HM Treasury

Contingent Liability Approval Framework

Guidance Update – April 2023

April 2023

HM Treasury

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Chapter 1 – Introduction and Context

Context

1.1 Contingent liabilities are, in the context of Managing Public Money (MPM) and HM Treasury spending control, commitments to use public funds if uncertain future events occur. This is a wider definition than the accounting definition of contingent liabilities, as set out in IAS 37. MPM states that "because commitments can evolve into spending, they should always be scrutinised and appraised as stringently as proposals for consumption". It also makes clear that Parliament expects advance notice of any commitments to the future use of public funds. Contingent liabilities expose the government to fiscal risk that is not covered by the core fiscal framework. Their appropriate management is an important part of the government's approach to ensuring the sustainability of the public finances.

1.2 As the UK's finance ministry, HM Treasury has a responsibility to ensure the effective and efficient use of taxpayers' money. This document aims to provide HM Government officials guidance on contingent liability policy and the contingent liability approval process. In particular it sets out how Treasury intends to scrutinise two types of contingent liabilities, indemnities, and guarantees. It also provides guidance on completing the contingent liability checklist and signposts to support in the Contingent Liability Central Capability. This guidance will be kept under review. It should be read alongside MPM Chapter 5.5 and Annex 5.4[1], Consolidated Budget Guidance[2] and where relevant other documents such as the Sourcing Playbook[3].

1.3 If you have any questions about the content of this document or about any specific contingent liability, you can contact HM Treasury at ContingentLiabilitiesBranch@hmtreasury.gov.uk.

Structure of the document

1.4 The document is set out as follows:

i. **Chapter 2 – Types of contingent liability**. This Chapter defines contingent liabilities and provides guidance on when Treasury approval and parliamentary notification are necessary.

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[1] Managing public money - GOV.UK

[2] Consolidated budgeting guidance - GOV.UK

[3] The Sourcing Playbook - GOV.UK

ii. **Chapter 3 – Contingent Liability Approval and Notification**. This Chapter details the contingent liability approval process including how Treasury consent is obtained and how parliament should be notified

iii. **Chapter 4 – Principles for Achieving Value for Money**. This Chapter details general principles Treasury expect to be applied when considering new contingent liabilities

iv. **Annex 1 – The Contingent Liabilities Checklist**

v. **Annex 2 – The Contingent Liabilities Checklist guidance**

Box 1: Outline of the contingent liability approvals process

i. The contingent liability approval process has two parts. The first is Treasury consent, this mirrors the process of Treasury control and consent for departmental spending. The second is parliamentary notification, this ensures that parliamentary oversight of the supply and estimates framework is respected.

ii. Treasury consent is required when departments wish to enter into contingent liabilities that are either over their delegated limits or are novel, contentious, or repercussive. Treasury consent is not usually required if the contingent liability is entered into as part of their normal course of business.

iii. Departmental officials will usually engage with their spending team in the first instance to obtain HMT consent. The Treasury spending team will consult with others in Treasury including the Balance Sheet Team (who have responsibility for government's whole stock of contingent liabilities and contingent liability policy) before giving consent. Treasury has produced a contingent liability checklist to aid Treasury and departmental officials in communicating the policy proposition, financial implications and risks posed by a new contingent liability.

iv. In addition to Treasury consent, parliament must approve relevant government spending through the supply and estimates process – this is set out in detail in chapter 5 of MPM. As each contingent liability is individually unlikely to lead to spending, potential contingent liability crystallisations are not covered in the supply and estimates process and therefore require another means of parliamentary scrutiny.

v. Departments must therefore notify parliament before entering into new contingent liabilities which are outside their normal course of business and that do not have a statutory basis. This is set out in detail in annex 5.4 of MPM. Notification is normally done via a Written Ministerial Statement (WMS) and Departmental Minute. The WMS and Departmental Minute should be copied to the chairs of both the PAC and relevant departmental select committee. Parliament should be given 14 sitting days to scrutinise contingent liabilities before they are entered into by a department.

Role of the Contingent Liability Central Capability

1.5 Given the often complex nature of contingent liabilities and the need for appropriate commercial skills and expertise in their design, government has set up a new function "the Contingent Liability Central Capability" (CLCC). The CLCC is an analytical and advisory unit with both credit risk and insurance expertise. The unit forms part of UK Government Investments (UKGI), which is the government's centre of excellence for corporate finance and governance.

1.6 The CLCC has three strategic objectives

i. Review and report on existing contingent liabilities, to inform risk management and contingency planning.

ii. Provide advice and analysis on new contingent liability proposals.

iii. Promote contingent liability best practice across government

1.7 Treasury expect that departments work with the CLCC in the design of any new significant contingent liability to ensure risks are properly understood and value for money is maximised. Engagement with the CLCC should come as early as possible in the design phase of any new contingent liability, and ahead of departments seeking Treasury consent. You can contact the CLCC at CLCC@UKGI.org.uk.

Box 2: Support available from the CLCC

The CLCC provides advice and analytical support to government departments and arm's length bodies around new contingent liabilities, including:

- **Identification**: assisting departments with clarifying whether contingent liabilities require HMT consent, and supporting them through the process.
- **Risk quantification**: supporting departments with financial estimates by providing case studies, promoting relevant data and reviewing estimates using CLCC's credit and actuarial expertise.
- **Risk mitigation**: advising departments on policy design to reduce financial risks, and promoting robust risk management processes.
- **Charging**: advising departments on setting and benchmarking charges where risk is transferred from the private sector.
- **Communication**: assisting departments in completing the contingent liability checklist and in explaining the benefits and uncertainties inherent in new contingent liabilities.
- **Ongoing data and monitoring**: advising departments on systems for monitoring and reporting on realised losses.
- **Practical considerations**: team members with private sector insurance and banking experience can advise on practical considerations.
- **Precedents within public sector**: sharing insights from departmental contingent liability disclosures and bringing together colleagues to enable the transfer of knowledge, experience, and best practice.

Chapter 2 – Types of Contingent Liability

2.1 This Chapter defines contingent liabilities for the purpose of MPM and Treasury spending control. It also sets out when Treasury consent and parliamentary notification is required.

Types of contingent liabilities

2.2 **Contingent liabilities are, in the context of Managing Public Money (MPM) and HM Treasury spending control, commitments to use public funds if uncertain future events occur**. This definition differs from the standard accounting definition of a contingent liability. For example, it includes items accounted for as financial guarantees or insurance contracts, as well as those accounted for as contingent liabilities.

2.3 In some cases, it may also be appropriate to apply the contingent liability approval framework to provisions when provisions are made due to very high risk guarantees or indemnities – these should be discussed with the Treasury. Both remote and non-remote contingent liabilities are covered by the contingent liability approval framework. The following table shows the contingent liabilities most often entered into by government.

