Financial Reporting Advisory Board paper

IFRS 17 Insurance Contracts

Issue:	HM Treasury brought a draft version of the IFRS 17 application guidance to FRAB 149 in March 2023. Comments were raised in several areas. This paper sets out the changes made to the IFRS 17 application guidance since FRAB 149.
Impact on guidance:	The FReM and associated illustrative financial statements will be updated for financial year 2025-26.
IAS/IFRS adaptation?	Adaptations and interpretations have been proposed in this paper. In addition to providing the full application guidance, this paper highlights changes made since the application guidance was viewed by FRAB at the March 2023 meeting.
Impact on WGA?	The adoption of IFRS 17 may affect how insurance contract accounting is applied for the 2025-26 WGA (depending on the final decisions on interpretations/adaptations, effective date and early adoption).
IPSAS compliant?	There is no equivalent insurance accounting standard in IPSAS.
Interpretation for the public sector context?	This is covered above.
Impact on budgetary regime and Estimates?	The proposed budgetary regime will align with the accounting treatment.
Alignment with National Accounts	We have engaged with the ONS on treatment of insurance contracts in budgets and estimates from a National Accounts perspective. The ONS have confirmed they are content with HM Treasury's proposed regime from the National Accounts perspective.
Recommendation:	The Board considers and provides views on the issues discussed in this paper and agrees to the publication of the IFRS 17 application guidance shortly after the June 2023 FRAB meeting.
Timing:	Amendments to the FReM confirmed at this meeting will be published in December 2024. HM Treasury plan to release the IFRS 17 application guidance shortly after this FRAB meeting, subject to FRAB's decisions in this meeting.

DETAIL

A - Background

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

A.2 HM Treasury issued an Exposure Draft (ED) in January 2023 proposing changes to the FReM for IFRS 17. Draft application guidance was presented to FRAB in March 2023 where comments were made by members. The majority of the IFRS 17 application guidance was approved by FRAB in March 2023, but there were a handful of areas where FRAB were not able to make final decisions.

A.3 An updated draft version of the IFRS 17 application guidance addressing feedback received from the March 2023 FRAB meeting has been produced with consultation with the IFRS 17 Technical Working Group (TWG). The updated IFRS 17 application guidance can be found in Annex A (application guidance with tracked changes has been provided in Annex B).

B – Changes made to the IFRS 17 application guidance

The table below sets out changes made to the IFRS 17 application guidance from the version presented to FRAB in March 2023. For some changes made, further explanation and analysis is provided in later sections of this paper as referenced in the table.

Number	Application Guidance Section/ Paragraph	Explanation and rationale of change made
1	2.2.5	Paragraph added to highlight that contracts enforceable by law are within the scope of IFRS 17. Refer to section D below.
2	Section 2.4	Second bullet in box- minor changes made for clarity.
3	Section 2.7	Section deleted. Refer to section D below.
4	Sections 4.3. 4.4, 4.6	Refer to section E below.
5	6.1.1	Minor wording change for clarity. [HM Treasury don't necessarily expect insurance liabilities to be more common solely due to the implementation of IFRS 17].
6	6.1.6	We have confirmed with the ONS when the fiscal impact of insurance contract liabilities should be, which is when the liability is classified as a liability for incurred claims or when the payment is made (whichever is earlier).

Question for FRAB

1) Aside from changes 2, 3, and 4, do you have any comments on the changes made to the IFRS 17 application guidance noted in the table above?

C - IFRS 17 and Remote contingent liabilities

C.1 At previous FRAB meetings HM Treasury have presented the possibility for a dual reporting arrangement, whereby insurance contracts within the scope of IFRS 17 with a remote possibility of crystallising would also be reported in the accountability report.

C.2 At the March 2023 FRAB meeting, HM Treasury proposed to not include a dual reporting framework, meaning insurance contracts within the scope of IFRS 17 would be accounted for and disclosed in line with IFRS 17 only; there would be no further mandatory requirements to include disclosures in the accountability report.

C.3 The reasons for this conclusion are set out in FRAB paper 149(07), section C. HM Treasury maintain these key arguments for not including a dual reporting framework for insurance contracts within the scope of IFRS 17. Some FRAB members raised concerns over removing the dual reporting framework, in particular that it may be reducing information provided to Parliament.

