HM TREASURY

FRAB 139 (04)

19 March 2020

Financial Reporting Advisory Board Paper

IFRS 17 *Insurance Contracts* – Progress update

Issue:	This paper discusses the underlying principles behind the implementation of IFRS 17, gives an overview of the proposed application guidance structure, sets out several technical issues where an approach has been developed, and gives a list of further issues that are under consideration.
Impact on guidance:	The approaches under development here will form part of the IFRS 17 application guidance exposure draft to be shared in winter 2020/21.
IAS/IFRS adaptation or interpretations?	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?	IPSASB is not planning to develop an IPSAS on insurance contracts in the public sector.
Impact on budgetary regime?	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)?	ESA10 does not have an equivalent recognition of government insurance contracts so there will be misalignment; HMT staff have raised this issue with the ONS.
Impact on Estimates?	Not yet known.
Recommendation:	FRAB members are asked to: • consider and comment on the proposed principles for applying IFRS 17 in the public sector; • review and comment on the proposed structure for the application guidance; • consider the proposed approaches given for some technical issues; and • review the list of other technical issues under consideration, suggesting any further additions that should be brought in.
Timing:	The Treasury's work programme assumes IFRS 17 is applied from 2022-23 and will be kept under review. The IFRS 17 Application Guidance exposure draft will be put together in 2020 for FRAB approval November 2020 and consultation in winter 2020/21. The final application guidance and changes for the draft 2022-23 FReM will be published late in 2021. A detailed timeline forms Annex A to this paper.

DETAIL

Background

1. The International Accounting Standards Board (IASB) has issued IFRS 17 *Insurance Contracts*, which replaces IFRS 4 Insurance Contracts. In 2019 the IASB issued an exposure draft consulting on, amongst other things, deferring the effective date until 1 January 2022. HM Treasury has developed an IFRS 17 implementation work plan based on this timing which is included in Annex A.

2. It is worth noting that the IASB are reviewing the effective date at their March 2020 meeting (finishing 20th March 2020) and the staff papers for this meeting recommend deferring the effective date by a further year to 1 January 2023. If the effective date is deferred to 2023 HM Treasury will prepare a revised workplan.

3. HM Treasury has convened a working group with representatives from the relevant authorities, a range of government bodies affected by IFRS 17, and a selection of insurance accounting experts. A list of members forms Annex B to this paper.

4. HM Treasury has done some initial scoping of the impact of IFRS 17 which has indicated it is possible there will be an increase in the number of contracts deemed to be insurance contracts under IFRS 17 compared to IFRS 4.

Principles for implementing IFRS 17 in the public sector

5. IFRS 17 Insurance contracts is a complex standard developed primarily for use by private sector insurance providers. A range of issues must be addressed in order to implement the standard effectively in the public sector. It is therefore essential to have a clear understanding of what we hope to achieve.

6. There are two main reasons for implementing IFRS 17 in a UK government context: consistency, and control.

Consistency

7. UK government financial reporting makes use of the International Financial Reporting Standards (IFRSs) because they represent best practice in global financial reporting. Consistency with accounting practices used in the private sector around the world enhances the transparency of government annual reports and accounts. That aim is best achieved by applying the standards, as far as possible, in the same way they are implemented in the private sector.

8. HM Treasury has always sought to minimise adaptations and interpretations in the implementation of the standards, applying them only when necessary due to fundamental differences between the public and private sectors. For consistency with this approach, and to maintain consistency between government and private sector financial reporting, HM Treasury's view is that IFRS 17 should also be implemented with as few adaptations and interpretations as necessary.

9. HM Treasury is also mindful of ensuring that any adaptation or interpretation is consistent with adaptations or interpretations made when implementing previous standards. Therefore, the first stance of HM Treasury will be to propose adaptations that ensure consistency across the treatment of standards and to not propose any changes to IFRS 17 where previous standards have been implemented without adaptation.

Control

10. IFRS 17 sets out an approach to identifying, quantifying, and reporting on insurance contracts whether or not they are issued by an entity that describes itself as an insurance provider. UK government bodies are for the most part not primarily insurance providers, but many of them do issue contracts that meet the IFRS 17 definition of an insurance contract.

