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HM Treasury

Financial Reporting Advisory Board

IFRS 17 Update

Issue:	An update on the implementation of IFRS 17- Insurance Contracts in the public sector.
Impact on guidance:	HM Treasury is developing IFRS 17 application guidance. Any interpretations and/or adaptations will be brought into the Government Financial Reporting Manual (FReM).
IAS/IFRS adaptation?	Some interpretations and adaptations are likely to be necessary to fit IFRS 17 effectively to public sector conditions.
Impact on WGA?	IFRS 17 will impact on WGA when implemented; the potential impact is being considered with each issue raised.
IPSAS compliant?	There is no equivalent insurance accounting standard in IPSAS.
Interpretation for the public sector context?	Some interpretations and adaptations are likely to be necessary to fit IFRS 17 effectively to public sector conditions.
Impact on budgetary and Estimates regimes?	The budgetary regime will need to recognise insurance contracts and related cashflows. The mechanism may be shaped by the policy direction set out in HMT's report "The Government as Insurer of Last Resort".
Alignment with National Accounts	ESA10 does not have an equivalent recognition of government insurance contracts so there will be misalignment; HMT staff continue to engage on this issue with the ONS.
Recommendation:	FRAB members are invited to provide comments on this paper and provide feedback on the questions asked throughout the paper.
Timing:	IFRS 17 is effective in the private sector from 2023-24. The timing for adopting the Standard in the public sector is discussed in this paper.

DETAIL

Background

1. The International Accounting Standards Board (IASB) has issued IFRS 17 Insurance Contracts (the Standard), which replaces IFRS 4 Insurance Contracts.

2. At the March 2021 FRAB meeting HM Treasury presented an update on the IFRS 17 project, with a focus on the scope of the Standard. Since the last FRAB meeting HM Treasury has held further Technical Working Groups (TWG), where implementation of the Standard has been discussed in detail. The purpose of this paper is to update FRAB on these discussions.

Scope of the Standard

3. The scope of the Standard has been discussed in depth since the March 2021 FRAB meeting. Several different approaches were discussed and scrutinised in order to find the right balance between minimising the adaptations and interpretations in the FReM and ensuring the scope is appropriate for public sector entities applying the FReM.

4. The approach HM Treasury has taken is to provide guidance on scope setting out what is and is not a contract for the purposes of applying IFRS 17. IFRS 17 describes a contract as: 'an agreement between two or more parties that creates enforceable rights and obligations.[1]' Much of the discussion around scope was centred around whether legislation, in isolation, could be interpreted as a contract for the purposes of applying IFRS 17.

5. HM Treasury has therefore included guidance, stating that legislation and regulations, in isolation, are not equivalent to a contract as they are not agreements between two or more parties. This is explained in the extract application guidance in Appendix 1.

Question 1: Does the Board agree with HM Treasury's proposed approach to providing guidance on the scope of the Standard in the public sector?

Risk adjustment for non-financial risk

6. The next key discussion point was around the approach to the risk adjustment for non-financial risk.

7. IFRS 17 para 37 states the following:

   "An entity shall adjust the estimate of the present value of the future cash flows to reflect the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk."

