Australian Government
Australian Accounting Standards Board

XRB | Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Staff paper

Project:	**Insurance Activities in the Public Sector**	**Meeting:**	AASB August 2022 (M189) NZASB August 2022 (M102)
Topic:	Risk adjustments in measuring insurance liabilities	**Agenda item:**	AASB 4.3 NZASB 8.3
Contacts:	Angus Thomson athomson@aasb.gov.au	**Date:**	18 July 2022
	Tereza Bublikova tereza.bublikova@xrb.govt.nz	**Project priority**	Medium
	Patricia Au pau@aasb.gov.au	**Decision-making**	High
	Charis Halliday charis.halliday@xrb.govt.nz	**Project status**	Feedback on AASB ED 319 / NZASB ED 2022-3

Objectives of this agenda paper

1. The objectives of this agenda paper are for the AASB and the NZASB to:

   (a) CONSIDER key comments received on question 6 of AASB ED 319/NZASB ED 2022-3 *Insurance Contracts in the Public Sector* relating to the AASB proposal not to make modifications to the requirements for a risk adjustment and the NZASB proposal for a risk adjustment measured using a rebuttable 75% level of confidence; and

   (b) DECIDE on the risk adjustment requirements for the purposes of finalising the Standard.

Structure of this paper

2. This paper is structured as follows:

   (a) Background to the risk adjustment requirement in AASB 17/PBE IFRS 17

   (b) No modification versus 75% rebuttable presumption

   (c) Additional disclosures regarding sensitivity of insurance liabilities

   (d) Staff recommendations

   (e) Appendix A: Collation of comments on question 6 of AASB ED 319/NZASB ED 2022-3 regarding the risk adjustment

   (f) Appendix B: Current practice – risk margins.

Background to the risk adjustment requirement in AASB 17/PBE IFRS 17

3. AASB 17/PBE IFRS 17 defines 'risk adjustment for non-financial risk' as:

   > 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.

4. AASB 17.B87/PBE IFRS 17.AG87 explains:

> 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.

5. The risk adjustment for non-financial risk in AASB 17/PBE IFRS 17 is different from the concept of risk margin in the current Standards, which does not consider the compensation that the entity would require for bearing risks. Under the current Standards, the calculation of 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 [AASB 1023.5.1.6/PBE IFRS 4. D5.1.6].

Question for respondents in the Exposure Drafts

6. In respect of risk adjustments, question 6 of AASB ED 319/NZASB ED 2022-3 asked stakeholders whether they:

   (a) support the AASB approach of not modifying AASB 17 regarding the risk adjustment requirement; or

   (b) support 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

   (c) have a suggested alternative approach.

No modification versus 75% rebuttable presumption

Stakeholder feedback

7. Many respondents acknowledged that the proposed 75% rebuttable presumption would be straightforward to implement and avoid debate. One respondent [EQC] explicitly supported requiring the 75% rebuttable confidence level, while noting that, if this were to be removed, they would work with the New Zealand Treasury to determine a suitable risk adjustment. Staff also note that one of the stakeholders consulted by staff who did not subsequently lodge a comment letter was in favour of achieving consistency across public sector entities with the rebuttable presumption of a 75% confidence level.

8. Most respondents supported not having an explicit modification to AASB 17/PBE IFRS 17 for the following reasons:

   - consistency with principle-based standard setting;
   - many public sector entities would need to rebut the 75% confidence level because it would not be consistent with their pricing policies; and
   - a rebuttable 75% confidence level could be viewed as more onerous than the requirements for the private sector.

9. One respondent [PwC] who supported no modification to the Standard suggested that the Heads of Treasuries Accounting and Reporting Advisory Committee could be involved in setting a benchmark for risk adjustments among Australian public sector entities, rather than the Boards.

10. Staff note that two of the stakeholders consulted by staff who did not subsequently lodge a comment letter were confident that consistency across public sector entities could be achieved without the need for a rebuttable presumption.