Guarantees	Indemnities	Legal Cases	Purchaser Protections
When the government agrees to pay the debts of a third party if they default	When the government agrees to cover costs if a certain event occurs	When a lawsuit is brought against the government	Where the government provides warranties relating to asset sales

2.4 **A guarantee** is a commitment provided by a guarantor (in this case, the government) to take responsibility for the debt or performance obligations of another party. Some guarantees are accounted for on balance sheet as financial guarantees under IFRS 9. These are often called standardised guarantees in the public sector. For the purpose of the contingent liability approval framework financial guarantees are classed as contingent liabilities.

2.5 **An indemnity** is a commitment to cover costs if a certain event occurs. Some indemnities are accounted for on balance sheet as insurance contracts under IFRS 4 and in future IFRS 17. For the purpose of the contingent liability approval framework insurance contracts are classed as contingent liabilities.

2.6 Contingent liabilities are often created due to ongoing **legal cases**. This is because the outcome of legal cases may result in departments needing to make payments to third parties. These contingent liabilities do not need Treasury approval or parliamentary notification (as set out in Annex 5.4. 35 of MPM) as entering into them is not within a department's control – they arise when a third party takes legal action against a department.

2.7 **A purchaser protection** can take various forms including warranties, or various other commitments made by the selling department. In addition, departments entering into contracts often provide assurance against breach of contract through warranties. For the purpose of the contingent liability approval framework, purchaser protections are contingent liabilities. Standard warranties are usually part of a department's normal course of business. If departments are considering taking action that would lead to warranty pay-outs they should consider whether that spending would be novel, contentious or repercussive and so require Treasury contest.

2.8 Sometimes a contingent liability is created when an **uncertain spending commitment** is entered into, such as cases where the commitment made is unlimited in scale and the quantum of spend is extremely uncertain. These commitments will normally be accompanied by spending in the estimate. In these cases, departments should discuss with Treasury the appropriate format for Treasury scrutiny of the uncapped element of the spend. Usually, these spending commitments will be made on a statutory basis and so will not require parliamentary notification, but in cases where there is no statutory basis parliamentary notification will be needed as set out from paragraph 3.13 in this document.

2.9 Departments sometimes make commitments that may in future lead to the use of public funds, but that are vague as to the mechanism or trigger for any spending. If commitments are vague, they will usually not be considered contingent liabilities. If uncertain you should discuss whether a commitment constitutes a contingent liability with Treasury.

2.10 Departments sometimes make commitments to other departments to meet costs if uncertain future events occur. As the Crown is indivisible, ministers (and their departments) cannot give guarantees or indemnities to each other. They can, however, enter into commitments of conditional support with the same effect. These commitments do not need parliamentary notification. Unless they are part of a department's normal course of business (paragraph 2.11) they should be discussed with Treasury.

Normal course of business

2.11 Contingent liabilities taken out in the normal course of a department's business do not need notification to parliament. In addition, departments are often given delegation to enter into contingent liabilities in the normal course of business without treasury consent, even if they are above a department's delegated authority limit, although this is not provided in all cases. If a contingent liability is novel, contentious, or repercussive it cannot be part of a department's normal course of business.

2.12 Normal course of business is defined in Box A5.4A of MPM. For a liability to be considered part of a department's normal course of business it must be the case that incurring the liability is the accepted standard practice for undertaking the activity <u>and</u> that the activity is part of the department's business model which has been authorised by parliament. The key test for if the liability is the accepted standard practice for undertaking the activity is whether two private sector bodies would use the same terms. A liability is not in the normal course of business simply because the activity is part of a department's normal course of business. Incurring the liability needs to be part of the normal course of business.

2.13 The Cabinet Office produces model service contracts[4] that can be used by departments as templates. These contracts contain contingent liabilities which, as they are consistent with standard commercial contracts, should be considered as part of normal course of business and so do not require Treasury consent or parliamentary notification.

2.14 In addition, sometimes contingent liabilities become established practice and so part of normal course of business over time. They in effect become the standard practice for undertaking the activity. Departments should keep track of the contingent liabilities they consider to be part of their normal course of business, and they should be open to scrutiny on those liabilities from Treasury and parliament. A contingent liability that is normal course of business for one department isn't necessarily part of normal course of business for another.

2.15 If in doubt over whether a contingent liability is part of a department's normal course of business, you should contact Treasury.

[4] [Model Services Contract - GOV.UK (www.gov.uk)]

Contingent liabilities requiring Treasury consent

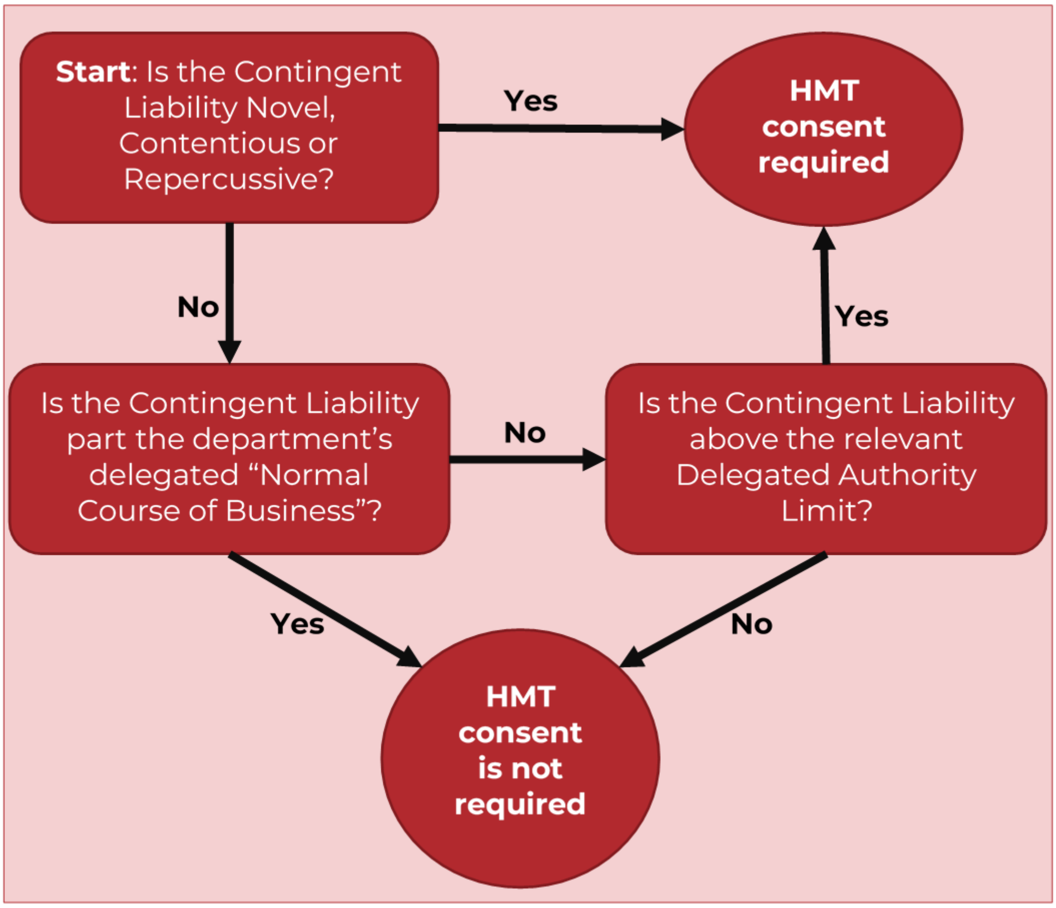
2.16 If taking on a contingent liability is within a department's control, then there are three further steps to assessing whether the contingent liability requires Treasury consent.

i. Firstly, is the contingent liability novel, contentious, or repercussive? If it is, Treasury consent is always required.

ii. Secondly, is the contingent liability part your department's delegated normal course of business? If it is, Treasury consent is not required.

iii. Finally, if the contingent liability is neither novel, contentious or repercussive nor part of a department's normal course of business then Treasury consent is required if the maximum exposure of the contingent liability is above the departmental delegated authority limit (DAL) for contingent liabilities. If a department has no specific contingent liability DAL, then they should use the CDEL limit if the contingent liability crystallises in CDEL and the RDEL limit if it crystallises in RDEL.

