Financial Reporting Advisory Board Paper

IFRS 17 *Insurance Contracts* – Progress update

Issue:	This paper provides the Board with a progress update on the project to adapt / adopt IFRS 17 for the UK public sector.
Impact on guidance:	None at this stage. Application guidance and changes for the draft 2022-23 FReM will be published late in 2021.
IAS/IFRS adaptation or interpretations?	This will be revisited in a later paper to the Board. IFRS 4 and related interpretations currently applies without public sector adaptation or interpretation.
Impact on WGA?	None at this stage but the changes in the FReM will affect WGA.
IPSAS compliant?	IPSASB is not planning to develop an IPSAS on insurance contracts in the public sector.
Impact on budgetary regime?	Not yet known.
Alignment with National Accounts (ESA10)?	ESA10 does not have an equivalent recognition of government insurance contracts so there is potential misalignment; HMT staff are raising this issue with the ONS.
Impact on Estimates?	Not yet known.
Recommendation:	HM Treasury ask the Board to note the progress made, and to provide any comments on the issues identified.
Timing:	No changes are expected to be made to the FReM until the 2022-23 financial year.

DETAIL

Background

1. The International Accounting Standards Board (IASB) has issued IFRS 17 *Insurance Contracts*, which replaces IFRS 4 Insurance Contracts and is expected to be effective for accounting periods beginning on or after 1 January 2022, following an IASB decision to defer the effective date by one year.

2. As agreed by the Board at the November 2018 meeting (FRAB 132), the planned timetable for implementation of IFRS 17 in the public sector is the 2022-23 financial year. The agreed workplan forms Annex A to this paper.

Emerging issues

3. Three interrelated significant issues have emerged from the working group discussions:

a) Scope and self insurance

The IFRS 17 Technical Working Group consider resolving the scope questions to be the highest priority issue. An insurance contract under IFRS 17 is:

> "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 policyholder."

Because of this broad definition, and because of the wider government policy of absorbing risks through self-insurance, IFRS 17 will apply to many contracts that are not described or currently treated as insurance contracts.

- Self insurance arrangements between government bodies (eg, a guarantee given by one government body to another) would net off in the Whole of Government Accounts consolidation process, but would need to be disclosed as insurance contracts in the individual accounts of the bodies concerned.
- Self insurance arrangements involving a transfer of risk into the public sector (eg, a guarantee given by a public sector body to an external entity) are likely to be insurance contracts under IFRS 17. Guarantees may currently be IFRS 9 liabilities, or IAS 37 contingent liabilities, or remote contingent liabilities. There may also be unwritten and unrecognised commitments that would nevertheless meet the criteria to be counted as an insurance contract under IFRS 17.

There is likely to be some connection here to the work of the balance sheet review team on the management of contingent and remote contingent liabilities across government.

b) Alignment with National Accounts:

ESA 2010 has no equivalent recognition of insurance contracts in government accounts. However, there is some relevant discussion of government guarantees; three kinds of guarantees are recognised: derivatives (which fall under the normal treatment of derivatives), standardised guarantees, and "one-off" guarantees.

ESA 2010 5.190 defines standardised guarantees as those which "are issued in large numbers, usually for a fairly small amount, along identical lines". One-off guarantees by contrast are given on a case-by-case basis, often for significant amounts under individual contractual arrangements. The Manual on Government Deficit and Debt (MGDD) discusses the differences in more detail in section VII.4.

MGDD clearly states that "formal guarantee commitments which are rather close to insurance schemes" are not included in either definition.

It is not yet clear how the categories for guarantees, insurance, contingent liabilities, and provisions between National Accounts and IFRS will all relate to each other in future. It seems likely that the lack of a direct equivalence on government insurance contracts will lead to misalignment, potentially on a large scale. Determining the scope of IFRS 17 is the first step to working out how big this impact could be.

c) The accounting treatment

The accounting treatment for insurance contracts set out in IFRS 17 is based on a risk-adjusted probability-weighted estimate of discounted future cash flows. Insurance contracts are grouped according to the nature of their risks and their start date, and the cash flows and risk adjustment are determined for each group as a whole. If an entity expects to make a profit on a group of insurance contracts, once the cash flows have been adjusted both to account for the time value of money and for insurance risk, then this profit is recognised as the contractual service margin (CSM) and amortised over the life of the contract.