11. Some respondents also support the Boards providing some form of application guidance, including:

- to assist entities to determine when an estimate other than the central estimate would need to be used; that is, when other than a zero risk adjustment would be needed [OAG];
- on the basis that the risk adjustment requirement in AASB 17/PBE IFRS 17 is simply an expression of compensation required due to the uncertainty in fulfilling the liability – additional application guidance should be provided to assist entities that do not require compensation [TSY NZ]; and
- to explain whether a public sector entity can have a zero risk adjustment and the circumstances when this may be appropriate [HoTARAC and ACAG]
- explaining how the risk adjustment requirements differ from the existing risk margin requirements [ACC].

12. Staff note that one of the stakeholders consulted by staff who did not subsequently lodge a comment letter expressed the view that a zero risk adjustment does not seem realistic in respect of insurance liabilities and the uncertainty associated with them.

Staff comments – compensation for risk

13. A strict application of the AASB 17/PBE IFRS 17 definition of 'risk adjustment for non-financial risk' to an entity that does not seek to be compensated for bearing risk would seem to result in a zero risk adjustment. Since almost all public sector entities do not seek to be compensated in their pricing of levies/premiums for bearing risk, it could reasonably be expected [based on the definition alone] that they would determine zero risk adjustments [a liability with a confidence level of 50%].

14. However, based on AASB 17.B87/PBE IFRS 17.GA87 (quoted in paragraph 4 above), many of the same public sector entities may be reluctant to say they are 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.

15. In a private sector context, in which most entities seek to be compensated for bearing risk, the definition and AASB 17.B87/PBE IFRS 17.AG87 both point to a risk adjustment above zero.

16. Given that most public sector entities do not have a level of compensation in mind to anchor their thinking on the measurement of risk adjustments, there remains a concern about the time and resources that might be expended by public sector entities and their advisers debating how the unmodified requirements of AASB 17/PBE IFRS 17 would apply.

17. Staff note there could be two competing perspectives:

Risk adjustment would typically be zero ***[compensation perspective]***	***Risk adjustment would typically be positive*** ***[indifference to variable cash flows perspective]***
Public sector entities typically set levies/premiums at break even. An entity literally not seeking to be compensated for bearing risk and **based on the 'risk adjustment' definition** would measure its liability for remaining coverage and liability for incurred claims using a 50% confidence level.	Many public sector entities have large liabilities for incurred claims [often their largest liability by far]. Entity management **may not be indifferent** between fulfilling the claims liability and fulfilling a liability that will generate fixed cash flows with the same expected present value. Accordingly, that entity would measure its liabilities for incurred claims using a confidence level above 50%.

18. Staff note that, as previously discussed by the Boards in November/December 2021 (see Agenda Paper 5.3 for the November 2021 AASB meeting, which is also Agenda Paper 9.2 for the December 2021 NZASB meeting), it is feasible that the confidence level for measuring a liability for remaining coverage, which is based on premiums [under the premium allocation approach] could be different from the confidence level applied to the liability for incurred claims. It is also feasible that the actual pricing structure does not necessarily reflect the risk appetite of the entity. The minutes for the November/December 2021 meetings note that the Boards agreed to avoid interpreting AASB 17/PBE IFRS 17 on this issue, including not proposing any public sector guidance or modifications that would be construed as interpretations of the matter.

19. If the Boards are to provide guidance on risk adjustments in a public sector context, staff consider that they would need to address the two potentially competing perspectives [**compensation** *versus* **indifference to variable cash flows**] in that guidance. Staff believe this can be done in a manner that would not involve interpreting AASB 17/PBE IFRS 17 – refer to paragraphs 22 and 23 below.

Staff comments – pricing for 'capital management' purposes

20. Staff note that pricing decisions can be based on a range of factors. Complications can arise, for example, when entities include a margin in levies for capital management purposes. By way of illustration, an entity may need to build up its capital in preparation for enhancing future benefits or to make up for previous under-reserving because claims experience has been worse than expected.