Chart 1: Treasury consent flow chart



2.17 Maximum exposure is defined as the maximum possible limit of government's exposure over the lifetime of the contingent liability. For example, a limit placed in a contract. If there is no legal or contractual limit, the maximum exposure is unlimited even if there is a quantified reasonable worst case exposure. In addition, if there is a limit on the exposure per crystallisation but no limit on the number crystallisations, the maximum possible exposure is unlimited.

2.18 When a contingent liability is called (crystallises) departments usually need to make that payment from their existing budgets but other arrangements exist in some cases. If Treasury consent was required to enter into the contingent liability the relevant Treasury spending team and the Treasury Balance Sheet Team should be notified if the liability crystallises.

Contingent liabilities requiring parliamentary notification

2.19 It is a department's responsibility to ensure proper parliamentary notification occurs. There is not usually a requirement to notify parliament in instances where a contingent liability arises due to events outside a department or ALB's control rather than through an active policy decision, ahead of that liability being taken on. Contingent liabilities, regardless of their source, will need to be reported in departmental accounts.

Box 3: Notifying liabilities to parliament – MPM text

1) The rules for notifying parliament of liabilities are very similar to those for public expenditure. Generally speaking there is no requirement to inform parliament about any liability which:

• arises in the normal course of business;

• arises under statutory powers (subject to third bullet point of paragraph 2); or,

• would normally require notification (i.e. neither arising in the normal course of business nor under statutory powers) but is under £300,000 in value.

2) There are some exceptions to this general rule. Parliament should be notified of any liability, even if it meets one or more of the criteria given in paragraph 1, which:

• arises as a result of a specific guarantee, indemnity or letter of comfort where the guarantee is not of a type routinely used in commercial business dealings;

• is of such a size, relative to the department's total budget, that parliament should be given notice;

• arises under specific statutory powers which require parliament to be notified; or,

• is novel, contentious or potentially repercussive

2.20 If in doubt over whether a contingent liability should be notified to parliament you should consult the Treasury. It is best practice to prioritise transparency to parliament and notify if in doubt.

Contingent liabilities of ALBs and other entities

2.21 ALBs classified as central government are subject to delegations from their sponsor departments that are in turn subject to delegations from Treasury. ALBs need consent from their sponsor department if they wish to enter into contingent liabilities above their delegated limits. If the contingent liability is above the sponsor department's delegated limit from Treasury, then Treasury consent is required. Contingent liabilities that are either novel, contentious or repercussive always need Treasury consent.

2.22 Entities linked to departments but outside of central government (e.g., public corporations) may give rise to financial consequences for their sponsor departments if they cannot meet their contingent liabilities. Any financial consequences of that type would be a form of contingent liability for the sponsor department in question. Therefore, when these entities take on contingent liabilities their sponsor departments should seek Treasury consent for any associated contingent liability which may exist for the sponsor department, if that associated contingent liability is above the sponsor department's delegated limit or is novel, contentious, or repercussive. If the sponsor department considers that no associated contingent liability arises for the department itself this should be clearly set out to Treasury.

Chapter 3 – Contingent Liability Approval and Notification

3.1 This Chapter provides detail about the contingent liability approval and notification process. There are two parts, Treasury consent and Parliamentary notification. In addition, this Chapter covers department's reporting requirements. Each of these stages is described below. As with all areas of policy development, early engagement with the Treasury is recommended.

Treasury consent for contingent liabilities

3.2 Treasury consent for contingent liabilities mirrors Treasury consent for spending. Treasury consent is required if departments wish to enter into contingent liabilities that are either novel, contentious or repercussive, or where the maximum exposure of contingent liabilities is above the department's delegated limits. Treasury consent is also required for substantive changes to or the renewal of existing contingent liabilities. Approval is based on information provided and where there are subsequent changes (either to the proposal or the wider context) departments should reengage with Treasury.

3.3 Treasury will consider any proposed contingent liability on its merits but in general Treasury expect certain principles to be applied to demonstrate value for money – these are set out in Chapter 4 of this document.

3.4 Approval should be sought from the relevant Treasury spending team (who are responsible for the department's policy priorities and the affordability of any contingent liability) who will work with the Treasury Balance Sheet Team (who are responsible for government's overall stock of contingent liabilities and contingent liability policy).