C.4 Further discussion with FRAB members subsequent to the March FRAB meeting identified that there is a misalignment between the definition of a contingent liability for accounting purposes and the definition used for HM Treasury for (a) spending control purposes (ie the process that central government bodies need to go through to receive HM Treasury approval to enter into particular transactions) and (b) for parliamentary oversight purposes. For spending control and parliamentary oversight purposes, per the Contingent Liability Approval Framework (CLAF), contingent liabilities are '*commitments to use public funds if uncertain future events occur*'[1]. As noted in CLAF paragraph 2.2, '*it includes items accounted for as financial guarantees or insurance contracts, as well as those accounted for as contingent liabilities.*' CLAF paragraph 2.3 notes the definition also includes provisions and covers both remote and non-remote contingent liabilities.

C.5 FReM 6.7.1(b) requires: '*a brief description of the nature of each of the entity's material remote contingent liabilities (that is, those that are disclosed under parliamentary reporting requirements and not under IAS 37) and, where practical, an estimate of its financial effect. Further guidance on managing contingent liabilities can be found in Annex 5.4 of Managing Public Money, and in the supplementary Contingent liability approval framework.*'

C.6 HM Treasury's view is that the intention of the current FReM requirement 6.7.1(b) to disclose remote contingent liabilities in the accountability report is to capture those which fall outside the disclosure requirements of IAS 37 (specifically paragraph 28 of IAS 37) but are still within the scope of IAS 37. The intention is not to widen the scope of a contingent liability from an IFRS perspective or to disclose liabilities in the accountability report which do not fall within the scope of IAS 37.

C.7 HM Treasury's view is informed by the guidance in the FReM about this issue prior to 2015-16, which is much more explicit about the scope of the guidance being aligned with IAS 37. The full guidance prior to 2015-16 can be found below this paragraph. We think that the change to the guidance in 2015-16 was made because of the general simplifying and streamlining project that aimed to make central government annual reports and accounts more accessible and better meet the needs of users and there was no intention to introduce

[1] Contingent liability approval framework paragraph 1.1.

a substantive change in the scope of the guidance (ie widening the scope beyond IAS 37 remote contingent liabilities).

Other notes relating to Parliamentary accountability

3.2.13 In addition to the requirements for notes supporting the *Statement of Parliamentary Supply*, entities covered by Managing Public Money or Managing Public Money Northern Ireland should include the following disclosures, where the amounts are over the limit prescribed in *Managing Public Money or Managing Public Money Northern Ireland*:

a) information about contingent liabilities not required to be disclosed under IAS 37 Provisions, Contingent Liabilities and Contingent Assets because the likelihood of a transfer of economic benefits is considered too remote, but included for parliamentary reporting and accountability purposes. For quantifiable remote contingent liabilities, the note should disclose the opening balance, any increase in the year, any amounts that crystallised in the year (that is, the liabilities have become reportable under IAS 37), any obligations that have expired during the year and the closing balance. The note should also state the amount that has been reported to Parliament by departmental Minute and provide a reconciliation between that and the disclosed amount where different. Reporting entities should list unquantifiable remote contingent liabilities, explaining why they are unquantifiable;

C.8 Therefore, HM Treasury propose to update FReM 6.7.1(b) as follows (changes are in red) '*a brief description of the nature of each of the entity's material remote contingent liabilities (that is, contingent liabilities in scope of IAS 37 but are not required to be disclosed in the financial statements because the likelihood of a transfer of economic benefits is considered too remote) ~~those that are disclosed under parliamentary reporting requirements and not under IAS 37~~) and, where practical, an estimate of its financial effect. ~~Further guidance on managing contingent liabilities can be found in Annex 5.4 of Managing Public Money, and in the supplementary Contingent liability approval framework~~*.'

C.9 HM Treasury propose to make this change in the 2023-24 FReM. This guidance is consistent with wording used in the FReM prior to 2015-16.

C.10 Additionally, FReM paragraph 6.7.1(g) bullet point 1 will need to be amended as follows: '*This reconciliation shall cover both contingent liabilities reported under IAS 37 and ~~non-IAS 37~~ remote contingent liabilities within the scope of IAS 37 and disclosed in the parliamentary accountability report rather than the financial statements.*'

C.11 The HM Treasury view is that a transaction cannot be within the scope of IAS 37 and IFRS 17 at the same time. IAS 37 specifically removes from its scope transactions within the scope of IFRS 17.