A simplified treatment, the premium allocation approach (PAA) is available for short-term insurance contracts where the measurement would not be materially different from those given under the full accounting treatment.

Applying the IFRS 17 accounting treatment requires an entity to make a number of actuarial judgements and calculations. Unusual or one-off insurance contracts may require more work as there will be fewer points of reference or starting assumptions to apply.

Progress

4. The IFRS 17 Technical Working Group is prioritising the scope issue, and has addressed it by developing a draft decision tree to help government bodies determine whether and how they will be affected by IFRS 17. The draft forms Annex C to this paper.

5. Discussions on alignment and on the accounting treatment will be the next focus for the Group.

Next steps

6. Once the decision tree paper is finalised it will form the basis of an informal consultation, running from June to September 2019. Departments will be asked to give a high level estimate of the impact of IFRS 17, which will help inform future discussions on alignment issues and on any interpretations or adaptations needed for the accounting treatment. This will also raise awareness of IFRS 17 issues across government.

7. The technical working group will begin to review alignments issues and the accounting treatment set out in IFRS 17 in detail, and will continue to consider implications of the edge cases raised during the scope discussion.

8. HMT staff will also raise alignment issues with the ONS and press for early consideration on the National Accounts implications.

9. An exposure draft of IFRS 17 application guidance is expected for the March 2020 FRAB meeting.

Recommendation

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

HM Treasury
13th June 2019

Annex A: IFRS 17 Work Plan

Date	Activities
March 2018	FRAB Paper – Initial review
November 2018	FRAB Paper – Overview of Standard and Work Plan – FRAB endorsed the IFRS 17 work plan
March 2019 – March 2020	Technical Working Groups to work through the Standard and understand the application and risk profile across the public sector, as well as potential adaptations and interpretations
June 2019	FRAB Paper - updates on technical working groups and planned informal consultation
June-September 2019	Informal consultation around IFRS 17 scope paper to determine a rough estimate of the potential impact of the standard
March 2020	FRAB – Exposure Draft and Application Guidance for approval for consultation
April – September 2020	Exposure Draft Consultation
October/November 2020	Exposure Draft Responses
November 2020	FRAB meeting to consider adoption of the standard based on the exposure draft and response
December 2020 – November 2021	Publish FReM extract and Application Guidance; or further opportunity to consider any FReM changes
March & June 2021	FRAB meetings for further consideration if needed
November 2021	FRAB approve 2022-23 FReM
December 2021	Publish 2022-23 FReM
April 2022	UK public sector implementation of IFRS 17