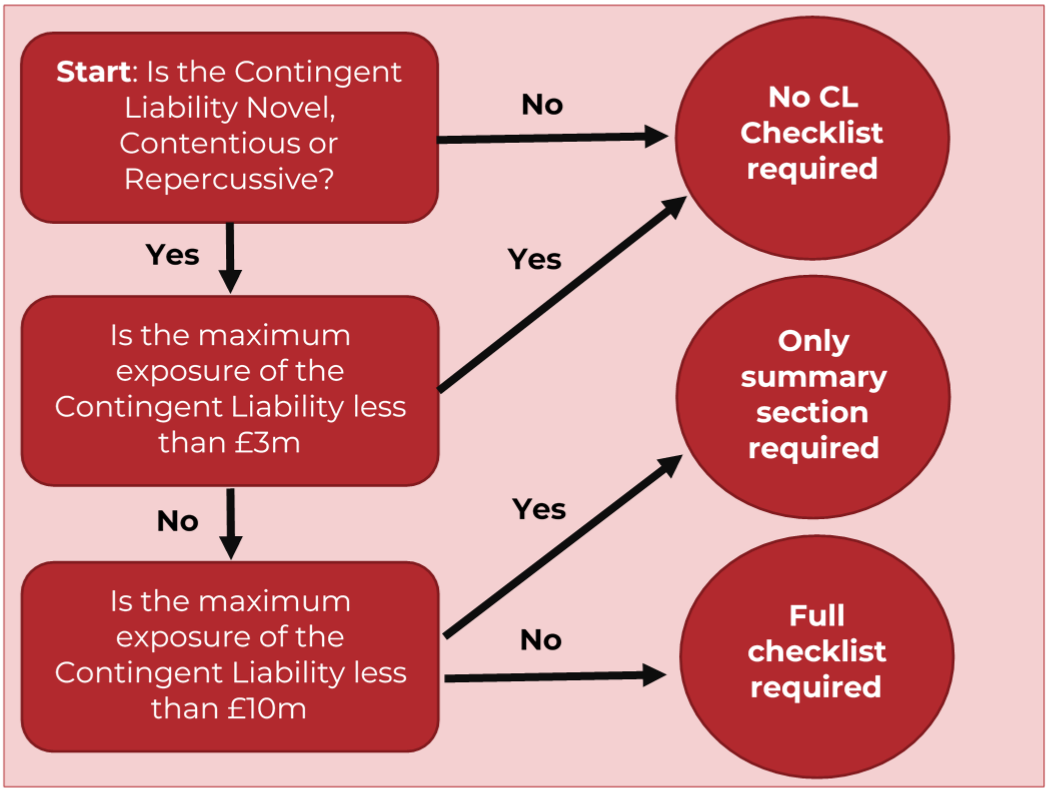
The contingent liability checklist

3.5 The contingent liability checklist is designed to create a standardised method of describing guarantees and indemnities to aid communication between departments and Treasury. The objective of the checklist is to give Treasury a clear, quantified understanding of the proposed contingent liability so that a fully informed assessment can be made of whether to provide Treasury consent.

3.6 As set out in paragraph A5.4.19 of MPM, HMT expects a checklist to be completed for all relevant contingent liabilities. This is to ensure risks are properly understood and managed. If, exceptionally, a contingent liability must be agreed to before a checklist can be completed, then the checklist should be completed retrospectively. Completion of the contingent liability checklist will form part of HMT's annual AO assessment.

3.7 **Treasury will usually expect a full contingent liability checklist to be completed for any guarantee or indemnity which is novel, contentious, or repercussive and that has a maximum exposure greater than £10m over its lifetime.** For a guarantee or indemnity which is novel, contentious, or repercussive and with a maximum exposure between £3m and £10m over its lifetime only the summary section of the checklist will usually be required. If a contingent liability does not need Treasury consent, due to it being part of a department's normal course of business or below its delegated limit, then a checklist will not be required.

Chart 2: Checklist requirement flow chart



3.8 Early engagement on upcoming contingent liabilities is encouraged so it is often good practice for a draft or partially completed checklist to be shared with Treasury to facilitate discussion and policy design. The checklist is intended to be a flexible document. In some cases, the questions in the checklist will not be relevant to the contingent liability under consideration. It is also possible there will be other relevant information departments wish to include to support their case for a new contingent liability.

3.9 In some cases, Treasury will also expect to receive a full business case – usually when the contingent liability is large or is created as part of a new government activity. In these cases, the checklist and business case will have significant overlaps. The checklist should usually be completed first and discussed with Treasury as the business case will tend to provide more detail than the checklist.

3.10 Once a checklist has been submitted to relevant spending team officials and the Balance Sheet Team, Treasury expects at least 5 working days to assess the completed checklist and if necessary, advise ministers. In many cases the process will be iterative and will depend on how quickly officials drafting the checklist are able to provide further information. In particularly urgent cases, this timeline can be compressed. Departments are expected to have applied appropriate scrutiny to contingent liabilities before providing a final checklist and requesting Treasury consent. In most cases where Treasury consent is required this will include departmental Accounting Officer (AO) and ministerial sign off.

Contingent liabilities in procurement

3.11 Most indemnities arising from procurement will be part of standard commercial contracts and so will be part of a department's normal course of business. When non-standard indemnities are provided as part of a procurement, and these indemnities are either above a department's delegated authority limit or novel, contentious or repercussive, Treasury consent is required. More detail is provided in MPM A5.4.17.

3.12 The expected cost of the indemnity should be considered alongside all other costs and benefits of the procurement as part of the procurement business case. Treasury consent for the indemnity should be sought alongside Treasury consent for any related spending rather than as a standalone contingent liability.

Parliamentary notification

3.13 Parliament expects advance notice of any commitments to future use of public funds for which there is no active request for resources through Estimates and that have no statutory basis. Chapter 2 of this document details when contingent liabilities need parliamentary notification.

3.14 Departments should notify parliament using both WMS and departmental minute – both of which should be cleared by Treasury. The departmental minute is the official record of the contingent liability and should, like all departmental minutes, be placed in the House of Commons Library. The WMS acts to draw members' attention to the minute. The departmental minute should be copied to both the chair of the PAC and relevant departmental committee. The liability should not be incurred until at least 14 sitting days after the contingent liability has been notified, although it can be announced as long as it is appropriately caveated.

3.15 If, exceptionally, a new liability needs to remain confidential, the chairs of the relevant select committee and the PAC should be informed; then parliament should be informed openly when the need for confidentiality lifts. If it is not possible for the full 14 sitting days to be provided due to the urgency of the contingent liability, then the department must explain the need for urgency to parliament and agree revised wording of the WMS and departmental minute with the Treasury. This is set out in full in MPM.

Reporting

3.16 The final stage of the contingent liability approval process is reporting. The contingent liability will be reported through Estimates and in the departmental or ALB Annual Report and Accounts - for details see The Government Financial Reporting Manual[5]. Following publication in the departmental or ALB Accounts, the Treasury will publish on a consolidated basis, as part of the Whole of Government Accounts (WGA), contingent liabilities for the whole public sector.

3.17 As part of their forecasts, the Office of Budget Responsibility (OBR) may publish their assessment of government's contingent liabilities and their impact on the public finances. The starting point for these publications will be the contingent liability checklists. Treasury will coordinate a process of confirming details of any contingent liabilities with departments before publication.

3.18 In addition, one of the objectives of the CLCC is to report on the government's whole stock of contingent liabilities. They will do this through an annual report. CLCC will contact departments to discuss the data requirements they need to achieve this objective.

5 Government Financial Reporting Manual: 2022-23 - GOV.UK (www.gov.uk)

Chapter 4 – Principles for Achieving Value for Money

4.1 This Chapter details the principles Treasury expect departments to apply when entering into new contingent liabilities. The principles described will not always be appropriate but when a department chooses not to apply them Treasury expects the rationale to be clearly set out.

Principles applied to contingent liabilities

4.2 **Affordability** – contingent liability crystallisation should be affordable within existing departmental budgets. Departments should be able to manage the reasonable worse case crystallisation of any contingent liability they hold. A reasonable worst-case crystallisation of a contingent liability will not be considered unforeseeable and so will not normally meet the bar for a reserve claim. Detail on reserve claims is set out in Box 2B of Treasury's Consolidated Budget Guidance. If that is not possible, then departments must agree with Treasury an appropriate funding arrangement before entering into the contingent liability although the bar for an alternate arrangement will be high.

4.3 **Market failure** – when government offers indemnities or guarantees that transfer risk from the private to the public sector there should be a clear articulation of the market failure necessitating government action. Why have private insurance or credit markets not been able to offer these financial products or why should government support the activity facilitated by these financial products?

