HM TREASURY

FRAB 149 (07)
30 March 2023

Financial Reporting Advisory Board paper

IFRS 17 Insurance Contracts

Issue:	HM Treasury published an Exposure Draft on IFRS 17 in January 2023. This paper provides summaries of the feedback received on the Exposure Draft and HM Treasury proposals on what the final FReM guidance on IFRS 17 should be.
Impact on guidance:	The FReM and associated illustrative financial statements will be updated for financial year 2025-26.
IAS/IFRS adaptation?	Adaptations and interpretations have been proposed in this paper. Many of these have been seen and discussed by FRAB in previous meetings. In addition to providing the full application guidance, this paper highlights changes made since the application guidance was viewed by FRAB at the November 2022 meeting.
Impact on WGA?	The adoption of IFRS 17 may affect how insurance contract accounting is applied for the 2025-26 WGA (depending on the final decisions on interpretations/adaptations, effective date and early adoption).
IPSAS compliant?	There is no equivalent insurance accounting standard in IPSAS.
Interpretation for the public sector context?	This is covered above.
Impact on budgetary regime and Estimates?	The proposed budgetary regime will align with the accounting treatment.
Alignment with National Accounts	We have engaged with the ONS on treatment of insurance contracts in budgets and estimates from a National Accounts perspective. The ONS have confirmed they are content with HM Treasury's proposed regime from the National Accounts perspective.
Recommendation:	The Board considers and provides views on the issues discussed in this paper and agrees to the publication of the IFRS 17 application guidance shortly after the March 2023 FRAB meeting.
Timing:	Amendments to the FReM confirmed at this meeting will be published in December 2024.

DETAIL

A - Background

A.1 The International Accounting Standards Board (IASB) has issued IFRS 17 Insurance Contracts (the Standard), which replaces IFRS 4 Insurance Contracts. IFRS 17 was approved for adoption by the UK Endorsement Board on 16 May 2022.

A.2 HM Treasury issued an Exposure Draft (ED) in January 2023 proposing changes to the FReM for IFRS 17. The consultation period for the Exposure Draft ended in February 2023.

A.3 HM Treasury have received a total of 15 responses. Entities who responded ranged from government departments and ALBs, regulators and auditors. There were some common themes to the comments raised, which are discussed further below.

A.4 The updated IFRS 17 application guidance can be found in Annex A (application guidance with tracked changes has been provided in Annex B).

B – Changes made to the IFRS 17 application guidance

The below table sets out changes made to the IFRS 17 application guidance as a result of feedback from stakeholders. For some changes made, further explanation and analysis is provided in later sections of this paper as referenced in the table.

Number	Application Guidance Section/ Paragraph	Explanation and rationale of change made
1	2.3.5 – 2.3.7	These paragraphs have been added to explain the application of IFRS 17 paragraph B11. From HM Treasury's consultations with central government departments, it was identified that entities were applying this paragraph to determine whether a contract was in scope of IFRS 17. Given the importance of this guidance in IFRS 17, HM Treasury propose to include guidance on how the paragraph is intended to be applied to ensure a consistent application of the guidance across entities.
2	Section 2.4 Contingent Liabilities (now deleted in tracked changes)	Refer to section C below.
3	Section 2.7 (new section for intra-government agreements)	Refer to section D below.
4	3.2.3.2	When discounting, there are instances where the current discount rate is used and other instances where the discount rate at initial recognition is used. When to use each of the type of discount rate is explain in IFRS 17 paragraph B72, but it is proposed that the IFRS 17 Application Guidance