21. Staff consider that it would be reasonable to distinguish cases of 'capital management' and 'capital repair' from cases when an entity is pricing with a view to being compensated for risk. That is, there may be cases when entities price above break even for reasons other than seeking to be compensated for risk, which should be acknowledged. Staff consider that guidance around these issues could be useful.

Staff comments – proposed additional guidance

22. Staff consider that the risk adjustment definition and related AASB 17/PBE IFRS 17 explanatory material should not be modified, but that additional guidance be provided along the following lines.

(a) Public sector entities that do not seek to be compensated for bearing risk in their pricing/funding [which may relate to funding from levying insureds or from elsewhere, such as from sponsoring governments] would be expected to have zero risk adjustments in their liabilities for remaining coverage. There would be no implicit risk adjustment, in particular, under the premium allocation approach, which measures liabilities for remaining coverage based on levies/premiums received.

(b) An ongoing policy of break-even pricing would be indicative of a public sector entity that is not seeking to be compensated for bearing risk.

(c) Some public sector entities may seek to be compensated for bearing risk, which would be determined based on identifiable facts and circumstances [such as pricing above break even] and, therefore, have risk adjustments above zero in their liabilities for remaining coverage.

(d) Pricing a margin into levies for 'capital management' purposes, including building reserves to enhance future benefits or make up for previous under-reserving for the entity on a stand-alone basis because claims experience has been worse than expected, would not be regarded as seeking compensation for bearing risk.

(e) Entities that are not indifferent between:

(i) fulfilling the claims liability that has a range of possible outcomes arising from non-financial risk; and

(ii) fulfilling a liability that would generate fixed cash flows with the same expected present value;

would be expected to have risk adjustments above zero [measure its liabilities for incurred claims using a confidence level above 50%].

(f) Break even pricing is not, of itself, inconsistent with having a risk adjustment for liabilities for incurred claims. An entity may not price for bearing risk over the long term, but nonetheless not be indifferent to the risk of uncertainty in the timing and/or amount of claims cash flows.

23. Staff consider the Basis for Conclusions should explain the public sector context for the guidance and recommend including the following points.

(a) In the private for-profit sector, there would generally be expected to be some, at least broad, connection between the compensation charged for bearing risk included in setting premiums and the extent to which the insurer is indifferent between the two sets of cash flows referenced in AASB 17.B87/PBE IFRS 17.AG87. This broad connection would be expected given that private sector insurers endeavour to remain profitable and are expected to remain solvent from a prudential reporting perspective.

(b) In the public sector, due to an entity holding a monopoly position and/or implicit or explicit government guarantees, the broad connection noted in (a) above may not exist. Accordingly, a public sector entity might use a confidence level of 50% in pricing levies/premiums, which are the basis for measuring its liabilities for remaining coverage (including under the premium allocation approach) while measuring its liabilities for incurred claims applying a confidence level above 50% (and have a risk adjustment above zero).

24. Based on the information stakeholders have provided about how public sector arrangements are currently being managed, staff acknowledge that the likely practical outcome of the above explanatory material would be that:

(a) in measuring their **liabilities for remaining coverage**:

(i) most [possible all] public sector entities would be expected to have **zero risk adjustments** because risk is not priced into their levies/premiums, which is consistent with current practice;

(ii) in the event that risk is priced into a public sector entity's levies/premiums, it would have a **risk adjustment above zero**;

(b) in measuring their **liabilities for incurred claims**:

(i) some public sector entities would have **zero risk adjustments** on the basis that their managements are **indifferent** between the two sets of cash flows referenced in AASB 17.B87/PBE IFRS 17.AG87;

(ii) some public sector entities would have **positive risk adjustments** on the basis that their managements are **not indifferent** between the two sets of cash flows referenced in AASB 17.B87/PBE IFRS 17.AG87.