4.4 **Charging for risk** - departments should ensure that guarantees and indemnities offered to the private sector, and public sector bodies outside central government, are charged for appropriately. The charge should normally be at least enough to compensate for expected costs. Commercial rates, higher than expected costs, should be charged for commercial services. When departments do not wish to charge for risk, they should be able to put forwards a clear and compelling case. This is set out in MPM A5.4.13.

4.5 **Value for money against other options** – Often contingent liabilities will have no upfront cost. This, in of itself, is not a justification for entering into contingent liabilities. A contingent liability's expected cost should be evaluated when considering VfM. If public spending equal to that expected cost generates better policy outcomes, then it will likely achieve better VfM than the contingent liability. Loans and equity investments should also be considered instead of guarantees. Government should be risk neutral at the margin when assessing the cost of contingent liabilities. For example, a 1% chance of a £100m liability and a 10% chance of a £10m liability both have the same expected costs. When assessing VfM they should be treated equivalently.

4.6 **Time limited** – contingent liability exposure should be limited in time. Time limits should apply to both the risk exposure (i.e., the dates between which an event could occur causing the liability to crystallise) and the liability exposure (i.e., the dates between which a claim could be paid). This time limit can be long dated but should be as short as possible to fulfil its policy objectives.

4.7 **Limited exposure** – the government's risk exposure should be capped or limited where possible. There should be a clear VfM case for offering uncapped indemnities. The scope of any indemnity should be limited, so that risk exposure is only provided for damage or loss as is necessary to achieve the policy objective. If possible, indemnity crystallisations should be provided as loans instead of grants. All guarantees should have a limited exposure. For guarantees with a potentially unlimited uptake, there should be a limit on the amount any individual/entity can borrow.

Box 4: Other contingent liability best practice to consider

In addition to the principles set out above which should be applied to all contingent liabilities the below best practise should be considered where relevant to specific contingent liabilities.

Risk sharing – when government relies on other organisations to take credit or insurance decisions on its behalf (for example, commercial banks) risk should be shared so that those decision makers are appropriately incentivised to identify and price risk. When providing indemnities, the party most able to control risk should retain a financial incentive to do so to minimise moral hazard, for example by retaining a share of losses if an indemnity crystalises.

Negligence – departments should not take on liabilities to contractors which would indemnify the contractor in the event of the contractor's own negligence or that of a sub-contractor.

Litigation rights - the government should retain litigation rights in legal proceedings associated with contingent liabilities.

Creditworthiness – when issuing guarantees, consideration should be given to the creditworthiness of the borrowers, to ensure an understanding of the risk of default the guarantee exposes the government to.

Collateral – it could represent good value for money to require the recipients of guarantees to post collateral to minimise risk help by the government.

Programmes - departments often consider introducing multiple contingent liabilities as part of a programme or scheme. For example, a new guarantee or insurance scheme. Treasury will have an interest in both the overall programme and possibly individual contingent liabilities within the programme. Departments should agree appropriate governance with Treasury when entering into contingent liability programmes with clear criteria for when further Treasury consent will be needed, the information Treasury will need to grant that consent, and any appropriate scheme level reporting.

Funds – it is rarely good VfM for departments to set up funds to pay for the future crystallisation of contingent liabilities. Funds expose HMG to market risk unnecessarily and lock up resources that could be used for other purposes. Treasury must agree to the creation of any new fund to meet contingent liabilities. This is set out in MPM A4.8.5 and A5.1.13.

Annularity – spending due to the crystallisation of contingent liabilities and income received from any fees charged for contingent liabilities are annualised under the normal public sector budgeting rules. This means income cannot normally be moved between years to pay for crystallisations.

Subsidy Control – often when transferring risk from the private to public sector subsidy control legislation will need to be considered. This is especially important in cases where government does not charge to cover expected losses. Further guidance can be found in the Statutory Guidance for the United Kingdom Subsidy Control Regime.

Subsidising insurance – if third parties are given grant funding to purchase insurance, consideration should be given to government providing an indemnity instead of the grant.

Annex 1 – The Contingent liability checklist

The contingent liability checklist is designed to allow Treasury and departmental officials to discuss the details of a proposed contingent liability. The checklist will also form the basis of any advice to Treasury ministers. Treasury would encourage departments to share checklists in draft form to enable joint policy discussions ahead of any final decision.

If a business case is required, a pragmatic approach should be taken to the checklist given the significant overlap. It is usually best to discuss the checklist with HMT first as it will contain the key information needed which the business case will then further detail.

The Contingent Liability Central Capability (CLCC) (CLCC@UKGI.org.uk) are available to support departments in the design of contingent liabilities and to ensure best practice is met across government. As part of that process, they will be able to assist your department in the completion of this checklist.

When sending a checklist to Treasury please include a contact email for the relevant policy official, the commercial sensitivity of the proposed contingent liability and group or team responsible for the proposal.

Annex 2 of this document provides detailed guidance to support the completion of the checklist.

1. Summary

1.1: Please set out details of the contingent liability/liabilities for which you are seeking Treasury consent.

1.2: Please complete the following table summarising the financial impacts of this contingent liability. If you have used an alternate method to calculate expected cost, please adjust the table accordingly.

Contingent Liability Summary Table	
(1) Start and end dates of risk exposure [the dates between which an event could occur causing the liability to crystallise]	
(2) Start and end dates of liability exposure [the dates between which a claim could be paid]	
(3) Maximum exposure (£ millions)	
(4) Reasonable worst case exposure (£ millions)	
(5) Average cost per crystallisation (£ millions)	
(6) Probability of crystallisation [if only one crystallisation can occur] *or* **Expected number of crystallisations** [if more than one crystallisation is possible] (%/number)	
(7) Lifetime expected gross cost [average cost per crystallisation (5) multiplied by probability of/expected number of crystallisations (6)] (£ millions)	
(8) Lifetime expected income (£ millions)	
(9) Lifetime expected net cost [Lifetime expected gross cost (7) minus Lifetime expected income (8)] (£ millions)	
(10) Probability of any costs arising [for single event CLs this would be the same as the probability above, for portfolios this will be higher – perhaps even 100%] (%)	

1.3: Why is it beneficial for government to take on this contingent liability?

1.4: Please provide an options analysis demonstrating what alternatives have been considered.

2. Evidence and Rationale

2.1: Please provide evidence to support the maximum possible and reasonable worst case estimates in the summary table, including an assessment of uncertainty.

2.2: Why is this size necessary? If there is no explicit maximum, please explain why.

2.3: Why is the risk and liability exposure of this contingent liability necessary? If the contingent liability exists in perpetuity, please explain why.

2.4: Will there be any review points where parameters of the liability can be changed and are there options to exit the liability before the maturity?

2.5: Please provide evidence to support the “Average Cost per Crystallisation” in the summary table, including an assessment of uncertainty?

2.6: Please provide evidence to support the “Probability of Crystallisation/Expected Number of Crystallisations” in the summary table, including an assessment of uncertainty.

2.7: Please provide evidence to support the income received estimate in the summary table, including an assessment of uncertainty.

