

Is it time to start discussing the future of UK GAAP for life insurers?

September 2024



pwc



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1. Introduction

What a journey it has been from 1997 to 2024 and the first full reporting under IFRS 17!

The implementation of IFRS 17 has been a significant multi-year effort for insurance companies, requiring changes to accounting policies, data, models and accounting systems and infrastructure. This has required insurers to allocate significant resources, both in terms of time and financial investment, to ensure compliance with the new standard. With the majority of implementation work now behind us in the UK and the first wave of annual financial statements under the new standard published earlier this year, there will now be an opportunity to assess the level of transparency, comparability, and consistency of financial reporting achieved for insurance contracts.

However, by number, most UK life insurance companies still apply UK Generally Accepted Accounting Practice ('GAAP') rather than International Financial Reporting Standards ('IFRS'), be that in their annual report or for the statutory accounts of insurance entities within a group. FRS 103 Insurance contracts was issued by the Financial Reporting Council ('FRC') in the UK in March 2014 and was introduced as part of the FRC's efforts to align UK and Irish accounting standards with IFRS. With IFRS for insurance contracts having moved on from IFRS 4 to IFRS 17, what is next for life insurers reporting under UK GAAP and what can we learn from the implementation of IFRS 17 to ensure the direction taken is both appropriate and proportionate? Further, with the implementation of the Solvency UK reforms this year, UK GAAP is the final piece of the financial and regulatory reporting landscape to be assessed for UK life insurers.

In this publication we will consider the history and context of UK GAAP, discuss if and why the FRC may consider change to be required and suggest what the various possible approaches could be to account for insurance contracts. Our focus will be on the measurement of the insurance contract liabilities and reinsurance assets whilst recognising the need to maintain coherence with other items in the primary financial statements. Furthermore, whilst a single UK GAAP measurement approach for life and general insurance business may be necessary we focus in this publication only on life insurance.

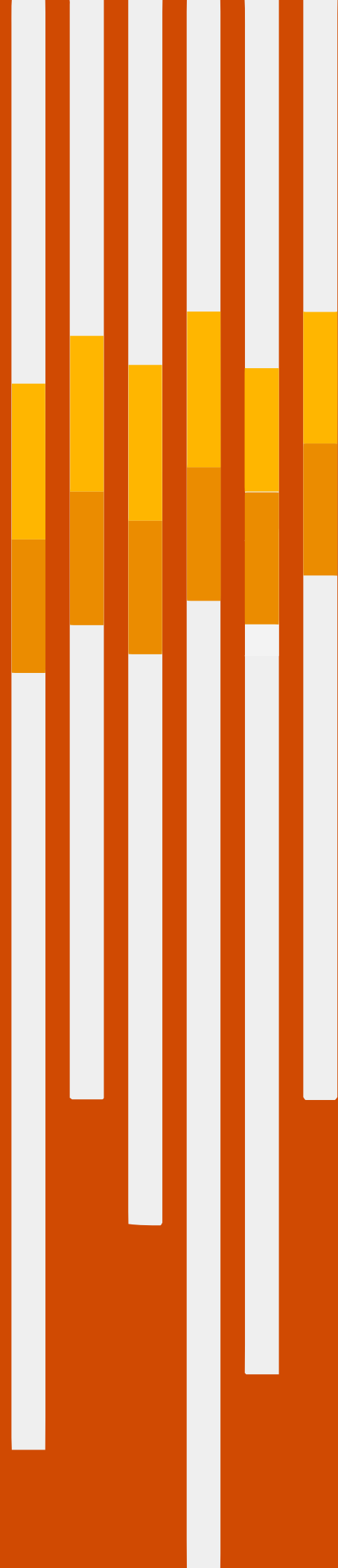




Any change to UK GAAP will require careful consideration as life insurers from the largest to the very smallest in the UK use this as a basis for accounting. Key topics to consider will include the cost versus benefit not only for shareholders, but also for policyholders, due to the prevalence of with-profits funds and mutuals applying UK GAAP, and the tax implications, including how HMRC may view any accounting changes.

The IASB's IFRS 17 standard may seem an easy option, especially as UK GAAP is increasingly aligning with IFRS, however, the experience of those who have implemented this standard, especially for with-profits contracts, may suggest this is not the right or proportionate answer."

