HM Treasury

Financial Reporting Advisory Board

IFRS 17 and remote contingent liabilities

Issue:	This paper seeks views from Board members on whether one-off remote contingent liabilities should be within the scope of IFRS 17. We understand there are concerns with measuring one-off remote contingent liabilities (such as indemnities for extreme events) under the IFRS 17 measurement model.
Impact on guidance:	None at this stage.
IAS/IFRS adaptation or interpretation for the public sector context?	None at this stage.
Impact on WGA?	None at this stage.
IPSAS compliant?	None at this stage.
Alignment with National Accounts	N/A.
Impact on budgetary regime and Estimates?	None at this stage.
Recommendation:	No recommendation- the paper is seeking views from Board members.
Timing:	N/A

DETAIL

Background

1. In June 2023 the IFRS 17 application guidance was released: IFRS_17_Application_Guidance-_December_2024.pdf.

2. The application guidance was approved by the Board at the June 2023 FRAB meeting and was the culmination of a project which was first presented to the Board in November 2018. As set out in the IFRS 17 update to the Board in March 2020, the goal when implementing the Standard was '*to achieve the benefits while minimising the cost*', which would be done by '*a mixture of central accounting policy choices (i.e. interpretations and adaptations), and by providing high quality guidance and support through the implementation process.*' (refer to paragraph 14 of the March 2020 paper).

3. Key principles set out in the March 2020 paper were consistency and control. As stated in paragraph 12 of the March 2020 paper '*Implementing IFRS 17 will allow government bodies to find and value all the places where they are contractually exposed to insurance risk. This is an essential step towards putting together a central portfolio of all the insurance contracts issued by UK central government. Quantifying the insurance risk associated with each contract will support better management of those risks, ensuring that the government is using resources wisely.*'
4. A key issue with applying IFRS 17 in central government is the scope of the Standard. As stated in paragraph 30 of the March 2020 paper, many remote contingent liabilities may meet the definition of an insurance contract, but in many cases may not be material.
5. Full due process was undertaken when developing the IFRS 17 application guidance. The guidance was fully consulted on.
6. Though we were aware there were likely some remote contingent liabilities (both quantifiable and unquantifiable) which could fall into the scope of IFRS 17, consultation responses did not raise measurement of these types of liabilities as a significant issue which needed to be addressed in the application guidance. It was expected that these remote contingent liabilities to have an immaterial value under the IFRS 17 measurement model due to their very low probability of crystallising.
7. Recent informal engagement has found that there are more transactions in scope of IFRS 17 than expected when the application guidance was being developed and these are potentially quite onerous to value under the IFRS 17 measurement model.
8. We understand there are now significant concerns, shared by many departments and the Government Actuary's Department (GAD), with applying IFRS 17 to one-off remote contingent liabilities. Their view is that accounting for these liabilities under IFRS 17:
    - may be misleading;
    - has significant budgetary implications which could undermine good financial management as, due to the significant estimation uncertainty of one-off remote contingent liabilities with a lack of data, they can be very challenging to estimate to bid for taut and realistic budgetary cover;
    - is very costly to comply with and may be poor VfM.
9. **This paper seeks views from FRAB members on whether IFRS 17 should be applied to one-off remote contingent liabilities, which are not 'normal insurance arrangements'.**

IFRS 17, IFRS 4 and IAS 37 interaction

10. Remote contingent liabilities are technically within the scope of IAS 37 but not disclosed (IAS 37 para 86).
11. It should be noted that liabilities within the scope of IFRS 17 (and previously IFRS 4) are outside the scope of IAS 37. The scope of IFRS 17 and IFRS 4 are substantially the same, the difference between the two standards is IFRS 4 had no prescribed accounting model and IFRS 17 does. IFRS 4 allowed entities to develop their own accounting model for contracts within its scope, but subject to the following rules:
    a. Entities could not recognise liabilities for contracts not in force.
    b. A liability adequacy test had to be carried out.
    c. The insurance liability is removed from the SoFP when the liability is extinguished.
    d. Entities could not offset reinsurance assets with insurance contract liabilities.

e. Entities could not offset reinsurance I&E with insurance I&E.

f. Entities had to consider whether reinsurance assets could be impaired.

12. IFRS 17 has a prescribed accounting model to ensure entities account for insurance contracts consistently.

13. The issue government entities have is that there are a number of liabilities which were previously disclosed as remote contingent liabilities but not valued on balance sheet (or valued at all if unquantifiable), which now must be measured through the IFRS 17 measurement model. This is a particular problem where remote contingent liabilities are unquantifiable, quantifiable but extremely unlikely to crystalise, or where entities do not have data on these liabilities (such as previous claims data) and where quantification is highly volatile.

