level risk adjustments, but that a reference in the Basis for Conclusions could be helpful?

Disclosures about risk adjustments

5.5 Table 5.1 outline disclosures required about risk adjustments that staff consider would be relevant to the circumstances of public sector entities in Australia and New Zealand.

Table 5.1

AASB 17/PBE IFRS 17	*AASB 1023/PBE IFRS 4*	*Staff comments*
All claim liability reconciliations must separately show movements for risk adjustments [100(c)(ii)]	Risk margin component within liabilities [17.2(b)]	Same disclosure in both standards – should be straight-forward to determine
Change in risk adjustment due to current service (recognised in the period) [104(b)(ii)]	No equivalent	Would often not be material as it relates to liabilities for remaining coverage, which are not generally large for public sector entities – should be reasonably straight-forward to determine
No equivalent	Percentage risk margin component within liabilities [17.2(c)]	This is the disclosure shown in column 2 of Table 3.2 – it can be calculated by a user in any case

Table 5.1		
AASB 17/PBE IFRS 17	***AASB 1023/PBE IFRS 4***	***Staff comments***
The approach used to determine the risk adjustment [117(c)(ii)]	Process used, including the way in which diversification is allowed for [17.2(e)]	Same disclosure in both standards – should be straight-forward to explain
The confidence level used to determine the risk adjustment. If the entity uses a technique other than the confidence level technique, disclose the technique used and the confidence level corresponding to the results of that technique [119]	Probability of adequacy applied [17.2(d)]	Effectively the same disclosure in both standards – should be straight-forward to disclose

5.6 Table 5.1 does not include risk adjustment disclosures relating to liabilities for remaining coverage determined using the general measurement model in AASB 17/PBE IFRS 17, which staff consider will not be relevant for public sector entities. This is because public sector entities in Australia and New Zealand are likely to be eligible to apply the simplified (premium allocation) approach to measuring liabilities for remaining coverage, rather than the more complex general measurement model. Staff note that the measurement model likely to be applied by public sector entities will be considered when the Boards deliberate on the topic of eligibility for the simplified (premium allocation) approach (at a future meeting).

5.7 Staff consider that the disclosures outlined in Table 5.1 are suitable for public sector entities applying AASB 17/PBE IFRS 17 and that no public sector modifications (either deletions or additions) are needed.

Question R3

5.8 Do Board members agree that it would be most relevant to require each public sector entity to apply the AASB 17/PBE IFRS 17 disclosures on risk adjustments with no specific public sector modifications?

Appendix A – Abbreviations

PBE IFRS 4 *Insurance Contracts* [PBE IFRS 4]

PBE IFRS 17 *Insurance Contracts* [PBE IFRS 17]

AASB 4 *Insurance Contracts* [AASB 4]

AASB 1023 *General Insurance Contracts* [AASB 1023]

AASB 17 *Insurance Contracts* [AASB 17]

AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*

AASB Discussion Paper *Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities* (2017) [AASB DP]

NZASB ED 2018-7 PBE IFRS 17 *Insurance Contracts* [ED 2018-7]