Anthony Coughlan, Partner

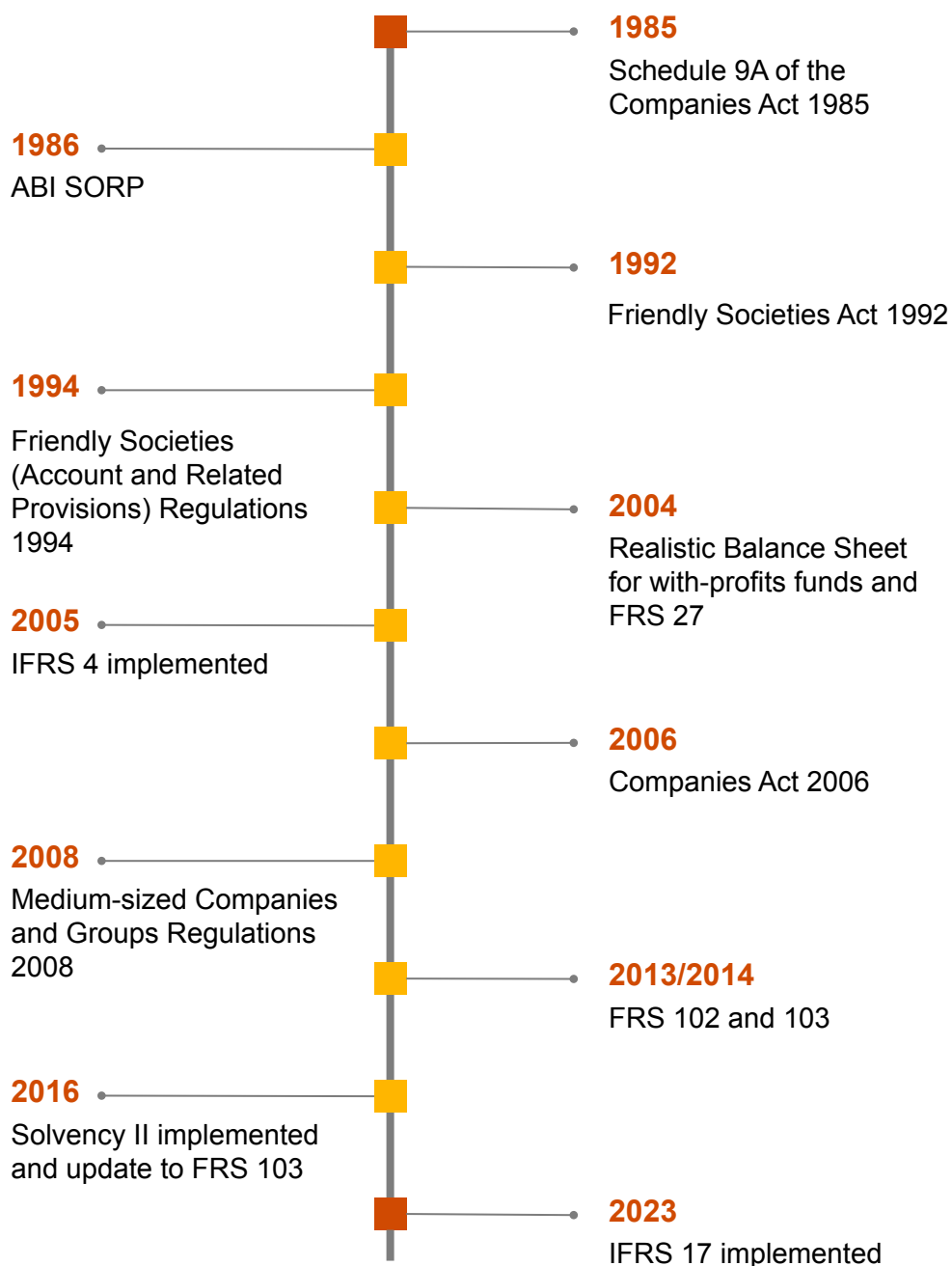


2. A reminder of the background and timeline to UK GAAP

The origin of UK GAAP for insurance contracts goes back nearly 40 years and the approach has seen several developments and changes over this time. In this section, we explore the historical developments, which insurers account under UK GAAP today and what the timeline is for future developments.

The development of UK GAAP

The financial reporting and accounting for insurers was originally set in the UK by the Companies Act 1985 and, although there have been changes, many of the basic components of accounting for life insurers are unchanged from 1985. The follow graphic and commentary set out the codification of UK GAAP.