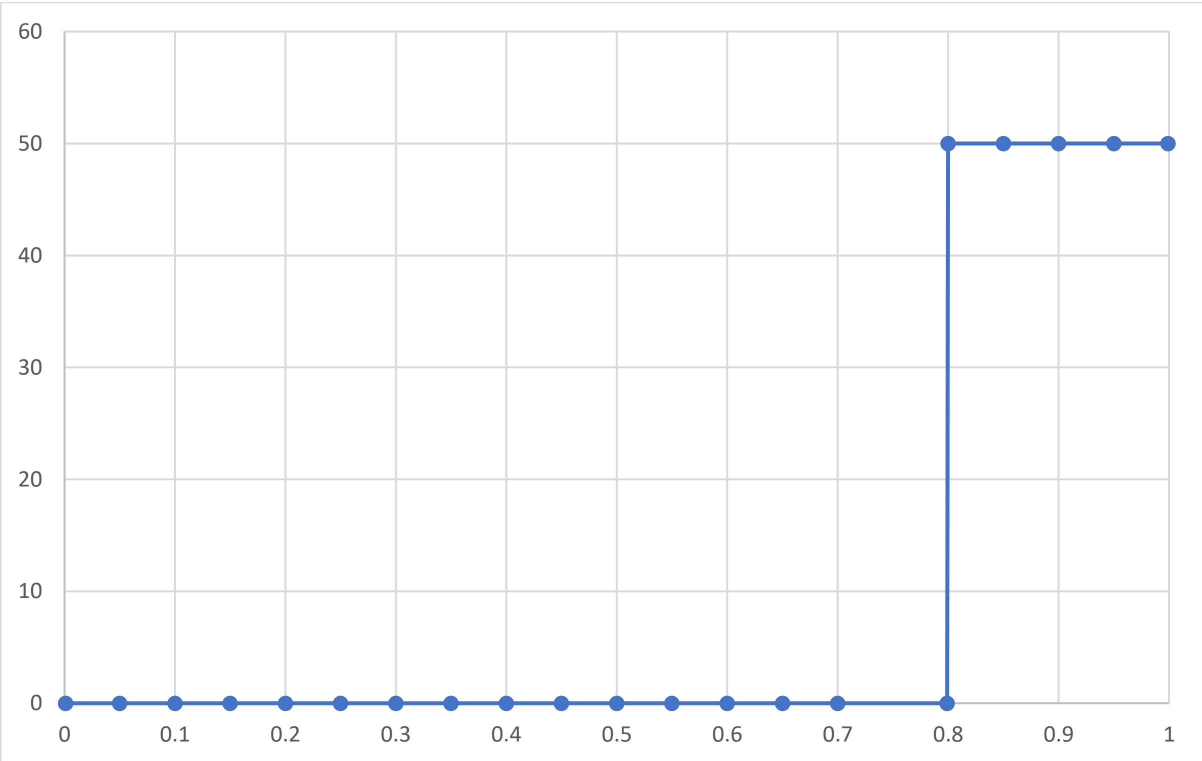
8. The risk adjustment for non-financial risk is defined as the compensation an insurer requires for bearing uncertainty over the amount and timing of future cash flows as it fulfils the contract.

[1] IFRS 17 para 2

9. In addition to measuring the risk adjustment for non-financial risk, IFRS 17 para 119 requires entities to disclose the confidence level at which the risk adjustment is measured. In the private sector it is expected that many entities will use a 75% level of confidence[2].

10. The requirement to choose and disclose a confidence level at which to calculate the risk adjustment may not be feasible for many public sector contracts and could even result in misleading disclosures in annual reports and accounts.

11. Consider the example of a contract with a remote probability of the insured event crystallising and the contract having a binary set of outcomes (either the insured event happens, or it doesn't happen- there is no in-between scenario). The probability distribution may look something like this:



12. The above distribution illustrates a scenario where there is an 80% chance of a £nil claim and a 20% probability of a claim of 50 (i.e., the probability of the liability crystallising is very low and there are binary outcomes; either the adverse event happens, or it does not). The mean in this scenario is therefore 10 ((80% x £0) + (20% x £50)). If the entity was to take the 75th percentile as the confidence level the risk adjustment would be -£10 (at the 75th percentile the value of potential outstanding claims is £nil less the mean of £10 gives to -£10)- this result may be confusing to the readers of the accounts.

13. An entity could set a confidence level of 90%, with the value at the 90th percentile being £50 and giving a risk adjustment of £40 (£50 less the mean of £10). This would

[2] Online Moody's (p.7) and Milliman's (p.8) for evidence many entities will be using a confidence internal of 70% - 75%.

mean the expected value of the claim plus the risk adjustment would be close to the maximum possible value of the claim.

14. Similarly, if another hypothetical claim has a 1% probability of occurring, but the amount paid if it did crystalise was £100m, then the probability weighted value is £1m but the entity would have to hold £99m as the risk adjustment if the risk adjustment was set at the 99th percentile or higher; if the risk adjustment percentile was set at anything lower than 99% it would be negative. This is not what the risk adjustment calculation is trying to achieve and would have significant implications for budgeting purposes.

15. The reasons that the IASB required the disclosure in paragraph 119 are set out in paragraphs B215 to B217 of the Basis for conclusions. As the risk adjustment is entity-specific, the confidence level disclosure provides an imperfect means of providing some comparability to understand whether some companies are very risk-averse, and others are not.

16. However, in government the degree of risk aversion between departments/ other government entities is already more comparable and consistent than between private sector entities. As such it is the view of HM Treasury that costs of including this disclosure requirement (IFRS 17 para 119) outweigh the benefits (with the costs being the need to calculate the confidence level at which risk adjustment was measured).