Staff comments – impacts of the proposed guidance

25. The impact of the guidance described in paragraph 24 on the measurement of liabilities for incurred claims by public sector entities would differ depending on their circumstances – the following examples are illustrative. Appendix B to this paper outlines current practices on risk margins among Australian and New Zealand public sector entities.

Standard currently applied by the entity	***Risk margin currently applied by the entity***	***Risk adjustment under AASB 17/PBE IFRS 17***	***Likely impact***
AASB 1023/PBE IFRS 4	**75%** confidence level	**50% plus** confidence level	No change [if 50% plus = 75%] or small change
		50% confidence level	Reduced liability
AASB 137 [Australia only][1]	**50%** confidence level	**50% plus** confidence level	Increased liability
		50% confidence level	No change
	75% confidence level	**50%** confidence level	Reduced liability

26. Any transitional adjustment would be expected to be a debit/credit to insurance liabilities and a credit/debit to equity [AASB 17/PBE IFRS 17.C4(c)]. The transition adjustment amount could be material because some public sector entities have liabilities for incurred claims that relate to decades of past accident/underwriting years.

1 AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*. Staff are not aware of any New Zealand public sector entities that are candidates for applying PBE IFRS 17 which are currently applying PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*.

27. Staff note that, in cases in which there is a link between pricing [setting levies/premiums] and the accounting position, there could be, for example:
    (a) temporary downward impacts on pricing for an entity that moves from measuring insurance liabilities based on a 75% confidence level to a 50% confidence level; and
    (b) temporary upward impacts on pricing for an entity that moves from measuring their liabilities based on a 50% confidence level to a 75% confidence level.

Additional disclosures

Stakeholder feedback

28. Some respondents mention that sensitivity disclosures relating to best estimates would be useful to help explain potential variability in insurance liabilities, particularly when an entity has a zero risk adjustment [TSY NZ and ACC].

Staff comments

29. AASB 17/PBE IFRS 17 already requires the following disclosures:
    - in respect of insurance liabilities as a whole, sensitivities around key assumptions and the impacts on profit and equity, which would typically include disclosures of the impact on along the following lines [AASB 17/PBE IFRS 17.128]:
        - 5-10% plus or minus variation in weighted average term to settlement of claims
        - 5-10% plus or minus variation in the level of claims
        - 1-2% plus or minus change of discount rate
        - 1-2% plus or minus change of inflation rate[2]
    - in respect of the risk adjustment, the confidence level applied [AASB 17/PBE IFRS 17.119].[3]

30. Staff consider that, because public sector entities do not have the same focus around compensation for bearing risk that exists in the commercial private sector, the reporting of risk adjustments by public sector entities might be less comparable than for the private sector. Accordingly, public sector entities should be required to make additional disclosures to help overcome the potential lack of comparability.

31. Staff consider that, in addition to the requirements noted above, public sector entities should be required to disclose, for example, sensitivity of insurance liabilities to changes to the confidence level, such as plus or minus 10%. The amounts are not difficult to determine and provide an overall snapshot of variability that builds on the existing AASB 17/PBE IFRS 17.128 disclosures. This disclosure would be a particularly useful for an entity that has a zero risk adjustment.

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2 Please note, these are typical examples of sensitivity disclosures required. The actual disclosures made in response to the requirements would depend on the entity's circumstances.

3 If the entity uses a technique other than the confidence level technique, the entity must disclose the technique used and the confidence level corresponding to the results of that technique [AASB 17/PBE IFRS 17.119]. Public sector entities would not be expected to use anything other than a confidence level approach.