Annex B - IFRS 17 Technical Working Group Participants

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

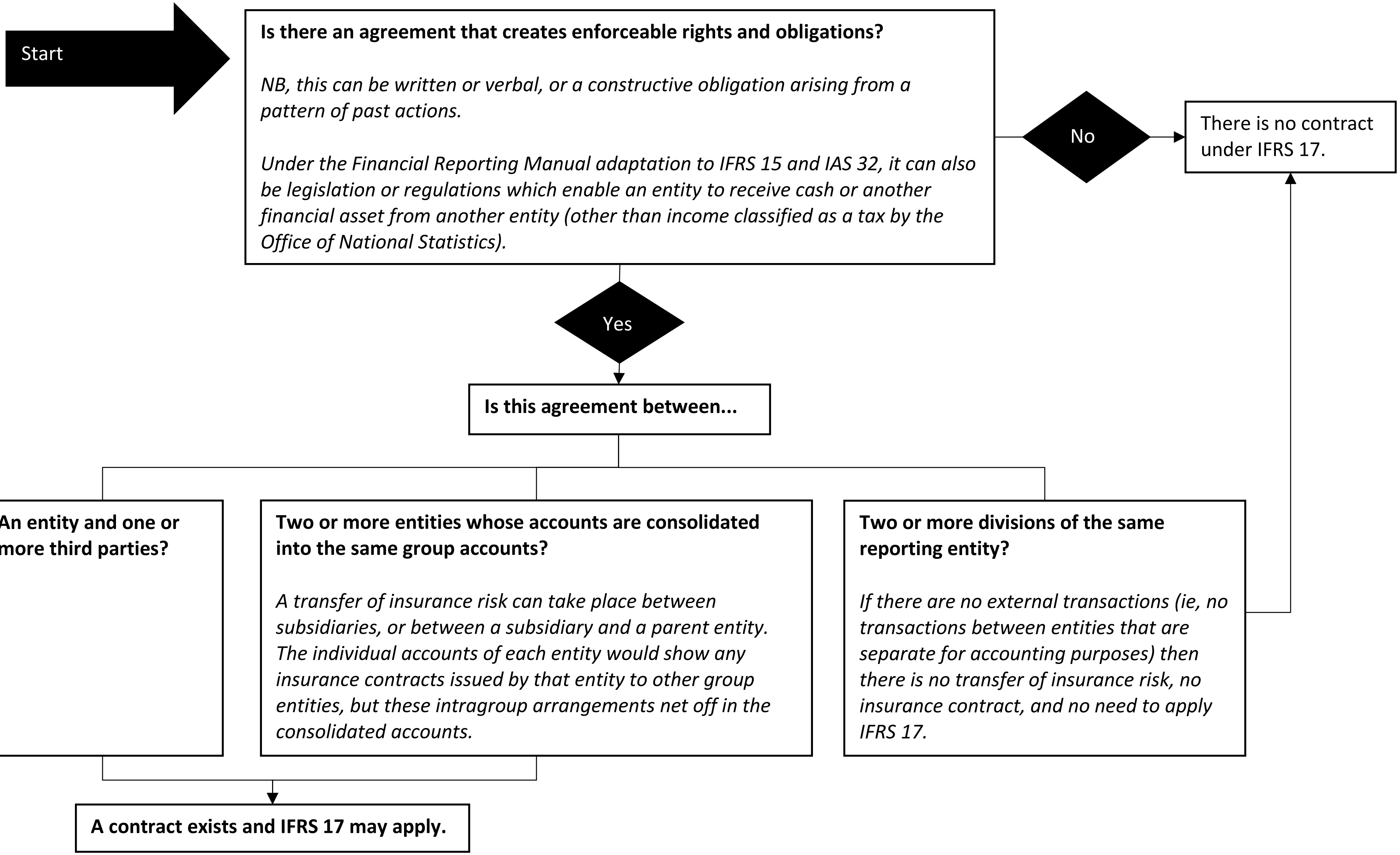
All papers will be copied to the Northern Irish Government.

External technical expert	
Andrea Pryde	IFRS Foundation

Other participants	
Nick Clitheroe	GAD
Elizabeth Dobson	DfT
Peter Drummond	HMRC
Andrew Firth	BEIS
Adam Golding	FloodRe
Chris Steiger	DfE
*Mohammed Swaleh	UK Export Finance

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

Annex C - IFRS 17 Scope Decision Tree DRAFT


Start
Is there an agreement that creates enforceable rights and obligations?
NB, this can be written or verbal, or a constructive obligation arising from a pattern of past actions.
Under the Financial Reporting Manual adaptation to IFRS 15 and IAS 32, it can also be legislation or regulations which enable an entity to receive cash or another financial asset from another entity (other than income classified as a tax by the Office of National Statistics).
No
There is no contract under IFRS 17.
Yes
Is this agreement between...
An entity and one or more third parties?
Two or more entities whose accounts are consolidated into the same group accounts?
A transfer of insurance risk can take place between subsidiaries, or between a subsidiary and a parent entity. The individual accounts of each entity would show any insurance contracts issued by that entity to other group entities, but these intragroup arrangements net off in the consolidated accounts.
Two or more divisions of the same reporting entity?
If there are no external transactions (ie, no transactions between entities that are separate for accounting purposes) then there is no transfer of insurance risk, no insurance contract, and no need to apply IFRS 17.
A contract exists and IFRS 17 may apply.

[redacted]

A contract exists. Does it require one party to make a payment to a second party, depending on the outcome of a future event?