17. HM Treasury's proposed approach is as follows:

    - The requirement to measure a risk adjustment for non-financial risk per IFRS 17 para 37 will **remain**.

    - However, the requirement to disclose the confidence level at which the risk adjustment has been measured (IFRS 17 para 119) **will be removed**.

18. The guidance for the risk adjustment for non-financial risk has been included in this paper in Appendix 2.

Question 2: Does the Board agree with HM Treasury's approach set out in the guidance on the scope of the risk adjustment for non-financial risk and the proposed adaptation to remove the requirements of IFRS 17 para 119?

Transition to IFRS 17 – Timing of implementation

19. IFRS 17 is effective from 1 January 2023 for entities applying IFRS. In previous FRAB updates, the working assumption has been that the Standard will be aligned to this timeframe with implementation in the public sector from 2023-24.

20. HM Treasury is now proposing to delay mandatory adoption of the Standard for at least 1 year (i.e. the earliest date of mandatory adoption of the Standard would be from financial year 2024-25) to allow full consideration of the adaptations and interpretations in the public sector and to provide entities sufficient lead time to implement.

21. The reasons for this are:

- IFRS 17 is a detailed and complex Standard needing some time to implement, set up new systems, processes etc. with the private sector having had a long lead time to prepare. However, the work plan for implementation in the public sector is based on the final standard once issued, requiring additional time to assess its application in the public sector.
- The potential adaptations and interpretations are still being considered with the proposed application guidance in development leaving insufficient notice for the public sector to prepare for and implement the Standard by financial year 2023-24.
- There are significant ongoing delays to the publication of public sector annual reports and accounts due to the impact of COVID-19, impeding transparency and accountability over the use of public funds by public sector entities. In central government, the return to a pre-recess laying timetable for almost all entities is expected to be achieved by 2022-23 at the earliest. Entities also need to implement IFRS 16 from financial year 2022-23, which creates another major reporting challenge. Mandatory adoption of IFRS 17 from 2023-24 may result in further delays to the financial reporting process as well as on the compilation of the WGA.

22. Instead of mandatory implementation of the Standard from 2023-24, HM Treasury propose a hybrid approach to implementing the Standard from 2023-24, in the same way as was offered for the implementation of IFRS 16, whereby entities who wish to implement from 2023-24 may do so with permission from HM Treasury and subject to any adaptations and interpretations having been agreed by FRAB.
23. It's important the option of early adoption is offered as there is at least one regulated insurer in the public sector who will have to adopt the Standard from 2023-24. This will also allow entities who wish to adopt from 2023-24 the option to do so. Though this can cause inconsistencies within the WGA, this is something which HM Treasury would look to manage internally.

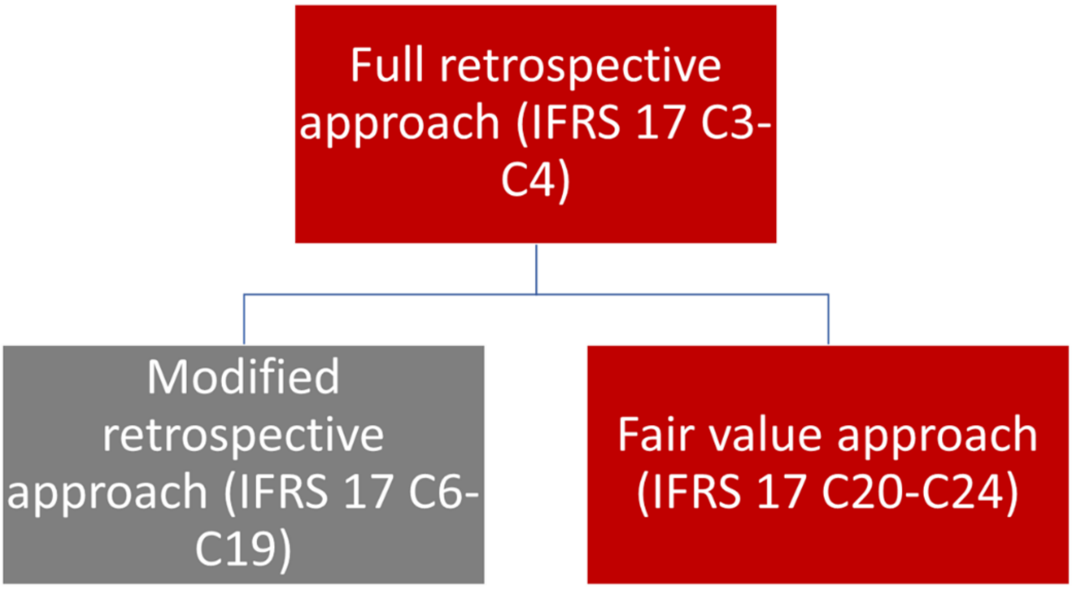
Question 3: Does FRAB support HM Treasury's proposal to delay mandatory adoption of IFRS 17 by at least 1 year?