2.8: Why is this level of income received appropriate? In particular, if your department does not intend to charge, please explain why.

2.9: If the liability crystallises, what is the impact on future crystallisations of this liability?

3. Risk management

3.1: What are the triggers for this contingent liability crystallising?

3.2: How does your department plan to monitor and report risks once the CL is approved, both to Treasury and internally?

3.3: What risk mitigation tools will be applied to reduce the risk of this liability crystallising and the quantum of any crystallisation?

3.4: Will the liability be funded in advance by, for example, holding assets against the liability? As set out in Box 4 of the contingent liability approval framework, this is rarely good VfM.

4. Affordability

4.1: If the contingent liability crystallised, how will your department meet the required payment (reasonable worst-case cost) from your department's existing budget?

4.2: What other liabilities are held by your department have similar triggers? If this liability crystallises what is your assessment of the impact on the likelihood of crystallisation of other liabilities – would this be affordable within existing budgets?

Annex 2 – The Contingent liability checklist guidance

This annex summarises the checklist format and provides detailed guidance on how to answer each question in the checklist. The CLCC (CLCC@UKGI.org.uk) are available to assist departments in completing this checklist and supporting contingent liability policy development. The CLCC have also published guidance (and will publish future guidance) on a number of technical areas related to contingent liabilities – this guidance can be found on the following webpage.

1. Summary

The first section of the contingent liability checklist asks departments to set out what the contingent liability is, how much it is expected to cost, the rationale for taking on the liability and an options analysis showing why this contingent liability has been put forwards amongst other options.

1.1: Please set out details of the contingent liability/liabilities for which you are seeking HMT approval.

i. This question asks you to summarise the contingent liability (CL) being proposed. Having read this section someone unfamiliar with the proposition and wider policy context should be able to understand what contingent liability your department wishes to enter into including what risk is being taken from who and why.
ii. This summary should include the type of CL (see table below)
iii. If the CL is arising as part of a procurement what is the status of the rest of the procurement? Normally CLs arising as part of a procurement should be agreed in the round with any other element of the procurement that needs Treasury consent.
iv. Who is the beneficiary of the CL – to whom would the payment be made if the contingent liability crystallised?
v. Is the proposed CL a single contingent liability or a programme of contingent liabilities? If it is a programme what role will Treasury have in approving each contingent liability within the programme?
vi. How will the CL be recorded in your accounts (e.g., financial guarantee, CL, remote CL, insurance contract, provision etc.)?

vii. What is the wider policy context for the CL? Have there been any previous government announcements or agreements (e.g., in a manifesto or at an SR) that relate to this proposal?
viii. Will your department charge the beneficiary of this CL – if so, what are the charging arrangements?
ix. When will the CL be entered into – when and how will parliament be informed?

Type of contingent liability	Category	Description
Indemnity	Procurement indemnity	An indemnity offered to a supplier as part of a procurement contract
	Policy indemnity	An indemnity offered to support private sector activity the government wishes to support that wouldn't occur without the indemnity
	Appointment indemnity	An indemnity against personal liability offered to an individual appointed to a role
	Inter-public sector indemnity	An indemnity offered by one part of the public sector to another – usually from central government to the wider public sector.
	Other indemnity	Any other indemnity
Purchaser protection	Purchaser protection	An indemnity offered to an organisation purchasing or using a government asset
Guarantee	Callable capital	An obligation from holding callable shares in an organisation
	Pension guarantee	An obligation relating to shortfalls in a funded pension scheme
	International guarantee	A guarantee arising due to agreements with other countries or

		international organisations
	Policy Guarantee	A guarantee offered to support private sector activity the government wishes to support that wouldn't occur without the guarantee
	Other Guarantee	Any other guarantee
Uncertain Cost	Uncertain Cost	A commitment that has such materially uncertain costs that it is classed as a contingent liability.
Other Contingent Liability	Other Contingent Liability	Any other contingent liability

1.2: Please complete the following summary table of the financial impacts of this contingent liability. If you have used an alternate method to calculate expected cost, please adjust the table accordingly.

i. This table summarises the financial implication of the proposed CL. Treasury officials will use this table in presenting the costs of this CL to Treasury ministers.
ii. Given the nature of CLs it is likely that the figures in this table will be estimates with a degree of uncertainty. The Evidence and Rationale section askes for more detail on these figures including detail on uncertainty. Please provide your best estimate, *at a minimum* an indication of the quantum using the categories provided below. It is acceptable to apply professional judgment when quantifying the financial impact in this table as long as it is explained in section 2. Professional judgment could include consulting domain experts, analytical experts, actuarial professionals or CLCC guidance as appropriate when producing estimates.
iii. If the CL is in a non-GBP currency, please covert it to GBP in the table and note the exchange rate used.
iv. **Start and end date of risk and liability exposure** - This section asks you to detail the time over which government could be exposed under this CL. Please detail both the risk exposure (i.e., the dates between which an event could occur causing the liability to crystallise) and the liability exposure (i.e., the dates between which a claim could be paid).
v. **Maximum exposure** – this should represent the maximum possible limit of government exposure over the lifetime of the CL. For example, a limit placed in a contract. If there is no legal limit,

please say that the maximum exposure is unlimited even if there is a quantified reasonable worst case exposure. If there is a limit on the exposure per crystallisation but no limit on the number crystallisations, the maximum possible exposure is unlimited.
Maximum exposure categories

- Unlimited
- More than £1bn
- £500m to £1bn
- £100m to £500m
- £50m to £100m
- £10m to £50m
- Less than £10m

vi. **Reasonable worst case exposure** – this is necessarily judgment based. It represents the costliest plausible manifestation of the CL crystallising over the lifetime of the CL once very highly unlikely scenarios have been discounted. You will be asked to set out what your reasonable worst case scenario is in 2.1. The nature of CLs means this will be an unlikely scenario that you do not expect to happen.
Reasonable worst case exposure categories

- More than £1bn
- £500m to £1bn
- £100m to £500m
- £50m to £100m
- £10m to £50m
- Less than £10m

vii. **Average cost per crystallisation** – this represents the average pay-out your department will have to make each time this liability crystallises. This should be the average pay out for each crystallisation rather than the average pay-out in each financial year. If there are a very large number of small crystallisation then the categories below are likely not appropriate. You'll be asked to provide evidence for this figure in 2.6
Average cost per crystallisation categories

- More than £1bn
- £500m to £1bn
- £100m to £500m
- £50m to £100m
- £10m to £50m
- Less than £10m

viii. **Probability of crystallisation or Expected number of crystallisations** – the answer to this question will depend on whether it is possible for the CL to crystallise once or multiple times. If the CL can crystallise only once, please provide the probability of the CL crystallising expressed in a percentage. If the CL can crystallise multiple times, please say how many times the CL is expected to crystallise on average. This can be less than once if the CL is unlikely to occur.

ix. For example, if it is possible the CL will crystallise 100 times (due to e.g., 100 guarantee contracts being signed as part of a guaranteed programme) and there is a 5% probability of each contract resulting in a pay-out then the expected number of crystallisations would be 5 (100 multiplied by 5%). If the probability of a pay-out was 0.1% for each contract, then the expected number of crystallisations would be 0.1 (100 multiplied by 0.1%).

x. If the CL is triggered by a future controllable government action, then answer this question with N/A.

xi. If the probability of multiple crystallisations is extremely low but technically possibly it may be more appropriate to answer this question with the probability of crystallisation – this should be discussed with the CLCC.