NB the payments can be in money, or in kind. For example, this would include an agreement to arrange for an engineer to come and fix a broken machine, or an agreement to replace the machine, as well as an agreement to make a cash payment to support the purchase of a replacement machine. See IFRS 17 paragraph B6.

No

Yes

Is the future event that would trigger payments *uncertain*?

Without uncertainty, there is no risk. IFRS 17 states that "at least one of the following is uncertain at the inception of an insurance contract: (a) the probability of an insured event occurring; (b) when the insured event will occur; or (c) how much the entity will need to pay if the insured event occurs."

No

The first party to the contract has no requirement to compensate the second party when a specified, uncertain future event adversely affects that second party. IFRS 17 does not apply.

Yes

Does the *specified* uncertain future event adversely affect the second party to the contract?

NB flood damage to a building owned or used by one party to the contract is specific to that party. If a contract requires a payment if there is a general increase in floods in a region, the variable is not specific to a party in the contract.

No

Yes

The contract requires one party (the issuer) to compensate a second party when a specified, uncertain future event adversely affects that second party (the policyholder). IFRS 17 may apply.

Do(es) the payment(s) required by the agreement amount to a transfer of risk from the second party (the policyholder) to the first party (the issuer)?

IFRS 17 states that a risk is transferred if:

a) *It existed for the policyholder before the agreement was made. Risks cannot be transferred by the contract that creates them. (IFRS 17 paragraph B11)*

b) *It is not returned back to the first party (the policyholder) in the form of a non-cancellable and enforceable mechanisms that adjust future payments between the parties as a direct result of the insured losses (see IFRS 17 paragraph B27).*

A useful question is: what would happen if this agreement was not in place?

No

No insurance risk has been transferred by the contract, so it is not an insurance contract and IFRS 17 does not apply.

Yes

Is the risk transferred insurance risk?

IFRS 17 defines insurance risk as "risk, other than financial risk, transferred from the holder of a contract to the issuer" and financial risk as "The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, currency exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract." (IFRS 17 Appendix A Defined terms)

No

Yes

The agreement is a contract that transfers insurance risk and IFRS 17 may apply.

HM TREASURY

FRAB 136 (XX)

13 June 2019

The agreement is a contract that transfers insurance risk and IFRS 17 may apply. Is the insurance risk significant?

IFRS 17 paragraph B17: "Insurance risk is significant if, and only if, an insured event could cause the issuer to pay additional amounts that are significant in any single scenario, excluding scenarios that have no commercial substance (ie no discernible effect on the economics of the transaction)."

NB 'significant' here has a different meaning from 'significant' or 'material' in other accounting contexts. The scenario that leads to the issuer paying significant additional amounts does not have to be probable, it only has to be possible. *If it is very unlikely, then its impact on the valuation of the insurance contract may be limited to the point where the present cost of that insurance contract under IFRS 17 is not material, but it would probably be necessary to apply the IFRS 17 calculation before an organisation could be confident of that conclusion.*

Note also that the significance must be assessed on a contract-by-contract basis.

No

The agreement is in a category specifically excluded from IFRS 17. IFRS 17 does not apply.

Yes

Does one of the exceptions set out in IFRS 17 paragraphs 7 and 8 apply?

7 (a): "warranties provided by the manufacturer, dealer, or retailer in connection with the sale of its goods or services to a customer"

7 (b): "employers assets and liabilities from employee benefit plans ... and retirement benefit obligations from defined benefit pension plans"

7 (c): "contractual rights or contractual obligations contingent on the future use of, or the right to use, a non-financial item" (eg licence fees, royalties)

7 (d): "residual value guarantees provided by a manufacturer, dealer or retailer and a lessee's residual value guarantees when they are embedded in a lease"

7 (e): "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 (f): "contingent consideration payable or receivable in a business combination"

7 (g): "insurance contracts in which the entity is the policyholder, unless those contracts are reinsurance contracts held"

8: If an entity has a contract which meets the definition of an insurance contract and also meets criteria given in IFRS 17 for a fixed fee contract it may (irrevocably) choose to apply IFRS 15 instead of IFRS 17.

Yes

No

There is "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 policyholder."

The agreement should be treated as an insurance contract under IFRS 17.