Question 4: If so, does FRAB agree to a hybrid implementation approach to allow departments to adopt the Standard from 2023-24 with HM Treasury approval?

Transition to IFRS 17 – Transition Approach

24. The transition approach was discussed at the October 2021 IFRS 17 Technical Working Group. It was agreed HM Treasury should propose mandating a transition approach for consistency reasons.
25. IFRS 17 requires the use of full retrospective restatement unless impracticable. If full retrospective restatement is impracticable entities can either choose the modified retrospective restatement approach or the fair value approach.
26. After discussion within the Technical Working Group, it was agreed HM Treasury would propose to mandate the full retrospective approach, and if impracticable the fair value

approach. The diagram below illustrates the transition approach (red = HM Treasury mandated approach:



27. The fair value approach has been chosen for ease of transition. Though the modified retrospective approach is a simplified version of the full retrospective approach, it can still be challenging and has a significant number of accounting policy choices which would need to be analysed and mandated.

28. Conversely, the fair value approach is more straightforward in its application, though the calculation of fair value may be a challenge in itself. Nonetheless, on balance there was agreement that the fair value approach is the preferred approach where full retrospective restatement is impracticable.

29. HM Treasury is currently looking at whether a fair value approach should be mandated for transition (i.e. if an entity uses the fair value approach, should the market, cost, or income approach be mandated). This is currently a work in progress.

No questions for FRAB as the work on the transition approach is ongoing, but we welcome any comments you may have.

HM Treasury

18th November 2021

Appendix 1 – Draft guidance on scope of IFRS 17

2.1 Definition of an insurance contract

2.1.1 For a transaction to be within the scope of IFRS 17, a contract must be in place. A contract does not need to be explicitly described as insurance, or as a contract, to be deemed an insurance contract. What matters is the substance: does it meet the description of a contract as used in IFRS 17, and does it transfer insurance risk?

> ### Definition of an insurance contract
>
> An insurance contract is a contract under which one party (the insurer) 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.[3]

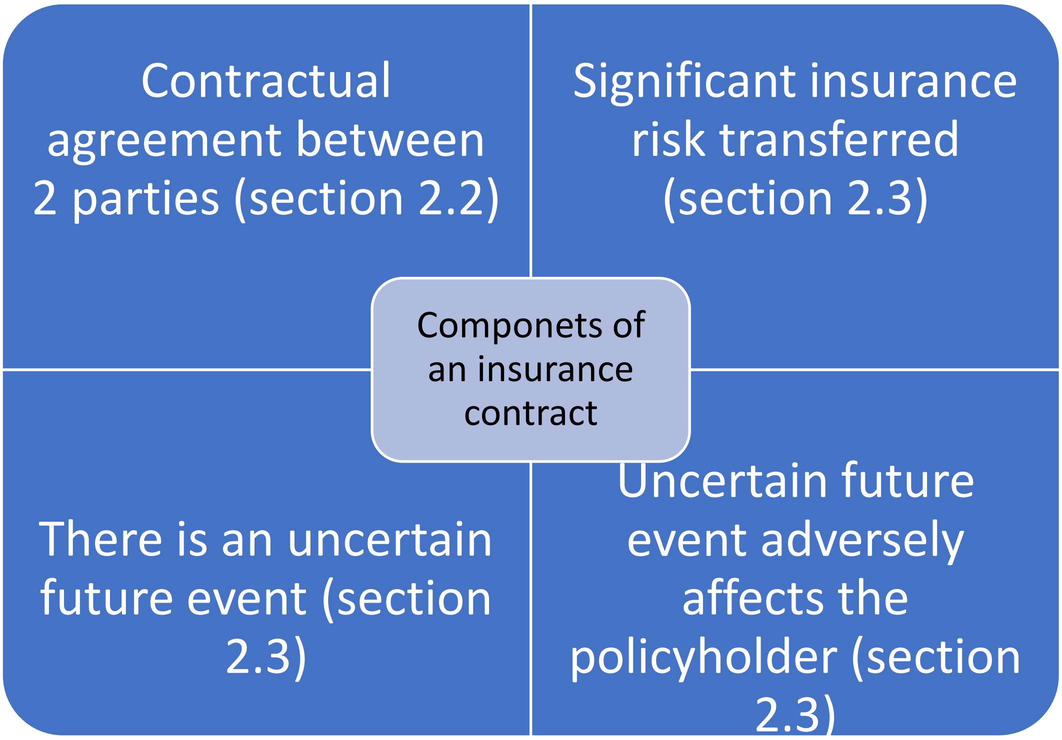
2.1.2 Any entity can issue an insurance contract if it has taken on insurance risk from another party. It does not have to charge a fee for the service, or to define itself as an insurance provider. The arrangement does not need to be described as insurance and does not need to be in writing. IFRS 17 only applies, however, if there is a contract as described below:

> ### Description of a contract
>
> A contract is described in IFRS 17 as an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices.[4]

2.1.3 Based on the definitions of an insurance contract in IFRS 17 entities should consider the following questions when determining whether a transaction is in scope of the Standard:

- Is there an agreement between two or more parties? (refer to section 2.2 below for further discussion of contracts in the public sector)
- Is there a transfer of risk from the issuer of the contract to policyholder? If so, is that risk insurance risk and does it meet the definition of significant insurance risk under the Standard? (refer to section 2.3 below)
- Does the contract cover an uncertain insured event which, if occurred, would adversely affect the policyholder? (refer to section 2.3 below)

[3] Refer to defined terms in IFRS 17 for a full definition of an insurance contract, significant insurance risk, policyholder and insured event.
[4] Please also refer to IFRS 17 para 2 for a full discussion of what a contract is under IFRS 17.



2.1.4 One area where the public sector differs to the private sector is how responsibilities set out in legislation interact with the concept of a contract in IFRS 17. Specifically, do legislative responsibilities equate to contractual obligations under IFRS 17? The next section provides guidance on this question.

2.2 When a responsibility is not a contract

2.2.1 Determining whether there is a contract (as described in IFRS 17) in place is the first step entities should undertake when assessing whether they provide insurance within the scope of IFRS 17. Many arrangements transfer significant insurance risk (see the next section) but do not meet the IFRS 17 description of a contract. These arrangements are not treated as insurance contracts within the scope of IFRS 17 and are accounted for under another appropriate standard or using accounting policies developed applying the Conceptual Framework.

2.2.2 As noted above, legislation can confer responsibilities on public sector organisations, but these are not necessarily contractual. For the purpose of applying IFRS 17 in the public sector, legislation and regulations, in isolation, are not equivalent to insurance contract – legislation and regulations do not fall within the scope of the definition. The key difference is that legislation and regulations enabling, for example, the NHS to provide healthcare free at the point of delivery or social benefits are not agreements between government and specific individual citizens or businesses. Rather, legislation and regulation can enable or oblige entities to provide services or make certain payments. They can include binding rights or obligations, can facilitate the creation of arrangements that fall within the definition of a contract and can form part of the implied terms of a contract, but in themselves are not agreements between parties.

Public sector interpretation: For the purpose of applying IFRS 17 in the public sector, legislation and regulations, in isolation, are not equivalent to insurance contract – legislation and regulations do not fall within the scope of the definition. They can include binding rights or obligations, can facilitate the creation of arrangements that fall within the definition of a

contract and can form part of the implied terms of a contract, but in themselves are not agreements between parties.

2.2.3 To provide an example, the NHS Act 2006 is not a contract between all NHS entities and a specific party; it is legislation setting out how NHS bodies should operate. Similarly, the numerous Social Security Acts or even the legislation drawn up to deal with COVID-19 are not contracts between the DWP and a specific party or HMRC and a specific party; again, this legislation sets out how DWP and HMRC are to operate when administering certain social benefits.