32. Staff acknowledge that this is akin to an approach that the Boards previously considered and rejected in developing AASB ED 319/NZASB ED 2022-3. In 2021, the Boards considered a range of possible approaches in respect of risk adjustments:

    (a) No modifications

    (b) No modifications – **with disclosure** required of a risk adjustment at a benchmark confidence level (such as 75%) to provide a point of reference for comparison

    (c) Specifying a zero risk adjustment – that is a confidence level of 50%

    (d) Specifying a zero risk adjustment – **with disclosure** required of a risk adjustment that would have been recognised if AASB 17/PBE IFRS 17 applied unmodified

    (e) Specifying a particular confidence level above 50% (such as 75%)

    (f) Specifying a particular confidence level above 50% – **with disclosure** required of a risk adjustment that would have been recognised if AASB 17/PBE IFRS 17 applied unmodified.

Staff recommendations

33. Staff recommend:

    (a) not to modify the requirements in AASB 17/PBE IFRS 17 to determine risk adjustments based on the compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise from insurance contracts;

    (b) providing guidance to the effect that:

        (i) public sector entities that do not seek to be compensated for bearing risk in their pricing/funding [which may relate to funding from levying insureds or from elsewhere, such as from sponsoring governments] would be expected to have zero risk adjustments in their liabilities for remaining coverage. In particular, under the premium allocation approach, which measures liabilities for remaining coverage based on levies/premiums received, there would be no implicit risk adjustment;

        (ii) some public sector entities may seek to be compensated for bearing risk, which would be determined based on identifiable facts and circumstances [such as pricing above break even] and, therefore, have risk adjustments above zero in their liabilities for remaining coverage. This could include cases in which entities have been tasked with raising revenue for the controlling government. However, it would not include cases in which entities have, for example, been tasked with building reserves to cater for long-term variability of cash flows of the entity on a stand-alone basis, without resorting to working capital from government;

        (iii) public sector entities that are not indifferent between fulfilling a liability that has a range of possible outcomes arising from non-financial risk and fulfilling a liability that would generate fixed cash flows with the same expected present value, would be expected to have risk adjustments above zero [measure their liabilities for incurred claims using a confidence level above 50%];

        (iv) some public sector entities may be indifferent between the two sets of cash flows mentioned in (iii) above and would be expected to have no risk adjustments [measure their liabilities for incurred claims using a confidence level of 50%];

(c) in the Basis for Conclusions, explaining the public sector context for the guidance [see paragraphs 22 and 23 above];[4] and

(d) requiring disclosure of the sensitivity of insurance liabilities to changes to the confidence level, such as plus or minus 10%.

Question for Board members

Q1: Do Board members agree with the staff recommendations noted in paragraph 33? If not, what other alternatives would you suggest?

4 Staff note that the Basis for Conclusions to AASB ED 319/NZASB ED/2022-3 currently includes discussion that might be inconsistent with these recommendations and would need to be revised, depending on the Boards' decisions at this meeting.

Appendix A: Collation of comments on question 6 in AASB ED 319 / NZASB ED 2022-3 – risk adjustments

Q6 The AASB is proposing no modifications 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.

In contrast, 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 in the NZASB's Exposure Draft 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 achieve a 75% confidence level (that is, a 75% probability of liabilities for incurred claims being adequate to meet actual claims).

(a) Do you support:

(i) the AASB approach of not modifying AASB 17 regarding the risk adjustment requirement; or

(ii) 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?

Please provide your reasons.

(b) Do you have a suggested alternative approach? If so, please outline the approach and provide supporting reasoning.

	Q6 – risk adjustments
OAG NZ	Does not support the NZASB proposed modification. Supports the principles-based approach that makes no modifications to PBE IFRS 17.37. PBE IFRS 17.37 [adjusting the estimated present value of future cash flows to reflect compensation required for bearing the uncertainty about the amount and timing of the cash flows] and PBE IFRS 17.119 [disclosures about the risk adjustment] are appropriate for public sector entities. Supports the AASB's conclusions and reasons for public sector entities to apply AASB 17/PBE IFRS 17 with no modification (see paragraphs BC126-BC127).