11. These contracts transfer insurance risks into the public sector, exposing the public purse to future costs if and when those risks crystallise. As part of a wider balance sheet review, HM Treasury has been examining how well the government manages its insurance risk liabilities. In the paper "Government as Insurer of Last Resort", published alongside the March 2020 budget, HM Treasury set out recommendations for improving the way the government manages its portfolio of insurance contracts.

12. Implementing IFRS 17 will allow government bodies to find and value all the places where they are contractually exposed to insurance risk. This is an essential step towards putting together a central portfolio of all the insurance contracts issued by UK central government. Quantifying the insurance risk associated with each contract will support better management of those risks, ensuring that the government is using resources wisely.

Other considerations

13. There are clear advantages to implementing IFRS 17, but there is an associated cost. Government finance teams will need to allocate significant resources to finding and quantifying insurance contracts. Some aspects of the valuation are technically challenging and will require actuarial expertise.

14. HM Treasury's goal in implementing the standard is to achieve the benefits while minimising the cost. This can be achieved with a mixture of central accounting policy choices (i.e. interpretations and adaptations), and by providing high quality guidance and support through the implementation process.

Board members are asked to consider and comment on the proposed principles for applying IFRS 17 in the public sector.

Proposed structure for the IFRS 17 Insurance contracts application guidance

15. A proposed structure has been developed for the IFRS 17 Insurance contracts application guidance and is set out in Annex C to this paper.

16. The application guidance is intended for those who are already asking whether IFRS 17 applies to them. HM Treasury is considering what further support might be needed to engage with finance teams that are aware of uncertain future obligations but might not think that these could be considered insurance contracts.

Board members are asked to review and comment on the proposed structure for the application guidance set out in Annex C.

Technical issues with proposed approaches

17. HM Treasury's IFRS 17 Technical Working Group has started to develop thinking on how to approach the key technical issues. This section of the paper sets out those areas where that thinking is most developed, in order to give Board members a view of the direction of travel and a chance to share their perspectives and insight. These options will be developed further and will come back to the Board for review and approval in the draft exposure guidance.

Scope

18. IFRS 17 applies to all insurance contracts, defined as ‘a contract under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policy holder’. Contracts, in an IFRS context, are situations where there is an agreement which has created rights and obligations and are therefore legally enforceable. This does not include situations where the government may offer compensation for a future event but also has the freedom to change its mind.

19. Public sector bodies are in a unique position as they take on insurance risk in instances where private sector providers would or could not. The government has responsibilities to many different stakeholders and is expected to continue to exist and need to respond in conditions that would not apply to most private sector organisations.

20. It is important to differentiate between those situations where the responsibilities of government meet the requirements to be defined as an insurance contract, and those where the government may have a responsibility to act but is not party to an insurance contract.

21. Interpreting the scope of IFRS 17 too broadly would mean making assumptions about the freedom future governments have to make policy choices. Those assumptions could be taken as commitments to take certain actions and, if published in the annual report and accounts, could create a new constructive obligation that might give rise to legal challenge in future if the government took a different path. In effect, by recognising an insurance contract, the government might create one.

22. IFRS 17 Technical Working Group (TWG) members agree that the purpose of the standard is to better quantify the commitments that the government has already makes or intends to make, not to manufacture new commitments out of areas of uncertainty. Due to the risk of confusion, it would be helpful for the application guidance to set out some parameters that give a consistent view of what would be in scope of IFRS 17 and what would be out of scope of IFRS 17.

The definition of a contract

23. The Government Financial Reporting Manual (FReM) includes adaptations and interpretations to standards that have already been implemented in the public sector which expand the IFRS definition of a contract.

24. These adaptations relate to IFRS 15 *Revenue from contracts with customers,* IFRS 16 *leases,* and IAS 32 *Financial Instruments: presentation.* Specifically, the adaptation for IFRS 16 states “The definition of a contract is expanded to include intra-UK government agreements where non-performance may not be enforceable by law”.

25. The IFRS 17 TWG therefore will consider these adaptations when considering whether to make a similar adaptation to IFRS 17 to ensure that the definition of a contract is consistent across all financial standards.