2.2.4 Contrast this with commercial health insurance. A party purchasing commercial health insurance will have a contract with the private healthcare provider e.g., a policyholder could have a 10 year insurance contract with a private healthcare provider, which will obligate the private healthcare provider to provide care in accordance with the insurance contract for those 10 years. This is an explicit agreement between policyholder and issuer setting out what is being covered and the duration of the cover which is legally enforceable.

2.3 Insurance risk vs financial risks, significant insurance risk and uncertain future events

2.3.1 Once it has been determined a contract is in place, another consideration is the type of risk transferred from the policyholder to the issuer. A central concept of IFRS 17 is the transfer of risk. However, to be within the scope of IFRS 17, the risk transferred must be insurance risk.

2.3.2 IFRS 17 defines insurance risk as any risk which is not a financial risk. A financial risk is defined in IFRS 17 below:

What is a financial risk?

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.

2.3.3 Therefore, if the risk transferred is not a financial risk, it is an insurance risk. The next question to ask is whether the insurance risk is significant or not. Significant insurance risk is a key term in the Standard as an insurance contract cannot exist without the entity accepting significant insurance risk from the policyholder.

What is significant insurance risk?

Insurance risk is significant if, and only if, an insurance event could cause the issuer to pay additional amounts that are significant in **any single scenario**, excluding scenarios which have no commercial substance.[5]

It is important to note that significant insurance risk can exist even if the insured event is extremely unlikely or the expected present value of the contingent

[5] IFRS 17 para B18

cashflows is a small proportion of the expected present value of the remaining cash flows from the insurance contract.5

Paragraphs B17-B23 of IFRS 17 discusses significant insurance risk in more detail.

2.3.4 The final part of the definition of an insurance contract is that compensation is provided by the issuer to the policyholder for an uncertain future event which adversely affects the policyholder. This part of the definition is relatively straightforward and IFRS 17 paras B3-B5 discussed this in further detail.

2.4 Contingent liabilities

2.4.1 The annual reports and accounts of entities following the FReM must include details of material remote contingent liabilities. Guidance on the Contingent Liability Approval Framework broadly defines remote as the probability of future settlement being very small.

2.4.2 Remote contingent liabilities do not meet the IAS 37 criteria for disclosure in IFRS compliant financial statements as the likelihood of them crystallising is very low. Remote contingent liabilities therefore sit outside of the financial statements entirely and are disclosed in the Parliamentary Accountability Report.

2.4.3 However, significant insurance risk as defined in IFRS 17 can exist even if:

- the probability weighted presented value of the contingent cash flows is a small proportion of the remaining cash flows from the insurance contract; or
- the insured event is extremely unlikely[6].

2.4.4 It is possible that an obligation could be both an insurance contract in scope of IFRS 17 and a remote contingent liability as defined in the FReM and the Contingent Liability Approval Framework.

2.4.5 If a remote contingent liability is recognised as an insurance liability on-balance sheet, in all likelihood the value of that on-balance sheet liability would be significantly lower than the amount disclosed in the accountability report as the insurance liability value on the balance sheet is probability weighted.

2.4.6 Under IFRSs, IAS 37 excludes from its scope contracts meeting the definition of insurance contracts under IFRS 4 and IFRS 17. Therefore, where a contract may appear to be a provision or contingent liability under IAS 37 and an insurance liability under IFRS 17, it should be accounted for under IFRS 17.

2.4.7 It is important that high standards of parliamentary accountability are maintained, and Parliament is notified of remote contingent liabilities which may have a significant impact through the supply estimates process. As such, the following rules must be followed:

- If a liability meets the definition of an insurance contract it must always be accounted for under IFRS 17 and included on the balance sheet.
- If a liability which is an insurance contract under IFRS 17 would also meet the definition of a contingent liability or provision under IAS 37, that liability must be accounted for under IFRS 17.

[6] IFRS 17 para B18

- If a liability meets the definition of an insurance contract under IFRS 17 and a remote contingent liability as defined in the Contingent Liability Approval Framework, as well as being accounted for under IFRS 17 it must also be disclosed within the parliamentary accountability report as a remote contingent liability.

2.4.8 This means that insurance liabilities within the scope of IFRS 17 which would also meet the definition of a remote contingent liability, that have a maximum exposure of at least £3m and are novel, contentious or repercussive should go through the Contingent Liability Approval Framework process.

2.5 Insurance and reinsurance contracts between public sector bodies

2.5.1 As mentioned in Section 1, entities in the UK public sector will generally self-insure against risks as this achieves better value for money. Entities within the same group may also provide insurance to each other, for example a department providing insurance to one or more of its agencies or ALBs.