	Q6 – risk adjustments
	Public sector entities set levies to recover expected costs – the central estimate is the most relevant amount for these expected costs. Recognising a liability above the central estimate would mean the entity will recover levies and other funds at an amount over and above what it requires or expects to pay in claims. This would be inconsistent with the principle of inter-generational equity. While acknowledging the cost-benefit reasons for proposing the rebuttable presumption, they are not considered sufficiently compelling to justify a 75 % confidence level, rather than using the central estimate, when measuring a liability for incurred claims. If a rebuttable presumption was required, it would be preferable for the rebuttable presumption to be that no risk margin is included, and if this is rebutted, then the entity uses a 75% confidence level. Recommend that: • A public sector entity be required to apply PBE IFRS 17 without the proposed modification; and • Application guidance be included in PBE IFRS 17 to assist entities to determine when an estimate other than the central estimate would need to be used.
PwC	Do not disagree with the AASB proposal for not modifying the AASB 17 requirement for a risk adjustment. There is inherent risk in estimating these future cashflows and a risk adjustment acknowledges this. While pragmatically we can see how a 75% confidence level can be justified, as this is a principle-based standard, a particular per cent should not be legislated. Significant judgement would need to be applied by public sector entities to determine the level of compensation they require for bearing the risk of uncertainty associated with liabilities for incurred claims. In the private sector risk adjustments have trended over time towards consistency, assisted by guidance from APRA. Encourage as part of the implementation process for the Heads of Treasury Accounting and Reporting Advisory Committee (HoTARAC) to do an analysis and adopt something like the NZASB approach as part of their implementation process for all public sector entities to: (1) have a consistent approach based on a common confidence level, (2) reduce report preparation costs by removing the need for management and auditors to determine/assess risk adjustments, and (3) better illustrate the impacts of any changes in risk adjustments, which provides useful information about changing levels of uncertainty about the amount and timing of cash flows over time.

	Q6 – risk adjustments
TSY NZ	Preparers, auditors, and users need to be very clear about the purpose of the risk adjustment in the public sector and its usefulness to users of public sector financial statements. Under the current proposed standard, the Treasury does not think that is the case. The proposal suggests two conflicting rationales for the adjustment, which leads to two different interpretations of risk adjustments for public sector insurance arrangements: • First Rationale: Risk adjustment as an allowance for uncertainty; and • Second Rationale: Risk adjustment as a compensation for uncertainty Neither 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 is likely to lead to unnecessary and costly debates between preparers and auditors and confusion among users. *Implication for the proposed standard* 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. ***Option 1:*** 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 (the first rationale), the definition of the risk adjustment should be reworded in such cases to reflect that, and additional guidance provided to assist in its calculation. ***Option 2:*** If the risk adjustment is simply an expression of the compensation required due to the uncertainty in fulfilling the liability (the second rationale), additional application guidance should be provided to assist preparers who do not 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. **Treasury prefers Option 2** – it provides the cleanest and most understandable position for preparers, auditors and users. However, Treasury would prefer Option 1 to the rebuttable presumption currently proposed in ED 2022-3.