What is an unquantifiable remote contingent liability?

14. Although IAS 37 does not require the reporting of remote contingent liabilities, for transparency purposes they are disclosed in an entity's ARA. This disclosure ensures parliament are informed of the exchequer's potential material exposures (even if the exposure is very unlikely to crystallise).
15. Entities can often have several remote contingent liabilities which are unquantifiable. The reasons for them being unquantifiable includes:

    a. Involving multiple improbable scenarios (often including complex and changing technology).

    b. Considerable uncertainty associated with the complex and improbable scenarios.

    c. Objective evidence to support valuations is not available (as the scenarios are unique).

What is the IFRS 17 measurement model?

16. The IFRS 17 general measurement model (GMM) requires the insurance contract liability to be measured using:

    a. The expected cashflows within the boundary of the contract, discounted to present value.
    b. An adjustment for non-financial risk.

    c. A profit element, which is the difference between the premiums charged and a. and b. above.

17. To measure the expected cashflows of an insurance contract, entities estimate the expected value (the probability-weighted mean) of a full range of possible outcomes[1]. This is done using all reasonable and supportable information available without undue cost and effort[2]. IFRS 17 also states that the scenarios developed include catastrophic losses under existing contracts[3]. Paragraph B41 of IFRS 17 provides a non-exhaustive list of information entities are to consider when measuring the expected cashflows of the contract:

    a. Information about claims previously reported.

    b. Other information and known characteristics about the contract.

    c. Historical data from own sources and external sources.

    d. Current price information.

[1] IFRS 17 paragraph 33(a).
[2] IFRS 17 paragraph B37.
[3] IFRS 17 paragraph B40.

18. It should be noted that, for many one-off remote contingent liabilities which meet the definition of an insurance contract, the information in a), c) and d) does not exist as the risks insured are unique to government entities.
19. It could be argued that government entities are exposed to more risks with a theoretical unlimited liability. Companies do not take on these types of risks as often, and are therefore not frequently exposed to these types of measurement issues.
20. The adjustment for non-financial risk increases the insurance contract liability and represents the compensation the entities require for the uncertainty around the timing and amount of cashflows. As noted in IFRS 17 paragraph B91(a), risks with a low frequency and high severity have a larger risk adjustment; government remote contingent liabilities will often be very low frequency and high severity if they crystallised.

Examples of remote contingent liabilities which may look like insurance

21. Below are some examples that may be insurance contracts and highlight the difficulty with applying the IFRS 17 measurement model to certain liabilities. Please note that by including these examples, HM Treasury are not opining on whether they are insurance contracts.
22. The MoD has issued indemnities to several companies relating to the handling of nuclear fissile materials and other nuclear risks. This remote contingent liability is unquantifiable.
23. The MoD also issued an indemnity in relation to the disposal of Gruinard Island in the event of claims arising from the outbreak of specific strains of anthrax on the Island. This remote contingent liability is unquantifiable.
24. DfT has a commitment to fund any shortfall of toll revenue from the Mersey Gateway Bridge to meet Halton Council's financial obligations. This is quantifiable with a highest reasonable estimate of £1.1bn.
25. DfT have issued several indemnities related to the construction of HS2. This is quantifiable with a highest reasonable estimate of £191m. There are also unquantifiable remote contingent liabilities associated with HS2.
26. Several departments have issued pension guarantees, where a judgement needs to be made on whether they are in scope of IFRS 17.

What are the measurement issues faced with one-off insurance type arrangements?

27. The key reason why measurement of one-off insurance type arrangements is challenging, is due to **a lack of data**. Some of the risks being covered are so remote that no claims have ever occurred. It is unlikely that there will be any useful external data available because the types of risks being measured have not previously resulted in any claims.
28. Where there is no data either internal or external that can be used to place a value on these risks this leaves expert judgement as the only option for valuing the risks. Due to the nature of the risks being measured, we understand experts do not feel they are able to place figures on the probability of such remote events happening with a sufficient degree of confidence. Any numbers produced through this method would be challenging to justify to auditors and would essentially be an educated guess with a considerable level of estimation uncertainty.
29. To provide an example, a department accepts a 3rd party claim against their contractor where the total costs are in excess of the contractor's own insurance limit. Typically, this may be costs in excess of £20m or more. In order to place a value on this risk it would be necessary to assess the

likelihood of an event occurring that exceeds £20m, and also the likelihood of claims at a series of increments over £20m in order to derive a distribution. No such events have occurred in the past and the safety measures in place make this exceedingly remote. Thus, there is no data to use to help make an expert judgement.