		would benefit from including this guidance as a reminder to accounts preparers.
5	Discount rate adaptation below paragraph 3.2.3.9	The change made to the adaptation is in red: 'There is a rebuttable assumption that the financial instrument discount rate (as stated in PES papers) will be used to discount IFRS 17 insurance liabilities, except for insurers regulated by the Prudential Regulation Authority (PRA) and entities whose principal business activity is insurance or reinsurance.' The wording in red was added to clarify what was meant by 'regulated insurers'. Entities in central government have complex relationships with their sponsor departments and HM Treasury, such that one could interpret there is a form of regulation by a core department/ HM Treasury on its arm's length bodies. To avoid these interpretations of HM Treasury's guidance, the wording in red was included, which was the intention of the adaptation.
6	3.2.3.10 – 3.2.3.11, 3.3.3	Refer to section E below.
7	3.4, in the table the row referencing IFRS 17 paragraph 20	HM Treasury propose not to mandate an approach for this accounting policy choice. After further consultation and analysis, it is unlikely central government entities will issue insurance contracts where laws or regulations constrain an entity's ability to set a different price or level of benefits for policyholders with different characteristics. It is therefore unclear which grouping approach would be optimal for central government entities. Consequently, HM Treasury propose not to mandate an approach.
8	3.4, in the table the row referencing IFRS 17 paragraph 81	There was an accounting policy choice which was missed from the ED relating to IFRS 17 paragraph 81. HM Treasury propose to mandate including changes in the risk adjustment for non-financial risk as part of the insurance service result rather than disaggregating between the insurance service result and finance income/ expenses. The reason for this is for consistency purposes between central government annual reports and accounts, consolidation into the Whole of Government Accounts (WGA) and because the costs of disaggregating are likely to outweigh the benefits to users of annual reports and accounts.
9	4.2.7	In this paragraph the rationale has been included for choosing the fair value approach to mandate as an alternative transition approach over the modified retrospective approach.
10	Section 4.4 (optional practical expedient)	A new section has been added to include the optional practical expedient. Refer to section F below.

11	Section 4.5 (transitional reliefs)	HM Treasury propose not to mandate the transitional relief which allows entities not to present qualitative information required by paragraph 28(f) of IAS 8 to disclose the amount of each financial statement line affected for the current and prior periods. This has not specifically been mandated as IFRS 17 already states entities do not need to provide this information. As such the adaptation appears unnecessary.
12	Section 4.6 (summary of transition approach)	This section has been added to summarise the transition approach.
13	6.1.6	Paragraph added to added further context to the budgeting regime proposed for insurance contracts.
14	6.1.8	Paragraph added to confirm that where entities have previously agreed a budgeting approach with HM Treasury, this will continue.
15	Section 6.2	Section added to state the impact of transitioning to IFRS 17 on estimates.

Question for FRAB

1) Aside from changes 2, 3, 6 and 10, do you have any comments on the changes made to the IFRS 17 application guidance noted in the table above?

C - IFRS 17 and Remote contingent liabilities

C.1 The IFRS 17 exposure draft included a requirement to disclose insurance contract liabilities which also met the definition of a remote contingent liability in the accountability report as well as in the financial statements. The rationale for this was to maintain high levels of parliamentary reporting and accountability as there was a concern IFRS 17 could result in some remote contingent liabilities being reclassified to insurance contracts accounted under IFRS 17 with an immaterial probability-weighted value (and therefore have less visibility in central government annual reports and accounts).

C.2 HM Treasury received several objections to requiring this dual reporting framework. The reasons for this were:

a. This dual reporting arrangement is not in place for other accounting standards. For example, there could be financial guarantee contracts accounted under IFRS 9 which have a remote probability of crystallising, but a similar dual reporting framework is not included for these types of liabilities.
b. Including this type of dual reporting arrangement is adding to the length of annual reports and accounts (which some respondents already consider lengthy documents).
c. The dual reporting arrangement could be seen as duplicative and confusing to readers of annual reports and accounts if they see the same transaction being disclosed at different values in the same annual report and account.

d. There are already processes in place to notify parliament of potential liabilities which are significant by size, are not used routinely used in commercial business dealings, have a statutory requirement to be notified to parliament or are novel, contentious or repercussive. Such liabilities are already required to be reported to parliament via a Written Ministerial Statement and departmental minute, which is laid in the House of Commons.

C.3 HM Treasury agree with the objections raised by respondents to the ED to the inclusion of the dual reporting framework for insurance contract liabilities which have a remote probability of crystalising.

C.4 **HM Treasury therefore propose to remove this requirement from the draft IFRS 17 application guidance.**

Question for FRAB

2) Do you agree with HM Treasury's proposal to remove the requirement to disclose insurance contract liabilities which also meet the definition of a remote contingent liability in the accountability report?