C.12 HM Treasury do not consider there is a significant transparency deficit caused by not having a dual reporting framework for non-IAS 37 'contingent liabilities' that meet the wider CLAF definition. As noted in FRAB paper 149(07), non-IAS 37 contingent liabilities meeting the CLAF definition, whether they are remote or not, are already separately reported to Parliament through Written Ministerial Statements. And transactions in scope of IFRS 17 will already be on the balance sheet and part of parliamentary and HM Treasury spending control totals.

C.13 HM Treasury do recognise however that the FReM guidance and requirements on the disclosure of remote contingent liabilities need to be updated. Clarity is required to reflect that the scope of remote contingent liabilities to be disclosed in the accountability report is remote contingent liabilities which are in scope of IAS 37, and not the wider CLAF definition. These changes are detailed above.

C.14 HM Treasury acknowledges that the proposal would remove any possibility of a dual reporting framework for other types of liabilities as well, such as IFRS 9 liabilities. The HM Treasury view is that the intention of the original guidance was to only include those liabilities within the scope of IAS 37 with a remote possibility of crystallising, and there are sufficient other reporting processes in place where all other CLAF contingent liabilities are reported.

C.15 As a compromise, HM Treasury propose to include a requirement for entities to include links to Written Ministerial Statements and Departmental Minutes in their ARA. This should alleviate the issue of these documents being difficult to find and scrutinise by parliament and other users of central government ARAs.

Question for FRAB

2) Do you agree with HM Treasury's conclusion not to include a dual reporting framework for insurance contracts in scope of IFRS 17 with a remote possibility of crystallising, and have a requirement to include links to existing written ministerial statements and departmental minutes on contingent liabilities notified to parliament?

3) Do you agree with HM Treasury's proposed update to FReM paragraph 6.7.1(b) and 6.7.1(g) from 2023/24 to more clearly define which liabilities are in scope of being disclosed in the parliamentary accountability report?

D - Intra-government agreements

D.1 In the March 2023 FRAB meeting, HM Treasury proposed widening the scope of IFRS 17 to include transactions which meet the definition of an insurance contract in all other ways aside from being legally enforceable. This proposal had not yet been fully consulted on with the IFRS 17 TWG or government more widely (and so FRAB were only asked whether they agreed with the proposal in principle, subject to further informal consultation).

D.2 At a high level, the Board was concerned that the case for expanding the scope to cover intra-government agreements for IFRS 17 was not as strong as with IFRS 16. The Board was concerned about the additional complexity and judgement that this proposal could create, and raised questions about the benefits of the proposal in terms of how many contracts would actually be covered by it. There were also a number of detailed questions about the interpretation of the proposal, including concepts like Crown indivisibility and enforceability.

D.3 The informal consultation on the proposal to widen the scope of IFRS 17 has now concluded. There was very little support to widen the scope of IFRS 17 to include agreements which are not legally enforceable. The reasons for this were:

a. The scope of IFRS 17 and IFRS 4 (the standard IFRS 17 is replacing) is almost identical. IFRS 4 had no adaptations to widen the scope to include contracts which are not legally enforceable. There have been no changes since IFRS 4 was adopted in the FReM which would suggest the scope needs to be adapted purely due to IFRS 17 being adopted. As such there is a lack of a conceptual reason to widen the scope of IFRS 17 compared to IFRS 4.

b. Based on the consultations with government entities, including scoping commissions, there is no evidence of material intra-government agreements which would fall within the scope of IFRS 17. Generally, government entities do not provide insurance services to other government entities in another departmental group. This significantly differs from IFRS 16 where feedback received identified some very significant intra-government contracts for leasing arrangements which may not be legally enforceable.

c. A possible scenario raised by a respondent is a government department providing insurance cover to subsidiaries (i.e. intra-group insurance arrangements). However, the view of HM Treasury is that such arrangements are very uncommon and highly unlikely to be material to a department's single entity accounts. For example, the Department for Education provides insurance coverage to its Academy Trusts (which are judged to be within the scope of IFRS 4). This arrangement is immaterial to the DfE. Therefore, an entity would need an intra-group insurance arrangement even larger than this (in relative terms) to be material. Based on HM Treasury's engagement with government departments, we are not aware of other large scale intra-group insurance-type arrangements in central government.

d. There are practical issues associated with the proposed adaptation from an implementation perspective. Widening the scope of IFRS 17 to include contracts which are not legally enforceable could, in theory, very significantly widen the number of transactions which need to be analysed for audit and assurance purposes when implementing IFRS 17.