	Q6 – risk adjustments
iCare	Supports not modifying AASB 17. The NZASB proposal would be more onerous than the requirements of the private sector. iCare's risk management is based on industry best practice and aligned to APRA Guidelines where practicable.
HoTARAC	Members support the AASB approach of not modifying AASB 17 regarding the risk adjustment requirement. However, we seek clarification from the AASB on the possible contradiction between paragraph BC114(b) that states public sector entities might determine a zero risk adjustment, and paragraphs BC109, 111 and 112, which state that requiring a zero risk adjustment would be inappropriate.
EQC	Historically have reserved at a 75% probability of sufficiency, and more recently at 85%, at the decision of the Board to take a more conservative approach. Overall, the application of the rebuttable 75% confidence level is more clear cut in application than the alternatives, as the determination of a risk adjustment could be contentious in the public sector. We note Treasury advice that the determination of the EQC levy must follow guidance in respect of compulsory levies; in particular that it must only reflect the cost of services provided, so no profit margin is allowed. Overall, we are supportive of the NZASB approach with the 75% rebuttable confidence level. If this were to be removed, we would work with our colleagues at The Treasury to determine a suitable risk adjustment.
ACAG	Supports the AASB approach of not modifying the AASB 17 requirement regarding the risk adjustment as this is consistent with a principles-based standard and allows public sector entities to have regard to their individual facts and circumstances. However, the Basis for Conclusions should explain whether a public sector entity can have a zero-risk adjustment and the circumstances when this may be appropriate. Contradictory views are expressed in paragraphs BC93 and BC114 which may result in differing application by public sector entities and their auditors, even when those entities have similar arrangements. Irrespective of whether the scheme is long tail, some ACAG Offices believe some risk adjustment may be necessary because: • even where the agency's liability is guaranteed by its government, own credit risk does not appear to be part of the AASB 17 definition of risk adjustment • public sector entities are subject to the same or similar variability of cash-flows (i.e., uncertainty of the amounts of outstanding claims) as private sector entities.

	Q6 – risk adjustments
ACC	The requirement should principles-based with the goal being to improve information for the users of public sector financial statements. ACC's funding policy is based on best estimate assumptions with no pricing for additional risk. The Government has an on-going obligation to fund the ACC Scheme and its funding policy is long-term in nature pursuant to the Accident Compensation Act. ACC is able to adjust future levies to make up for higher-than-expected past claims. Our balance sheet should be consistent with our funding policy and no risk adjustment be included. It is important for users to understand the uncertainty in large balance sheet items like insurance liabilities. We suggest a sensitivity is included for the risk adjustment, which would provide better transparency. Sensitivity analysis generally includes individual changes in assumptions. A sensitivity for risk adjustment would provide additional information in that it considers all assumptions at once. If we are required to recognise a risk adjustment on balance sheet, we are comfortable with the NZASB proposed modification above. We note that the proposed wording differs slightly from the current risk margin approach in IFRS 4 in that it explicitly mentions timing and non-financial risk. We would appreciate additional guidance on if/how the methodology proposed differs from the current risk margin approach.
ICWA	Support no modifications to AASB 17 regarding the risk adjustment. The addition of a risk margin on claim liabilities recognises the inherent risk in the valuation of future claim costs and that such liabilities are not risk-free. The ICWA intends to continue to apply a risk margin that will achieve a 75% probability of sufficiency across all its insurance portfolios. The disclosure requirements will enable users to understand the risk margin assumptions of the entity and provide the ability to compare the underlying assumptions of different public sector entities.
KPMG	We support not modifying the risk adjustment requirement as this is consistent with principle-based standard setting. Although NZASB approach of standardising the probability of sufficiency with a rebuttable presumption would make the requirement relatively straightforward to implement, we note the risk adjustment under AASB 17 is entity-specific. The risk adjustment is "revenue-like in nature" and therefore its information value for public sector entities will not be the same as for private sector counterparts, as the approach to pricing risk in their contracts is different. The risk adjustment information would be useful from a claims and claims management perspective, which we understand is where users' focus lies in the public sector.

Appendix B: Current practices – risk margins

B.1 The table below outlines the practices of a number of Australian and New Zealand entities with respect to risk margins. The table and commentary below is reproduced from the AASB [Agenda Paper 10.3] and NZASB Agenda Paper 5.3 for the April 2021 meetings of the Boards.

Entity		***Risk margin[1]***	***Currently applying***
Accident Compensation Commission (NZ)		Yes – 75% PoA[2]	PBE IFRS 4
Earthquake Commission (NZ)		Yes – 85% PoA	PBE IFRS 4
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 use 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

1 Some entities refer to a 'prudential reserve'.

2 **PoA = 'Probability of Adequacy' or 'Confidence Level'**. 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.

B.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.

B.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.