Constructive obligations

26. Under IFRS 17 an insurance arrangement does not necessarily give rise to insurance assets and/or liabilities if there is no insurance contract. Arrangements that do not meet the definition of a contract, as expanded for consistency with the IFRS 15, IFRS 16, and IAS 32 FReM adaptation, would not be regarded as insurance contracts even if they transfer insurance risk.

27. In practice this means that existing constructive obligations will need to be examined closely to determine whether they do impose future obligations on the department. The IFRS 17 TWG proposes that the default position should be to not recognise new constructive obligations unless a contract (or equivalent agreement) exists.

28. Any further proposed interpretations or adaptations that put parameters around the scope of insurance contracts will be rigorously tested within the public sector to ensure any unintended consequences of making and clarifications around the intended public sector scope of IFRS 17 is known.

Remote contingent liabilities

29. UK government bodies recognise a special category of remote contingent liabilities that do not appear in IFRS. These reflect situations with a low probability of occurring but a potentially extremely high impact if the risk crystallises. Remote contingent liabilities are prepared according to guidance given in Managing Public Money and are not recorded in IFRS financial statements. They are disclosed in the audited Parliamentary accountability report.

30. It is likely that many remote contingent liabilities may meet the definition of an insurance contract under IFRS 17. As IFRS 17 includes a risk adjustment in its valuation methodology, situations with a low probability of occurring are likely to give rise to low value insurance liabilities. In many cases these will not be material in the context of a set of government annual reports and accounts

31. To maintain high standards of Parliamentary accountability, therefore, the IFRS 17 TWG proposes that these scenarios could continue to be disclosed **both** as remote contingent liabilities **and** as insurance contracts under IFRS 17.

32. Even if the IFRS 17 disclosures are material, this will not lead to confusion between two different amounts presented in the financial statements as the remote contingent liability disclosures are made in the Parliamentary accountability report.

Transition arrangements

33. IFRS 17 sets out three different allowable transition arrangements:

a. entities that have the information available should apply IFRS 17 retrospectively,

b. those with partial information available can apply the modified retrospective approach, and

c. those which have no information available allowing them to recreate the value of an insurance liability in prior periods can apply the fair value approach.

34. The modified retrospective approach allows a valuable flexibility for a private sector insurance provider wanting to give comparable prior year figures but needing to make assumptions to do so. It is highly versatile, and therefore complex.

35. In the public sector there are some entities that have acted as insurance providers for many years and are already advanced in their preparations for implementing IFRS 17. These entities are likely to have the information available to apply a fully retrospective approach on transition.

36. Most other public sector entities that issue insurance contracts do not have the same level of expertise and evidence available. From their perspective, applying even a light-touch version of the modified retrospective approach may be difficult, and working through the permutations to determine how to do so is likely to be time- and resource-consuming.

37. The IFRS 17 TWG has discussed that, in the UK public sector, the fair value approach on transition could be the default approach for most entities. Those that have the information available and are prepared could apply a fully retrospective approach. Any entity wishing to take a modified retrospective approach instead could seek an exemption to do so from their relevant authority.

IFRS 17 and IFRS 9

38. IFRS 17 can be applied to groups of contracts that have previously been treated under IFRS 9, if those contracts have been designated as insurance contracts. The choice between IFRS 17 and IFRS 9 can only be made once for each group of contracts, on transition to IFRS 17, and then must be maintained in perpetuity.

39. Few UK government bodies have contracts currently treated under IFRS 9 that would be eligible for transition to IFRS 17 under this arrangement. Most of these contracts are owned by entities represented on HM Treasury's IFRS 17 TWG, and these TWG members have said that, as permitted by IFRS 17, they would prefer to continue to apply IFRS 9 to these contracts.

40. Given this strong preference, the benefits of consistency for Whole of Government Accounts, and that the wording in IFRS 17 implies that continuing to apply IFRS 9 should be the default position, the TWG proposes that this option could be disallowed for public sector bodies. All contracts currently treated under IFRS 9 would then remain under IFRS 9, whether or not they have previously been designated as insurance contracts. This would also be the case for entities who have delayed the implementation of IFRS 9 until the implementation of IFRS or for any future contracts that meet the requirements to be recognised under IFRS 9.

Board members are asked to consider and comment on the proposed approaches given for these technical issues.