D - Intra-government agreements

D.1 Some respondents queried whether intra-government arrangements which are not enforceable by law should be within the scope of IFRS 17, similar to intra-government leasing arrangements accounted under IFRS 16. Reasons for this included:

a. Consistency with adaptations HM Treasury have made to other accounting standards.

b. To provide clarity over whether intra-government agreements which are not legally enforceable are within scope of IFRS 17 in central government.

D.2 It should be noted that one entity held the view that the scope of IFRS 17 should not be expanded to include intra-government agreements which are not enforceable by non-legal means. The reason for this was experience from International Public Sector Accounting Standards (IPSAS), which suggests it is important for public sector accounting frameworks to provide clear guidance on whether to analyse transactions between binding and non-binding elements.

D.3 HM Treasury propose such agreements **should** be scoped into IFRS 17. The reasons for this are:

a. Reporting inter-government arrangements which are not enforceable by law would ensure consistency of approach with adaptations to IFRS 16, where the definition of a contract was expanded to include intra-government agreements that are not legally enforceable.
b. Government entities undertake a large number of transactions with each other (including within the same departmental group). Reporting intra-government insurance arrangements should ensure there is a complete picture of an entity's liabilities.

c. Including such arrangements in financial statements could incentivise better risk management by both the issuer and policy holder.

D.4 HM Treasury therefore propose to add a new adaptation to the IFRS 17 Application Guidance to include intra-government agreements that are not legally enforceable within the scope of IFRS 17.

D.5 This adaptation is intended to capture insurance-like arrangements between Crown bodies, or other governmental bodies, that are not legally enforceable but are in substance akin to an enforceable contract. It also aligns the definition of a contract with adaptations made to IFRS 16 in the FReM regarding intra-government agreements.

D.6 Although this adaptation broadens the definition of an insurance contract, it does not mean that all insurance-like intra-UK governmental agreements will meet this definition. Any such agreements made should be carefully analysed to determine whether they meet the definition of an insurance contract.

D.7 HM Treasury are cognizant that expanding the scope to include intra-government agreements at this late stage is a significant step to take. It will result in entities and auditors having to review all intra-government agreements (such as memorandums of understanding, framework agreements etc.) to see if there are any insurance arrangements therein. It may require procurement of additional insurance and actuarial expertise if insurance arrangements are identified in intra-government agreements.

D.8 HM Treasury are currently consulting with government entities to further understand the impact including this adaptation will have, such as:

a. Whether the proposed adaptation could result in any unintended consequences.

b. How much more burdensome compliance with IFRS 17 could be if the adaptation was included in the FReM.

c. Whether implementation of IFRS 17 from 1 April 2025 is achievable if this adaptation was included in the FReM.

D.9 If the HM Treasury consultation identifies any unintended consequences or other issues created by including this adaptation, including any impacts on the effective date of IFRS 17, we will bring the issue back to FRAB in an out-of-meeting paper. We are therefore asking FRAB to agree with this recommendation in principle, subject to any issues identified in consultation.

Question for FRAB

3) Subject to any issues identified in consultation, do you agree with HM Treasury's proposal to include intra-government agreements which are not enforceable by laws and regulations within the scope of IFRS 17?

E - Discount rates – associated disclosure IFRS 17 paragraph 120

E.1 IFRS 17 paragraph 120 requires the following disclosure: 'An entity shall disclose the yield curve (or range of yield curves) used to discount cash flows that do not vary based on the returns on underlying items, applying paragraph 36. When an entity provides this disclosure in aggregate for a number of groups of insurance contracts, it shall provide such disclosures in the form of weighted averages, or relatively narrow ranges.'

E.2 IFRS 17 Basis for Conclusions paragraph 198 states the reason for the disclosure of the yield curve used to discount cashflows is to allow financial statement users to understand how yield curves differ between entities. This rationale does not entirely apply to entities applying the HM Treasury discount rate as a single, central discount rate is used by all entities, meaning the comparability benefit of disclosing the yield curve is lost where the HM Treasury discount rate is used.