<u>Probability of crystallisation categories</u>

- More than 50% (in more than 1 year in 2 costs will occur)
- 25% to 50% (in between 1 year in 4 and 1 year in 2 costs will occur)
- 10% to 25% (in between 1 year in 10 and 1 year in 4 costs will occur)
- 5% to 10% (in between 1 year in 20 and 1 year in 10 costs will occur)
- 1% to 5% (in between 1 year in 100 and 1 year in 20 costs will occur)
- 0.1% to 1% (in between 1 year in 1000 and 1 year in 100 costs will occur)
- Less than 0.1% (in less than 1 year in 1000 costs will occur)

xii. **Lifetime expected gross cost** – this is probability of crystallisation or number of crystallisations multiplied by average cost per crystallisation. If you have used ranges take the higher numbers in calculating the expected cost. This figure is the average amount HMG should expect to pay out due to this CL over its lifetime. As HMG has a large portfolio of CLs, Treasury expect total cross government spending on CLs to be equal to the sum of each CL's expected cost.

xiii. **Lifetime expected income** – how much income do you expect to receive by charging the beneficiaries of this CL. If you are not charging put £0. Questions 2.8 asks you to justify why the level of income received is appropriate.

xiv. **Lifetime expected net cost** – this should be calculated as gross expected cost minus income received. A positive number means on average this CL will cost HMG money; negative number means on average HMG gains money.

xv. **Probability of any costs arising–** this represents the probability of any crystallisation of this contingent liability happening. This includes the probability of a single large cost and multiple small costs; this is not the probability of the reasonable worst case scenario occurring.

1.3: Why is it beneficial for government to take on this contingent liability?

i. Please set out the positive case for taking on this CL. What is the policy objective your department is trying to achieve and why will taking on this contingent liability achieve that objective? Treasury officials will use this case to explain to Treasury ministers why they should consent to your department taking on this CL.
ii. If your department has produced a business case for this CL, then this answer should link to the strategic case for the CL in your business case.
iii. This answer should set out how taking on this CL helps to advance the government's strategic priorities. It should also set out if this CL is in tension with any other government priorities.
iv. If a net present value (NPV) of this CL (based on the green book methodology) has been produced, then please provide that here and set out how the NPV has been calculated. A NPV isn't necessary to answer this question.

1.4: Please provide an options analysis demonstrating what alternatives have been considered.

i. This question asks you to provide an options analysis comparing this CL with other options. This should show how the proposed CL is best able to meet the government's strategic priorities and deliver value for money.
ii. The options analysis should compare the proposed CL with other CL options where for example more or less exposure is taken on, a do nothing option, and options such as lending or departmental spending where appropriate. If the proposed CL is part of a procurement, then the do nothing option should compare the price of the procurement with and without the CL and the option of not procuring.
iii. Options should be assessed against at least the strategic fit with the policy objective, deliverability, and value for money. Other criteria can be added to this assessment if you have used them in your own options analysis.

2. Evidence and Rationale

This section of the contingent liability checklist asks you to provide evidence on how you have estimated the financial impacts of the proposed contingent liability. These estimates will be uncertain and so this section provides space to discuss that uncertainty and any stress testing. It also asks you to provide a rationale for the scale of the financial impacts, time period of exposure and income received.

2.1: Please provide evidence to support the maximum possible and reasonable worst case estimates in the summary table, including an assessment of uncertainty.

i. This question asks you to provide evidence supporting the figures you have provided in table you have completed in 1.2.
ii. For maximum exposure, please set out if there is a maximum exposure how that maximum is achieved. For example, what contractual provisions are in place to limit exposure to this amount.
iii. The reasonable worst case scenario is necessarily judgment based. It is the costliest plausible manifestation of the CL crystallising once very highly unlikely scenarios have been discounted. Please describe the scenario you have considered. What happens in that scenario and what are the associated costs, how have you calculated these costs? Why have you chosen that scenario as your reasonable worst case? What assumptions have you made and how would changing those assumptions affect the cost in this scenario?
iv. If you have not been able to quantify the reasonable worst case, please describe the circumstances which might represent a plausible but costly outcome, and the factors which determine the size of the cost in that event.

2.2: Why is this size necessary? If there is no explicit maximum, please explain why.

i. This question asks you to justify why this maximum and reasonable worst case exposure is necessary to meet the policy objectives while achieving value for money.
ii. If the maximum exposure is not capped, why can the amount not be capped? What impact would capping exposure have on the policy objectives and on achieving VfM? If the exposure is capped could the cap be lowered, what would the policy and VfM impact be of a lower cap?
iii. In the reasonable worst case scenario, what could be done to reduce exposure proactively. Could government risk share or increase the amount of risk sharing it will undertake? What would the policy and VfM impacts of further risk sharing be?

2.3: Why is the risk and liability exposure of this contingent liability necessary? If the contingent liability exists in perpetuity, please explain why.

i. Please set out why the maturity in the summary table is necessary for meeting the policy objective and achieving VfM.
ii. If the CL exists in perpetuity, please set out why this is necessary. What would happen if the CL had a specific end date (e.g., significantly into the future)? Please set this out for both the dates exposed to risk and the dates exposed to liabilities.
iii. If the CL has a specific end date, please set out why this end date meets the policy objectives and achieves VfM. What would happen if the CL had a shorter maturity, how would this impact the policy objectives and VfM?

2.4: Will there be any review points where parameters of the liability can be changed and are there options to exit the liability before the maturity?

i. While you anticipate that the CL will exist until the dates set out in 2.3, circumstances may change, and it could be advantageous to exit the CL before these dates.
ii. It may also be beneficial to have review points where parameters of the liability can be changed, such as fees charged, or amount guaranteed/indemnified. Please can you set out whether there are review points, when they will be and what parameters will be considered.
iii. If there are opportunities to exit the CL before maturity, please detail them, for example break clauses or formal review points. How will your department monitor the CL to ensure the CL is retained only if it still delivers the policy objectives and achieves VfM.
iv. If there is no option to exit this liability before maturity, please set out why it is not possible to include one. What impact would an exit clause have on the policy objective and VfM.

2.5: Please provide evidence to support the “Average Cost per Crystallisation” in the summary table, including an assessment of uncertainty?

2.6: Please provide evidence to support “Probability of Crystallisation/Expected Number of Crystallisations” in the summary table, including an assessment of uncertainty.