Further technical issues under consideration

41. The IFRS 17 TWG has also identified some further issues for consideration where discussions on how to take these forward are still on-going. The below list is not exhaustive, and the TWG is anticipating further technical issues to arise over time.

42. HM Treasury is very grateful for any input the Board has on further technical issues to consider.

Whether to make adaptations where the standard gives a choice

43. Within IFRS 17 there are areas where the preparer of the financial statements is given an option on how transactions relating to an insurance contract can be recognised. For example, IFRS 17 gives a choice between how preparers can recognise the income from an insurance contract.

44. With the implementation of previous financial standards, unless there was a necessity to (for example, to enable consolidation for the Whole of Government Accounts), HM Treasury did not include adaptations to remove the choice given by the Standard.

45. Therefore, the TWG intends to take each choice presented separately and determine whether there will be tangible benefits for government financial reporting of removing the options available to public sector bodies applying IFRS 17.

Discount rates

46. The FReM sets out some areas where central government entities are required to use a Treasury discount rate, usually when there is not an interest rate inherent in the contract. HM Treasury issues a PES paper in December of every year setting out the discount rates that central government entities should use in these scenarios.

47. Under IFRS 17 the discount rates used to adjust future cash flows need to reflect not just the time value of money but also the characteristics of those cash flows and the liquidity characteristics of the insurance contracts themselves. A single discount rate set centrally is highly unlikely to be appropriate to any given situation, even if it was updated frequently enough to be useful at the inception of any given insurance contract (ie, daily).

48. The TWG will review the best approach to providing guidance on discount rates, for example using a Treasury discount rate as a default starting point. This would be consistent with the approach taken for other standards (e.g., HM Treasury sets a discount rate that can be used when applying IFRS 16 if no better rate is available). Under IFRS 17 it may not be possible for other bodies to simply refer to a rate set by the Treasury; further guidance may be needed on how to adjust that rate as appropriate.

What to include in the cash flows

49. Insurance contract liabilities and assets under IFRS 17 are valued at the present value of risk-adjusted future cash flows. Determining which cash flows can or should be included is an area of judgement. The TWG will review and consider what level of guidance is appropriate in this area.

Use of actuaries and actuarial advice

50. Reaching robust estimates to value insurance contracts requires actuarial as well as accounting skills, which has resource implications for departments.

51. It is not yet clear how much actuarial input will be needed in each case, or how far it will be possible to use the application guidance reduce the need for external advice. The central capability for managing the UK government's insurance portfolio, as proposed in HM Treasury's "Government as the Insurer of Last Resort" report, might go some way to make additional expertise available.

52. The TWG will continue to consider the resource impact implied by IFRS 17 and to examine how best the application guidance can support departments.

The Premium Allocation Approach (PAA)

53. IFRS 17 includes a simplified way of measuring insurance contracts that is applicable only to short term contracts, where the results it gives are deemed to be similar to those that would be obtained applying the full methodology.

54. The TWG will consider how and where public sector bodies might best make use of this Premium Allocation Approach.

Self-insurance and reinsurance

55. Under the principle of self-insurance in the public sector, as set out in Managing Public Money, arm's length bodies are encouraged to absorb risks where possible. The understanding is that their parent department will step in if the risks crystallise, and the cost is ultimately met by the Exchequer as this is better value for money than obtaining insurance (or reinsurance) from the private sector.

56. This set of assumptions means that there is no cost to an arm's length body when it takes on insurance risk, even though taking on that risk is a cost to the government. It also means that there is effectively a reinsurance arrangement between the arm's length body and its parent department, and potentially between the parent department and the Exchequer.

57. The TWG will consider when and where these reinsurance arrangements amount to reinsurance contracts that should be recognised as such and will develop guidance accordingly.

Board members are asked to review this list of technical issues under consideration, suggesting any further additions that should be brought in.