30. The Government Actuaries Department (GAD) and other government departments are of the view including these numbers within published accounts would be more misleading than not including them at all. There would also likely be a large amount of time spent trying to justify numbers to auditors.

31. Bringing these liabilities into the accounting regime will also bring them into the budgeting and estimates regime. It may be difficult to justify 'taut and realistic' estimates, as government is required to do, when significant liabilities are subject to this level of estimation uncertainty.

32. There are concerns this could undermine good financial management. This is because departments who have one-off remote contingent liabilities which are highly uncertain or volatile and very difficult to measure due to a lack of data might not be able to accurately bid for budgetary cover. This can lead to significant risks of overbidding for budgetary cover and therefore significant underspends. It could also lead to entities not bidding for enough budgetary cover, have a big swing on valuation at year end (due to the unusually high volatility of these types of liabilities) and end up breaching their parliamentary control totals (resulting in an excess vote and audit qualification).

Was IFRS 17 written for government insurance-type arrangements?

33. IFRS 17 applies to both insurers and non-insurers. It is the substance of the arrangement that determines whether a contract is within scope of IFRS 17 rather than whether the contract is described as insurance or whether the entity operates in the regulated insurance sector. That being said, whether IFRS 17 can be applied equally to the remote contingent liabilities listed above can be debated. For example, should IFRS 17 be equally applicable to an indemnity for a nuclear missile accidently exploding and car insurance?

34. Despite it being the case that IFRS 17 applies equally to non-insurers, many government departments and the Government Actuary's Department (GAD) are of the view that IFRS 17 was intended for insurers rather than government and that applying IFRS 17 to one-off remote contingent liabilities which are not normal insurance schemes is potentially misleading with a significant associated cost.

35. This is because these risks are very unlikely to occur, but due to their exposure, would result in a very large day 1 expense to the SoCNE, which is subsequently unwound. An example given is a maximum exposure of £15bn but with a risk of 1 in 1000 years of occurring. Many departments and GAD consider that recognising a large cost for it to be unwound thereafter may be misleading to users of the accounts. As explained above, there are also budgeting implications as the day 1 expense would hit the resource AME budget, for it to be reversed in subsequent years as negative resource AME.

36. The large day 1 expense occurs as one-off remote contingent liabilities are usually provided for no consideration. These arrangements are 'onerous contracts' and the costs are recognised immediately in income and expenditure under IFRS 17. Issuing insurance contracts covering highly volatile one-off remote contingent liabilities for no consideration is more common in central government.

37. Some are of the view that IFRS 17 was not designed for one-off risks which have no data. It was designed for insurance companies with data available to assess the distribution of possible outcomes. Some are of the view that estimates of insurance contract liabilities relying wholly on

management judgement are highly uncertain and provide little value to users of the accounts. It could also be significantly difficult to provide the required audit evidence to auditors if there is little or no data on which the estimate can be based.

38. The costs to measure one-off remote contingent liabilities (both quantifiable and unquantifiable) are considered high (both due to time costs and from employing experts). This is because many one-off remote contingent liabilities cover unique and highly complex scenarios, with no previous claims data and are very unlikely to occur.
39. There is an argument that a distinction should be made between 'normal insurance schemes' (such as those run by UK Export Finance, FloodRe, and PoolRe) and one-off insurance-type agreements with a very low probability of crystallising which are unique to government. This is because IFRS 17 was written for those types of schemes rather than one-off indemnities covering unique scenarios such as those described earlier in this paper.
40. Clearly, this view is counter to the key benefit stated in paragraph 3 of this paper that IFRS 17 will allow entities to better capture risks taken on by government and potentially enable government to better manage them.

Questions

41. HM Treasury seeks views from Board members on the following questions:

    a. Do you agree with the view that accounting for one-off remote contingent liabilities (such as indemnities for nuclear incidents), which are not normal insurance schemes, under IFRS 17 is potentially misleading to users of the accounts, due to a large cost being recognised in year 1, only for it to be unwound as negative expenditure in subsequent years as the risks have not crystallised?

    b. Should IFRS 17 be applied to one-off quantifiable remote contingent liabilities which are not 'normal insurance activity'?

    c. Should IFRS 17 be applied to one-off unquantifiable remote contingent liabilities which are not 'normal insurance activity'?

    d. If the reporting of one-off remote contingent liabilities was taken out of the scope of IFRS 17 in the FReM, would only applying IFRS 17 to certain entities and schemes be acceptable? [for example, IFRS 17 is only applied to FloodRe, PoolRe, UK Export Finance and departmental insurance schemes].

HM Treasury
20 March 2025