2. A reminder of the background and timeline to UK GAAP (continued)

UK GAAP codification

- **Schedule 9A of the Companies Act 1985:** The financial reporting and accounting for insurers was originally set in the UK by the Companies Act 1985. Schedule 9A was repealed in 2006 with the adoption of Part 15 of the Companies Act 2006 and the provisions of 'The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008' (SI 2008/410)¹ applicable to insurance groups (collectively termed the 'Act' in this publication). However, the basic components of accounting for life insurers are unchanged from 1985. The core features set out in the Act include:
 - The presentation of the balance sheet line items, where there is a requirement for insurance contract liabilities to be split between Long Term Business Provision ('LTBP') and Technical Provisions for Linked Liabilities ('TPLL'). TPLL contains index-linked annuities and unit-linked contracts, and the related 'Assets held to cover Linked Liabilities' are presented as a single line item on the balance sheet.
 - The presentation of the income statement, where the required technical and non-technical accounts are set out. As an example, in the technical account for life insurers, there is a requirement for explicit presentation of an earned premium determined as the gross premium written less the outward reinsurance premium in the period.
 - The LTBP is measured on the 'basis of recognised actuarial methods, with due regard to the actuarial principles laid down in Council Directive 92/96/EEC' [Effectively Solvency I]. In addition, there is the Fund for Future Appropriation ('FFA') liability (relating to with-profits funds) which '... shall comprise all funds the allocation of which either to policyholders or to shareholders has not been determined by the end of the financial year.'
 - Acquisition costs are deferred through an explicit asset (with conditions) and are defined as being ... 'costs of acquiring insurance policies which are incurred during a financial year but which relate to a subsequent financial year.'
- For Friendly Societies, accounts are prepared relative to the Friendly Societies Act 1992 and Friendly Societies (Account and Related Provisions) Regulations 1994 (as amended), rather than the Act and these entities regularly use UK GAAP².
- **ABI SORP:** The Statement of Recommended Practice ('SORP')³ on insurance was first issued by the Association of British Insurers ('ABI') in 1986 with various updates over the years, notably in 1990, 1999, 2005 and December 2006. The SORP was withdrawn from 1 January 2015 consistent with the effective date of FRS 103 (see next page).

¹ <https://www.legislation.gov.uk/ukSI/2008/410/contents/made>

² In relation to the Friendly Societies Act 1992 and Friendly Societies (Account and Related Provisions) Regulations 1994 (as amended), FRS 103 paragraph A3.3 notes that these '... make further requirements about the form and content of friendly society accounts, which do not generally appear inconsistent with the requirements of FRS 102 and FRS 103. However, for a non-directive society (as defined in the regulations) the regulations set out a different required format. We do not consider these requirements further in this publication.'

³ <https://www.abi.org.uk/globalassets/sitecore/files/documents/publication/public/migrated/prudential/sorp2006.pdf>

2. A reminder of the background and timeline to UK GAAP (continued)

- **ABI SORP (continued):** The SORP reflected an interplay between general accounting practice, the requirements of the Act and the prevailing (Solvency I) regulatory requirements, which was largely the measurement basis for insurance contract liabilities. The SORP notably provided guidance on certain accounting treatments, for example deferred acquisition costs for contracts within non-profit funds.
- **FRS 27:** In 2004, the UK Accounting Standards Board ('ASB') issued Financial Reporting Standard (FRS) 27 (Life Assurance⁴). FRS 27 provided specific accounting requirements for life insurance companies, including measurement of with-profits liabilities on a realistic basis and disclosures particularly related to capital. This reflected the accounting implications of the introduction of the (Solvency I) realistic balance sheet regime for with-profits funds in the UK. FRS 27 was withdrawn from 1 January 2015 consistent with the effective date of FRS 103 (see below).
- **FRS 102 and 103⁵:** The FRC⁶ issued these two Financial Reporting Standards in 2013 and 2014 respectively. Although FRS 102 includes a definition of an 'insurance contract' (including reinsurance contracts and financial instruments with a discretionary participation feature), it does not set out the accounting required for such a contract. This is contained in FRS 103 which consolidated existing guidance included within the International Accounting Standard Board's (IASB's) IFRS 4 (Insurance Contracts), the requirements in FRS 27 and certain elements of the ABI SORP. It allows insurers to continue with their current practices for insurance contracts whilst providing some flexibility, consistent with IFRS 4, to 'improve' the accounting basis (subject to constraints).

In 2016, limited updates were made by the FRC to FRS 103 to allow for the new insurance regulatory regime, Solvency II. As we will see later in the publication, after 2016 some insurers have used the provision in FRS 103 to change their accounting policies to more closely align with Solvency II.