Next steps

58. HM Treasury will continue to convene TWG meetings and develop the draft IFRS 17 application guidance. The draft will be revised over the summer and autumn of 2020 so that a final exposure draft can be shared at the November 2020 FRAB meeting, with a consultation to follow in the winter 2020/21, subject to the decisions made by the IASB in March 2020

Recommendation

59. HM Treasury ask the Board to note the progress made, and to provide any comments on the issues identified.

HM Treasury
19 March 2020

Annex A: IFRS 17 Work Plan

Date	HMT activities	Relevant external activities
March 2018	FRAB Paper – Initial review	
November 2018	FRAB endorsement of IFRS 17 work plan	
March 2019	• Technical Working Group 1	
April 2019	• Technical Working Group 2	
June 2019	• Technical Working Group 3 (teleconference to review the draft scope paper)	
June 2019	FRAB Paper - updates on technical working groups and planned informal consultation	
June-September 2019	Informal consultation around IFRS 17 scope paper	
October 2019	• Technical Working Group 4	
January 2020	• Technical Working Group 5	
24-28 February 2020		IASB meeting decides on proposed amendments to IFRS 17.
3 March 2020	• Technical Working Group 6	
16-20 March 2020		IASB meeting likely to confirm implementation date for IFRS 17.
21 March 2020	FRAB – update including the proposed structure of the application guidance, and proposed approach to selected issues, for FRAB review.	
Spring / Summer 2020	Follow up to the informal impacts consultation, via HMT departmental spending teams.	
14 April 2020	• Technical Working Group 7	
May-June 2020	• Technical Working Group 8	
June 2020	FRAB – exposure draft of the application guidance for review	
July – November 2020	FRAB engagement on exposure draft	
Winter 2020/2021	Exposure draft consultation	
Winter / Spring 2021	HMT to review and respond to consultation responses. • Technical Working Group 9 • FRAB out of meeting paper	

March 2021	FRAB meeting to consider the adaptations and interpretations of the standard based on the exposure draft and response
June 2021	FRAB meeting for further consideration if needed
Summer 2021	Publish Application Guidance
November 2021	FRAB approve draft 2022-23 FReM
December 2021	HMT publish draft 2022-23 FReM
April 2022	Provisional date for the UK public sector implementation of IFRS 17

This draft timeline is subject to the IASB confirming the implementation date for IFRS 17 and IFRS 17 being formally endorsed by the UK's new Endorsement Board leading to IFRS 17 becoming a UK-adopted international accounting standard.

Annex B - IFRS 17 Technical Working Group Participants

Relevant Authorities	
Gareth Davies	CIPFA
Kim Jenkins	Welsh Government
Ruth Ward	HM Treasury
*Steven Wareing / Marcin Sanocki	DHSC
*Aileen Wright	Scottish Government

All papers will be copied to the Northern Irish Government.

Technical experts	
*Nick Clitheroe / Steve Lewis	GAD
Peter Drummond	FRC, UK Endorsement Board
Andrea Pryde	PWC, FRAB member

Government body representatives	
Elizabeth Dobson	DfT
Andrew Firth	BEIS
Adam Golding	FloodRe
Ngan Jones	HMT
Craig Simpson	HMRC
Chris Steiger	DfE
*Mohammed Swaleh / Dimitrios Valsamidis	UK Export Finance

*Some individual members may swap in with colleagues over the course of this project.

Annex C: IFRS 17 Application Guidance proposed structure

The IFRS 17 Application Guidance needs to cover technical content at some length. It also needs to be clearly titled so that those looking to understand how to apply IFRS 17 can find it easily. Proposed content:

Forward: Uncertain future obligations

a. High-level view of the various possibilities (contingent liabilities, provisions, insurance contracts, financial instruments etc) and the differences between them

b. Links for users to be able to look at detailed guidance on each possibility to be sure that it applies to them

1. Introducing IFRS 17 insurance contracts

a. Purpose and benefits of the standard
b. Why public sector bodies issue insurance contracts

2. The scope of IFRS 17

a. Definition of an insurance contract
b. When a responsibility is not a contract
c. Insurance and reinsurance contracts between public sector bodies
d. Decision tree: is this an insurance contract?
e. Notes to the decision tree
NB to keep the decision tree readable, the text that was in the boxes on the original tree can be separated out here and expanded on if necessary.
f. Remote contingent liabilities

3. Application section:

a. Accounting entries for insurance contracts
b. More on discount rates
c. More on risk weighting
d. More on grouping insurance contracts
e. What to include in the cash flows
f. CSM (if you have it)
g. Disclosures

4. Transition arrangements

5. Whole of Government Accounts

6. Budgets and Estimates