E.3 **Consequently, the IFRS 17 Application Guidance includes a new adaptation to withdraw the requirement to comply with IFRS 17 paragraph 120 where the HM Treasury discount rate is used.**

Question for FRAB
4) Do you agree with HM Treasury's proposal to remove the requirements of IFRS 17 paragraph 120 where the HM Treasury discount rates are used by entities?

F - Transition requirements

F.1 The HM Treasury IFRS 17 ED proposed the following transition arrangements:

a. Entities should restate fully retrospectively in accordance with IFRS 17 paragraph C3 if practicable.
b. If full retrospective restatement is impracticable, then entities should restate using the fair value approach (FVA) instead of applying IFRS 17 paragraph C4(a). An adaptation was included in the IFRS 17 ED with the FVA to measure the contractual service margin (CSM) at £nil where application of the FVA would result in an excessive premium (and therefore avoid situations where onerous or breakeven insurance contracts are measured as highly profitable insurance contracts).

A more simplified transition approach

F.2 One entity held the view it was not likely full retrospective restatement will be practicable across government and proposed an adaptation allowing recognition at 1 April 2025 with no retrospective restatement, similar to IFRS 15 and IFRS 16.

F.3 Though HM Treasury understand arguments for a simplified approach to transition for central government bodies, we do not propose proceeding with this approach. The reasons for this are:

a. HM Treasury do not know for certain that full retrospective restatement will be impracticable for all groups of insurance contracts across all central government departments.

b. A transition approach with no retrospective restatement is not an option in IFRS 17. When implementing new accounting standards in central government, the principle followed is to stay as closely aligned to IFRS as possible. This option was considered too far removed from the requirements of IFRS 17.

The optional practical expedient

F.4 The IFRS 17 ED also included an alternative approach. This proposed to include a practical expedient where all insurance contract liabilities are measured at fulfilment cashflows. The rationale for including this practical expedient was:

a. Entities in central government are not expected to issue profit making insurance contracts. Generally, government will issue insurance contracts where the market is unwilling or unable to provide the cover. These contracts are issued to cover the costs of issuing the contract or at a loss. Therefore, HM Treasury do not expect a large scale of contracts which are profitable.
b. The fair value of a group of contracts is expected to be more than the IFRS 17 liability measurement, resulting in the recognition of CSM at transition. This includes onerous contracts as a market participant would require compensation above the risk adjustment to take on the contracts. This is magnified in central government where entities issue insurance contracts which the private sector is either enable or unwilling to issue.
c. Scenarios where the fair value of an insurance contract is less than the fulfilment cashflows are expected to be extremely rare. A scenario where the fair value calculated under IFRS 13 is less than the fulfilment cash flows could be where a market participant thinks they can fulfil the contract at a lower cost than government and require no risk margin.

F.5 The key benefits of including this practical expedient are:

a. It avoids scenarios where reporting entities are measuring onerous and breakeven insurance contracts as highly profitable contracts on the balance sheet as a large CSM is recognised. Most insurance contracts issued by central government entities (where their business is not mainly insurance-related) are expected to be onerous or breakeven.
b. It means entities do not need to apply the full requirements of IFRS 13 at transition. This makes transitioning to IFRS 17 significantly less burdensome and costly.

F.6 There was significant support for including this practical expedient in the FReM for the reasons set out above. The support was across different types of users of central government annual reports and accounts.

F.7 Though there was very strong support for including this practical expedient in the FReM, there were differing views as to whether it should be applied to all insurance contracts issued by central government entities or only those which are onerous or breakeven (or priced to be onerous or breakeven). Some respondents argued that the FVA should be applied to contracts which were profitable (or priced to be profitable/ priced on a commercial basis).

F.8 There was also a split of opinion between those who argued the practical expedient should be mandated and those who argued the practical expedient should be optional. **HM Treasury has proposed to include the practical expedient, but the include it as an optional practical expedient to be applied to contracts which are onerous or breakeven (or priced to**

be onerous or breakeven). The rationale for this is set out above and in the application guidance. This is to allow entities who can apply the FVA to do so, and also ensure profitable contracts are measured using the FVA.