For contracts issued by insurers that are not insurance contracts, primarily unit-linked investment contracts in the UK, there is a clear approach to accounting for them in FRS 102 (aligned to IFRS). This typically results in a financial liability based on the unit fund (due to the deposit floor) and the deferral of origination costs and fees (through an explicit asset and liability, respectively, on the balance sheet). We do not consider these contracts further in this publication.

It is also worth remembering that the FRC is the accounting standard setter for both the UK and the Republic of Ireland, so any changes to UK GAAP would need to consider the implications for insurers in Ireland.

⁴https://media.frc.org.uk/documents/FRS_27_Life_Assurance.pdf

⁵<https://www.frc.org.uk/library/standards-codes-policy/accounting-and-reporting/uk-accounting-standards/frs-102/> and <https://www.frc.org.uk/library/standards-codes-policy/accounting-and-reporting/uk-accounting-standards/frs-103/>

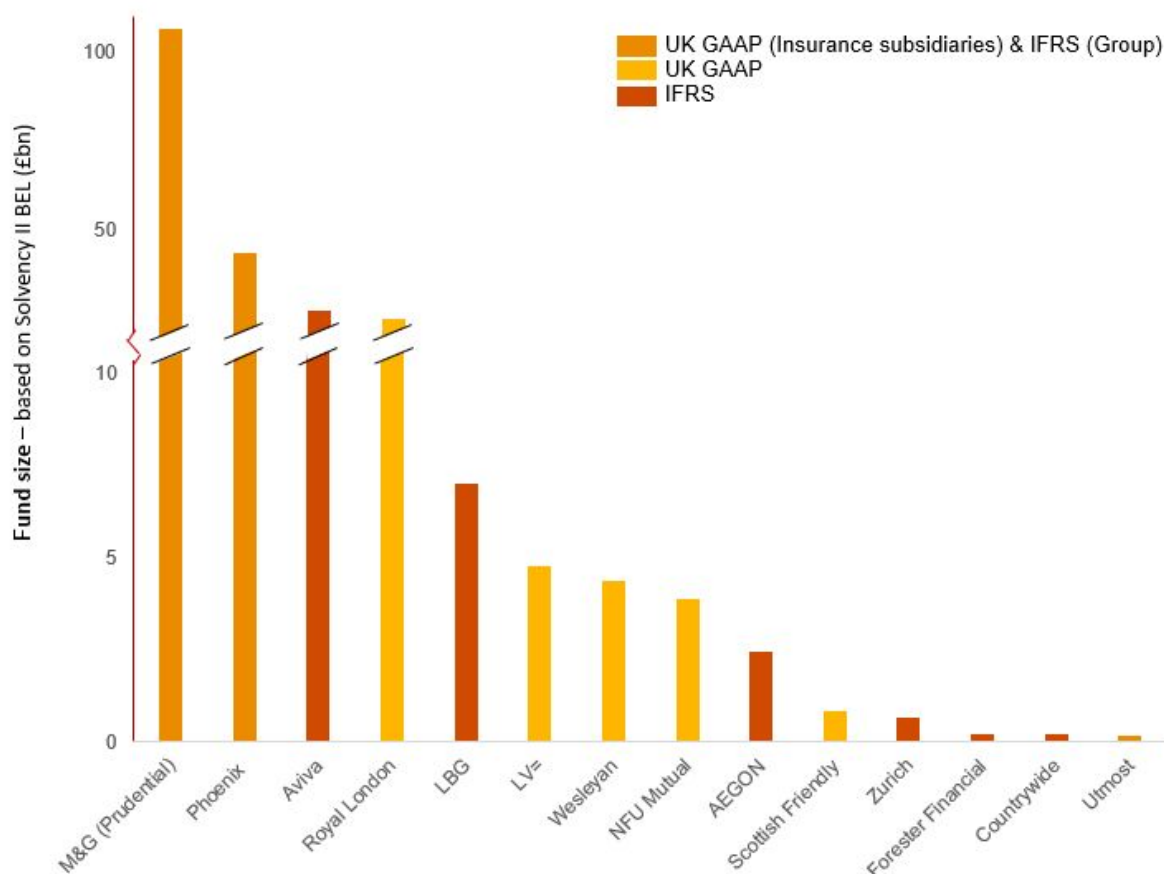
⁶The FRC is a prescribed body for issuing accounting standards in the UK and Republic of Ireland as set out in: (a) the Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012 (SI 2012/1741) for the UK; and (b) the Companies Act 2014 (Accounting Standards) (Prescribed Body) Regulations 2018 (SI No. 84 of 2018) for the Republic of Ireland.