2.7: Please provide evidence to support the “Income Received” estimate in the summary table, including an assessment of uncertainty.

i. These questions (2.6, 2.7 and 2.8) ask you to provide evidence supporting the figures you have provided in table you have completed in 1.2.
ii. Please set out how you have come to the figures provided in the summary table. Given the nature of CLs this is likely to be uncertain and so you should provide your best assessment and detail the points of uncertainty. If relevant, please set out the calculations you have used.

iii. If detailed analysis sits behind these figures (such as actuarial reports), please summarise the methodology and findings here and refer as appropriate to other supporting documents such as more detailed analytical reports.
iv. To assess uncertainty, where you have made assumptions, please detail them and the impact of reasonable changes to these assumptions on the figures provided.
v. If you are unable to provide any figures, please describe the circumstances under which a cost might arise and what will determine the size of the cost.

2.8 Why is this level of income received appropriate? In particular, if your department does not intend to charge, please explain why.

i. Please set out your department's planned charging approach and how you have come to the decision that the level of income you are set to receive is appropriate for this CL. Approaches to charging include no charge, charge to cover administration, charge to cover expected cost excluding admin or including admin and industry standard charging.
ii. If the CL is being entered into as part of a procurement, Treasury would not expect a fee to be charged but you should considerer whether the reduced cost of the procurement justifies the CL. You should set out the scale of the cost reduction.
iii. If your department is not charging a fee for this CL or receiving an economic benefit from the CL beneficiary in some way, please set out why charging a fee would not be appropriate. What impact would charging even a notional fee have on the policy objectives and on achieving VfM.
iv. If a fee is being charged, but the fee is insufficient to cover the gross expected cost of the CL please set out why it would not be appropriate to charge a fee covering the gross expected cost (such that the net expected cost is £0). Please set out how charging a fee to cover gross expected cost would impact the policy objectives or VfM.
v. It is often necessary to consider subsidy control legislation when considering the level of charging. If relevant, please set out how this CL is consistent with subsidy control legislation.

2.9: If the liability crystallises, what is the impact on future crystallisations of this liability?

i. This question asks you to consider how crystallisations of this CL may be correlated with future crystallisation of this CL. Given the nature of CLs this is likely to be highly uncertain but please provide at least an indicative qualitative assessment.
ii. If the CL crystallises – if any payment is made under the CL – will that increase, decrease, or not impact the probability and quantum of future crystallisations of this CL.

iii. For example, an indemnity could be capped such that only a certain £ quantum of payments could be made, in which case a crystallisation could lower the future amounts that could be paid under this CL. Or an indemnity could be triggerable only once, such that if the CL crystallises the probability of future crystallisations falls to 0%.
iv. Another example could be a guarantee scheme where a crystallisation could imply future crystallisations will be more likely due to credit risk being greater than anticipated.

3. Risk management

This section of the contingent liability checklist asks you to set out the triggers for this CL and how risks will be managed, including whether your department intends to put in place a fund to pay for future crystallisations.

3.1: What are the triggers for this contingent liability crystallising?

i. Please set out the chain or chains of events that would cause money to be paid out under this CL. How much warning will HMG have that this CL will crystallise?

3.2: How does your department plan to monitor and report risks once the CL is approved, both to HMT and internally?

i. What processes will your department put in place to monitor the risks this CL poses. Will those processes be linked to the monitoring of other similar CL or spending risks held by your department?
ii. How will your department assess whether the expected cost of the CL has changed? At what point will these changes be reported to HMT?

3.3: What risk mitigation tools will be applied to reduce the risk of this liability crystallising and quantum of any crystallisation?

i. What tools will your department have to mitigate the likelihood and quantum of any CL crystallisation?
ii. The most important risk mitigation tool will be ensuring the party most able to mitigate risk is incentivised to do so. How this is achieved will differ but often this involves agreeing risk sharing arrangements such as partial guarantees or excesses below which indemnities are not paid. Fees can also be a useful tool to incentivise the beneficiary of a CL to exit the CL at the earliest opportunity. Please set out how the party most able to mitigate risk is incentivised to do so under the design of the CL.

iii. Another important set of risk mitigation tools used to lower the financial cost of any crystallisation are collateral or covenants. Collateral could be placed so that if a guarantee is called government has a stake on the credit structure of an insolvent firm. Covenants can also be placed on the beneficiary to limit their actions and reduce risk; these can range from limits on debt to the halt of dividend payments while government support is ongoing. Please set out what risk mitigation tool are in place to lower the cost of any crystallisation, collateral, covenants or other.
iv. Please set out any other risk mitigation tools being applied to reduce the probability and quantum of any crystallisation of this CL.
v. Finally, if legal action is involved in the crystallisation of this CL who will represent the HMG's interests in any legal case?

3.4: Will the contingent liability be funded in advance by, for example, holding assets against the liability?

i. It is not normally good VfM for the payment of CLs to be funded in advance. Please set out whether your department propose to fund this liability in advance either by directly holding financial assets against the CL or through similar arrangement, e.g., where a supplier holds assets on behalf of your department.
ii. If your department does propose to fund this liability in advance, please set out why this is necessary to achieve the policy objectives and VfM, what would the impact be if the CL was not funded in advance?
iii. If a fund is used what investment strategy is proposed and how will the fund be governed?
iv. To note: your department will need to agree separately with HMT the use of a fund and any investment strategy.

4. Affordability

The final section of the contingent liability checklist asks you to assess whether the proposed contingent liability is affordable for the department planning to take it on.

4.1: If the contingent liability crystallised, how will your department meet the required payment (reasonable worst-case cost) from your department's existing budget?

i. This question asks you to set out why taking on this CL is affordable for your department. Departments are expected to meet calls on CL from within their existing budgets. If there is a risk that the crystallisation of a contingent liability would not be affordable within existing budgets your department must have agreed a plan for financing the contingent liability on crystallisation as part of HMT's contingent liability consent.

ii. Please set out how your department would meet the reasonable worst case scenario from within your existing budgets. For example, can the reasonable worst case be met from underspends or would existing spending need to be reprioritised. If spending needs to be reprioritised what would your reprioritisation plan be? How will this CL crystallising affect your department's wider delivery?
iii. To contextualise your response please provide information on the size of your department's relevant DEL budget.

4.2: What other liabilities are held by your department that have similar triggers? If this liability crystallises what is your assessment of the impact on the likelihood of crystallisation of other liabilities – would this be affordable within existing budgets?

i. This question asks you to assess the links between the proposed CL and other contingent liabilities held by your department.
ii. Given the nature of CLs and the policy remit of each department it is possible that the proposed CL will have similar triggers to other CLs currently held by your department. For example, your department may be exposed via multiple CLs to a single firm, sector of the economy, or country. Therefore, affordability needs to be considered on a portfolio basis not a single contingent liability basis.
iii. To answer this question please set out the details of any other CL held by your department with similar triggers. Set out their reasonable worse case exposure and your assessment of whether the proposed CL and these existing CL will crystallise at the same time.
iv. If it is likely that these CLs will crystallise at the same time, please provide an equivalent answer to questions 4.1 but for the full stock of CLs likely to crystallise at the same time.

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This document can be downloaded from www.gov.uk

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