F.9 HM Treasury recognises that including an optional practical expedient can increase the likelihood of inconsistencies in applying IFRS 17 by central government entities. However, HM Treasury's desire for a consistent approach must also be balanced with the complexity of transitioning to IFRS 17 and recognising that there is not a single solution which will be suitable for all groups of insurance contracts. **Consequently, on balance, HM Treasury have proposed to include this practical expedient as an optional practical expedient to be applied to onerous or breakeven contracts (or contracts priced to be onerous or breakeven).**

Questions for FRAB

5) Do you agree with the rationale for including the optional practical expedient?
6) Do you agree with the decision to have the practical expedient as optional rather than mandated?
7) Do you agree with HM Treasury's proposal to limit use of the practical expedient to insurance contracts which are onerous or breakeven (or priced to be onerous or breakeven)?

The adaptation to measure the CSM at £nil if excessive when applying the FVA

F.10 It should be noted that the proposed adaptation to measure the CSM at £nil where application of the FVA results in an excessive premium **remains**. This is because there may be insurance contracts which are slightly profitable, but application of the FVA could result in a much larger premium and CSM due to the nature of the contracts issued by central government bodies (very high impact if the risk materialises, such that private sector insurers will not accept the risks).

F.11 A small number of respondents did not agree with the adaptation to measure the CSM at £nil if the CSM calculated under the fair value approach was excessive. This was partly due to the lack of a definition of what is excessive means and entities subsequently making subjective judgements around the concept of 'excessive'.

F.12 HM Treasury is sympathetic to the view of a lack of a definition of what an excessive CSM is. This is why HM Treasury included a section in the application guidance stating 'Whether a theoretical premium calculated under IFRS 13 is excessive is a matter of judgement for entities to make. However, this judgement should be made in the context of the purpose of the adaptation, which is to avoid scenarios where the transition value under IFRS 17 has a large CSM when the contract is either breakeven, onerous or expected to generate a much lower level of profit.'

F.13 HM Treasury have stated the principle of what the adaptation is trying to achieve. HM Treasury is of the view that entities can make a robust judgement of what excessive is given the principle stated above, and that judgements of this nature are not significantly different to others made under other accounting standards (e.g. whether a liability is probable/ not probable/ remote under IAS 37). Finally, it is highly unlikely an acceptable definition of 'excessive' can be developed which goes beyond the guidance stated in the paragraph above.

F.14 1 respondent was of the view that if a robust valuation using IFRS 13 can be developed then it should be used. There were a few reasons for this:

a. The disclosure requirements in IFRS 17 paragraph 114 should be sufficient for the user of the accounts to identify that fair valuing the liability has produced the significant CSM.

b. Where a large CSM would be recognised under the FVA, entities should first analyse what the large CSM indicates, e.g., it might indicate that the fulfilment cashflows have been understated.

c. There may be instances where it might not be appropriate to reduce the CSM to £nil. For example, a government body may be offering insurance services to cover a temporary gap in the market which is in the process of reversing; this means the CSM information from the fair value approach could be useful information as it provides information on what the market would price the insurance contract at.

F.15 HM Treasury recognise the respondent has made good arguments for not adapting the FVA. Ideally, HM Treasury would like to keep adaptations to IFRS at an absolute minimum.

F.16 HM Treasury are still of the view that entities recognising a very large CSM on transition due to the mechanics of the fair value approach may not be an optimal position for central government annual reports and accounts.

F.17 Not including this adaptation could lead to a significant disparity in the measurement of the CSM for insurance contracts which existed at the transition date and insurance contracts issued after the transition date.

F.18 The large CSM is recognised due to the transition requirements. Had the entity issued the insurance contract after the transition date, the liability would be measured at fulfilment cashflows (or with a much lower CSM if slightly profitable), which is a significantly different result to measuring the liability at fulfilment cashflows with a very large CSM which unwinds into the SoCNE over time (as would happen using the transition requirements).

F.19 Additionally, not including the adaptation and practical expedient does introduce a risk of entities undertaking very significant IFRS 13 fair valuation exercises, where no active market exists, at significant cost and time, to produce a value which does not represent the probability-weighted valuation of the liability. This issue is exacerbated in central government due to the nature of the contracts issued (low probability, potentially very high impact, and with no market).