D.4 On the basis of the arguments above HM Treasury do not believe there is a strong enough reason to depart from IFRS 17 and widen the scope of IFRS 17 to include contracts which are not legally enforceable. Therefore, HM Treasury do not propose to widen the scope of IFRS 17 to include contracts which are not legally enforceable.

Question for FRAB

4) Does FRAB agree that the scope of IFRS 17 should not be widened to include contracts which are not legally enforceable?

E - Transition requirements

E.1 At previous FRAB meetings it was agreed that entities should transition to IFRS 17 using the Full Retrospective Approach (FRA). If the FRA is impracticable for a group of insurance contracts, then entities shall transition to IFRS 17 using the Fair Value Approach (FVA).

E.2 At the March 2023 FRAB meeting HM Treasury proposed a series of adaptations to the FVA to ensure unusual transition values are not recognised. The FVA requires the application of IFRS 13 to measure the contractual service margin (CSM), which is the profit on an insurance contract, and there was a risk the FVA could result in the transition value of contracts recognising a high level of profit even though public sector entities do not issue contracts which make large amounts of profit. This is possible as IFRS 13 measures the exit price in the most advantageous market, when in reality these contracts would not be issued by the market unless the insurer received a very large premium (hence why government provides the insurance coverage instead).

E.3 The adaptations proposed by HM Treasury in March 2023 were not accepted by FRAB. The main issue raised was that the practical expedient was optional rather than mandatory. The purpose of the practical expedient was to stop unusual transition values of IFRS 17 contract liabilities due to the mechanics of IFRS 13 as described above. Therefore, the view if FRAB members was that the practical expedient should be mandated to stop entities recognising such values.

E.4 HM Treasury are therefore proposing a new adaptation which is targeted towards insurance contracts where no premium is charged.

E.5 The proposed adaptation is as follows: 'For insurance contracts where a £nil premium is charged and the fair value approach is being used to transition to IFRS 17 for those contracts, entities must measure the transition value of those contracts at fulfilment cashflows.' Use of the word 'must' mandates the transition requirement, to mitigate FRAB's concerns.

E.6 The reason for targeting contracts where no premium is charged is as follows:

a. Contracts where no premium is charged are certain to be onerous and therefore subject to the risk of the FVA producing unusual transition values described above. These contracts cannot become profitable, unlike contracts where a premium is charged.

b. Based on scoping exercises and engagement with government departments (except for UK Export Finance, Flood Reinsurance Ltd and Pool Reinsurance Ltd) HM Treasury do not expect there to be large numbers of insurance contracts transitioning to IFRS 17. But if contracts were to fall within the scope at the transition date, it is most likely that there would be no fee charged for the insurance coverage. Therefore, an adaptation to cover contracts where a fee is charged would appear unnecessary.

E.7 HM Treasury would like to highlight that the FVA resulting in onerous contracts being measured as profitable contracts is a known consequence of applying the FVA under IFRS 17. Please refer to this paper, pages 18 and 19. HM Treasury look to minimise adaptations and interpretations to IFRSs unless necessary. It is therefore the view of HM Treasury that insurance contracts being measured using the FVA and being profitable is not necessarily an incorrect outcome- it is a known outcome of IFRS 17 transition. [This was why HM Treasury originally wanted the FVA transition adaptations to be optional and include the 'excessive premium' test].

E.8 On balance. HM Treasury recommend that, if onerous contracts **where a premium is charged** are measured as profitable using the FVA, that is an acceptable under IFRS 17 and in line with what would happen with in the private sector. The reason HM Treasury have scoped out contracts where **no premium is charged** is that these much more prevalent in government compared to the private sector practice (we are not aware of providing insurance coverage for free is a practice for private sector entities) and would clearly be onerous at transition (insurance contracts where no premium is charged cannot become profitable).

Question for FRAB

5) Do you agree with the proposed adaptation to the FVA to transition requirements, whereby contracts where no premium is charged and for which the FVA approach is being used are measured at fulfilment cashflows at the transition date?

Question for FRAB

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

HM Treasury

29 June 2023