Is self-insurance within the scope of IFRS 17?

The answer to this is no, except for, single entity financial statements where an entity provides insurance to another entity within the group. The following examples will illustrate this point:

- Instead of purchasing commercial insurance, an entity chooses to bear the risk of an uncertain future event adversely affecting them. This arrangement would be outside of the scope of IFRS 17 as there is no agreement with another party. Any related expenditure (e.g., if the risk crystallises) will be accounted for under another IFRS standard or using accounting policies developed applying the Conceptual Framework.
- A department provides an insurance service to its ALBs by agreeing to cover claims to damage incurred or loss of computer equipment. At the group level the transactions between the two entities associated with this service net off on consolidation. However, at the single entity level (i.e., at the core department only level) there may be an insurance contract is it is determined there is a contract in place between the department and its ALBs, with the department taking on significant insurance risk.

IFRS 17 para B27(c) explains this further.

2.5.2 IFRS 17 requires that reinsurance contracts are accounted for separately from the underlying insurance contracts to which they relate. The reason for this is that reinsurance contracts do not normally allow the entity the right to reduce amounts owed to the underlying policyholder by amounts they expect to receive from the reinsurer.

What is reinsurance?

If a parent department has agreed to provide cover to one of its agencies or other bodies that has issued an insurance contract, so that the cost of any risk that crystallised would be passed on to the department, then the insurance risk has been transferred again. Under IFRS 17 this second transfer constitutes a reinsurance contract.

The definition of a reinsurance contract under the Standard is an insurance contract issued by one entity (the reinsurer) to compensate another entity for claims arising from one or more insurance contracts issued by that other entity (underlying contracts).

2.5.3 An entity which has purchased reinsurance would recognise both the insurance contract and the reinsurance contract in its financial statements. If the insurance contract was a liability on the agency's statement of financial position, and the parent department had agreed to cover the whole cost of the risk crystallising, then the reinsurance contract would be a corresponding asset and the net impact would be zero.

2.5.4 There are two key differences when measuring reinsurance contracts, being the risk adjustment for non-financial risk and the contractual service margin (CSM) for a group of reinsurance contracts held.

- For reinsurance contracts held, the risk adjustment for non-financial risk represents the amount of risk being transferred by the holder to the issuer of reinsurance contracts.
- For reinsurance contracts held, the CSM is modified to represent a net cost or net gain on purchasing the reinsurance rather than representing unearned profit (as with normal insurance contracts).

2.6 Fixed-fee service contracts

2.6.1 IFRS 17 provides a scope exception for fixed fee service contracts so that such contracts may be accounted for under either IFRS 15 or IFRS 17, at the discretion of the entity subject to certain criteria.

2.6.2 An example could be a maintenance contract where the provider agrees to fix equipment after malfunction and the fee charged for the contract is fixed rather than variable based on the work to be performed. Such contracts could meet the definition of an insurance contract.

2.6.3 IFRS 17 allows entities to account for fixed fee contracts under IFRS 15 rather than IFRS 17 if the three conditions noted in IFRS 17 para 8 are met:

- the entity does not reflect an assessment of the risk associated with an individual customer in setting the price of the contract with that customer;
- the contract compensates the customer by providing services, rather than by making cash payments to the customer; and
- the insurance risk transferred by the contract arises primarily from the customer's use of services rather than from uncertainty over the cost of those services.

2.6.4 To improve consistency of public sector annual reports and accounts and consolidation of entities within the Whole of Government Accounts (WGA) the Standard in the public sector has been interpreted to mandate use of IFRS 15 where the criteria in IFRS 17 para 8 are met.

2.6.5 Public sector interpretation: the accounting policy choice to account for contracts meeting the criteria set out in IFRS 17 para 8 has been withdrawn. All entities applying the FReM shall account for contracts meeting the criteria in IFRS 17 para 8 under IFRS 15.

2.7 Financial guarantee contracts

2.7.1 Prior to the implementation of IFRS 17 entities may have financial guarantee contracts, which have similar features to insurance contracts. Financial guarantee contracts can be accounted for under IFRS 9 and are defined in IFRS as contracts which require the issuer to make specified payments to reimburse the holder for a loss it incurs due to the debt repayments not being received.