F.20 Therefore, on balance, HM Treasury propose the adaptation remains to reduce the burden of complying with IFRS 17 whilst enabling a reasonable probability-weighted value of the liability to be included on the SoFP. Though the optional practical expedient is proposed to be included, this would only be applicable for onerous or breakeven contracts (or contracts priced to be onerous or breakeven). There is still an issue that central government entities could issue slightly profitable insurance contracts, which could be measured with a very large CSM due to the mechanics of IFRS 17 and IFRS 13. **Therefore, HM Treasury are proposing to keep this adaptation.**

Question for FRAB

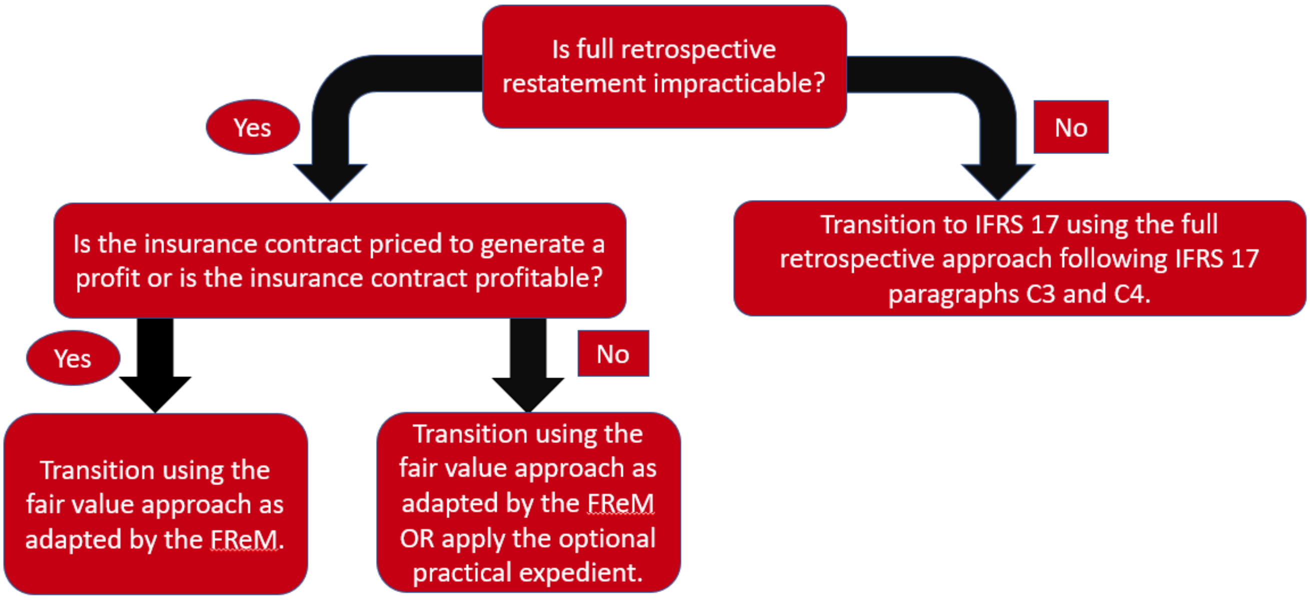
8) Do you agree with HM Treasury's proposal to keep the adaptation to the fair value approach to measure the CSM as £nil where the fair value approach results in an excessive CSM being recognised on the SoFP?

Summary of proposed transition requirements

F.21 Based on the responses the following transition approach is being proposed by HM Treasury:

a. Entities should fully retrospectively restate in line with IFRS 17 paragraph C3 if practicable to do so.
b. If full retrospective restatement is impracticable then, for contracts which are profitable (or priced to be profitable), entities should apply the FVA as adapted by the FReM.
c. If full retrospective restatement is impracticable then, for contracts which are onerous or breakeven (or priced to be onerous or breakeven), entities should either apply the FVA or optional practical expedient.

F.22 The proposed transition approach is illustrated below:



F.23 HM Treasury plan to publish IFRS 17 adaptations, interpretations and application guidance in April 2023 (pending FRAB approval).

Question for FRAB

9) Do you support HM Treasury publishing the IFRS 17 application guidance in April 2023, subject to any changes FRAB recommends?

HM Treasury

30 March 2023