2.7.2 Financial guarantee contracts transfer credit risk. IFRS 17 explicitly excludes from its scope financial guarantee contracts **unless** the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts[7].

2.7.3 Where an entity's contract(s) have met the conditions to be within scope of IFRS 17 the entity can elect to account for those contracts either under IFRS 17 or IAS 32, IFRS 7 and IFRS 9. The election can be made on a contract-by-contract basis but is irrevocable.

2.7.4 This accounting policy choice has been carried forward from IFRS 4 to IFRS 17 by the IASB. IFRS 17 Basis for Conclusions paragraph BC 93 notes that this option had intended to be a temporary solution but in practice, in the vast majority of cases, the accounting policy choice is clear, and no implementation issues arouse. Para BC93 also noted that the practice results in consistent accounting for economically similar contracts issued by the same entity.

2.7.5 NOTE FOR FRAB- WE EXPECT TO MANDATE IFRS 9 FOR FGCs- WORDING IS TBD.

[7] IFRS 17 para 7(e)

Appendix 2 – Draft guidance on the risk adjustment for non-financial risk

Risk adjustment for non-financial risk

3.2.1 To account for the uncertainty associated with insurance contract cash flows, IFRS 17 includes a risk adjustment. In the Standard this is referred to as, the risk adjustment for non-financial risk and it distinguishes it from the financial risk element addressed by the discount rate (IFRS 17 paragraphs 37 and B87-B92).

3.2.2 The risk adjustment for non-financial risk is defined as the compensation an insurer requires for bearing uncertainty over the amount and timing of future cash flows as it fulfils the contract.

3.2.3 IFRS 17 does not specify the estimation techniques that an entity should apply when calculating the risk adjustment. The standard does however, set out a list of characteristics that this adjustment should have, in paragraph B91.

3.2.4 The reasons for including this adjustment are explained further in the IFRS 17 Basis for Conclusions but to summarise the adjustment was included in the calculation of the insurance liability for the following reasons[8]:

- The adjustment results in an explicit measurement of non-financial risks, providing clearer insight into the insurance contracts.
- It provides useful information about the entity's view of the economic burden imposed by non-financial risk associated with insurance contracts.
- The adjustment results in profit recognition pattern reflecting profit from bearing risk and from providing insurance services.
- The adjustment highlights instances where the entity has charged insufficient premiums for bearing the risk that claims exceed premiums.
- The adjustment will report changes in risk promptly and in an understandable way.

3.2.5 IFRS 17 includes the principle of what the risk adjustment should represent. It does not set how to calculate the adjustment. One key thing to note is that the risk adjustment is calculated from the **perspective of the issuer- not the market**.[9] This means the risk adjustment for non-financial risk can differ between entities for similar groups of contracts.

3.2.6 To calculate the risk adjustment for non-financial risk, there are three common methods discussed by corporate finance professionals:

- Value at Risk (VaR) [also known as the confidence level technique]
- Tail Value at Risk (TVaR)
- Cost of Capital

3.2.7 As noted above, IFRS 17 does not prescribe a method for calculating the risk adjustment, so there may be additional methods to measure the risk adjustment for non-financial risk, and this guidance does not go into the above methods in any detail.

[8] IFRS 17 BC211
[9] IFRS 17 BC215

3.2.8 Paragraph 119 of IFRS 17 requires entities to disclose the confidence level used to determine the risk adjustment for non-financial risk. Where a technique other than the confidence level technique is used, entities should disclose the technique used and the confidence level corresponding to the results of that technique.

3.2.9 IFRS 17 Basis for Conclusions notes that the reason for this disclosure requirement is to allow users of financial statements to understand different entities' assessment of risk aversion; as noted above the risk adjustment is from the perspective of the issuer rather than the market. In simple terms, the confidence level disclosure allows users of financial statements to understand the level of the company's risk aversion.

3.2.10 However, within government the degree of risk aversion is already comparable and consistent. A department is unlikely to be deliberately more risk taking than others and all departments are subject to the same core control frameworks implemented by HM Treasury. For this reason, the confidence level disclosure is of less value in public sector annual reports and accounts. Consequently, the requirement to disclose the confidence level used the determine the risk adjustment for non-financial risk has been withdrawn for public sector entities.

Public sector adaptation: the requirement of IFRS 17 paragraph 119 to disclosure the confidence level used to determine the risk adjustment for non-financial risk has been removed.