2. A reminder of the background and timeline to UK GAAP (continued)

Which life insurers use UK GAAP today?

At FY23, the primary users of UK GAAP are operations containing with-profits funds. These are mutual insurers (e.g. Royal London), proprietary insurers with with-profits funds where the group is required to report under IFRS but statutory (subsidiary) accounts are under UK GAAP (e.g. The Prudential Assurance Company Limited, part of M&G plc), friendly societies or funds specialising in Holloway-style income protection policies. It is hard to gauge the exact number of life insurance operations which use UK GAAP to prepare financial statements, but we estimate that there are over 40 operations⁷ in the UK. Weighted by Solvency II best estimate with-profits liabilities, over 80% of UK insurers writing with-profits contracts (based on end 2023 data for the insurers in the chart below) report on a UK GAAP basis, highlighting the need to ensure that UK GAAP continues to provide a sensible basis for with-profits fund liabilities.

Figure 1: Reporting basis of UK With-Profits Funds at FY23



Source: PwC analysis and interpretation of FY23 SFCRs and accounts

⁷For example, as at June 2024, there are over 40 full members of the Association of Financial Mutuals (<https://financialmutuals.org/our-members/full-members/>)

2. A reminder of the background and timeline to UK GAAP (continued)

Looking forward, what can be expected for UK GAAP?

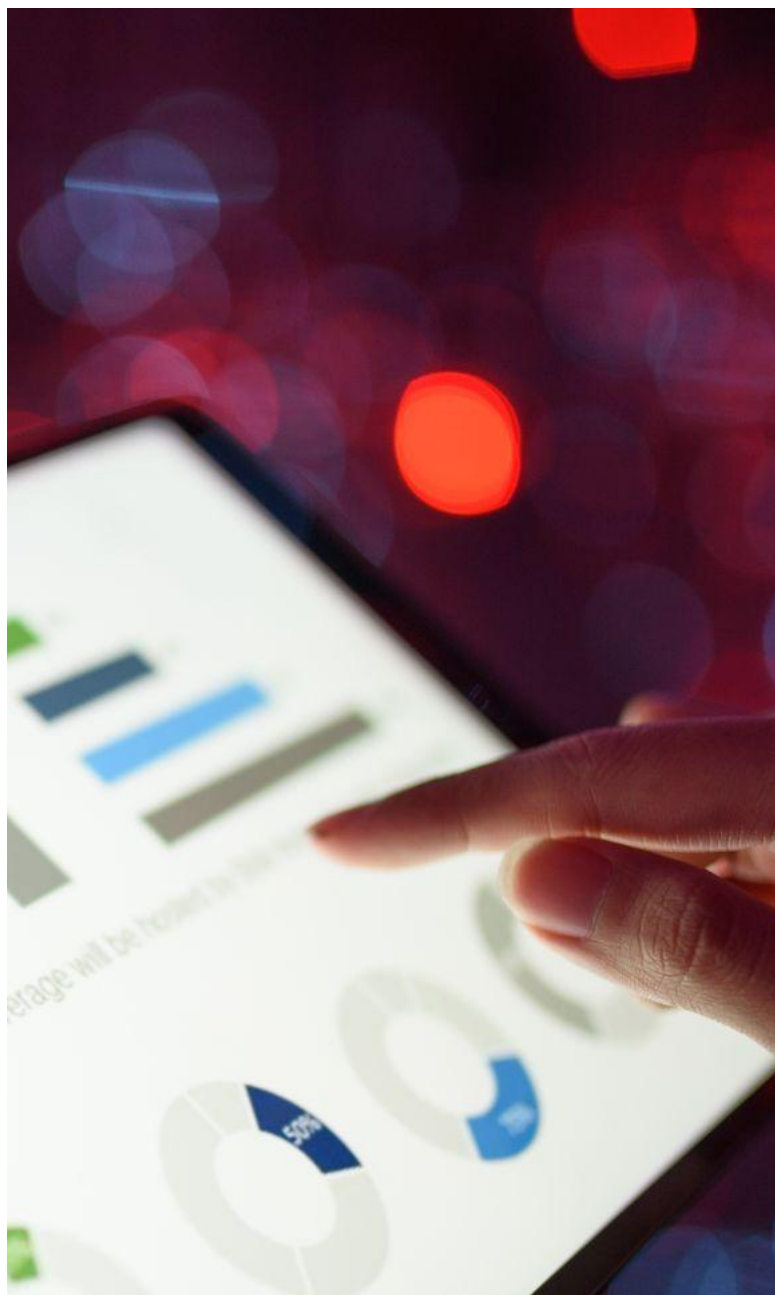
The FRC performs periodic reviews of UK GAAP, the latest being earlier in 2024 with changes effective from 1 January 2026. There were no changes to FRS 103, however the Basis for Conclusions⁸ was expanded to note:

‘... the FRC is likely to wait for several years’ implementation experience before considering alignment [with IFRS 17]. ... conflicts between IFRS 17 and company law have led the FRC to conclude previously that it is not currently possible to apply IFRS 17 in Companies Act accounts ... whilst continuing to maintain compliance with company law.’

A checkpoint on the future of UK GAAP is therefore expected following the post-implementation reviews of IFRS 17, notably:

- **Global** – The IASB has not confirmed the date of their review of IFRS 17, but experience from other standards⁹ suggests that the IASB would wait until most jurisdictions have at least two years of experience of applying IFRS 17. This would suggest that a review will not occur before 2027, or may even be later given the significant change IFRS 17 introduced.
- **UK** – The UK Endorsement Board (UKEB) has stated¹⁰ that they will carry out a review of the impact of adoption of IFRS 17 and publish their conclusion by 1 January 2028.
- **Continental Europe** – The European Commission is scheduled by 31 December 2027¹¹ to review the optional EU exemption from the IFRS 17 annual cohort requirement, taking into account the IASB post-implementation review.

With these timelines in mind it is therefore likely that any significant developments to UK GAAP are five years or more away before publication and further away from initial application.



⁸FRS 103 Basis for Conclusions paragraph 57A

⁹The IASB post implementation review process is set out here:

<https://www.ifrs.org/projects/post-implementation-reviews/>.

As examples: (1) IFRS 16 Leases was effective in 2018 and the post implementation review is commencing this year (2024); and (2) IFRS 9 Financial Instruments was effective in 2018 (excluding certain insurers) and the post implementation review was split into 3 phases - classification and measurement commenced in 2020 (because the change compared to previous standard, IAS 39 was not significant), impairment commenced in 2022 and hedge accounting has not yet started

¹⁰<https://www.endorsement-board.uk/endorsement-projects/ifrs-17>

¹¹<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32021R2036>

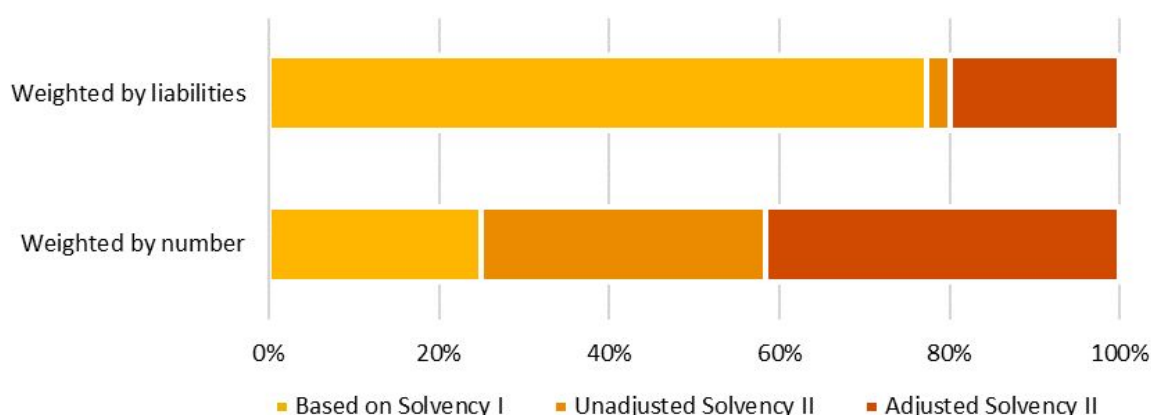
3. Is there a need for change?

To assess the need to change or evolve UK GAAP, we first consider the approaches used today to value insurance contract liabilities and the associated profit recognition, the key performance indicators used by mutual insurers (as the primary users of UK GAAP), and the basis for taxation.

What approaches are used today to value insurance contract liabilities (and related reinsurance contracts) under FRS 103?

Figure 2 summarises the approaches adopted to value insurance contract liabilities at FY23 for a sample of 12 insurers¹² reporting under UK GAAP.

Figure 2: Approaches adopted under UK GAAP (by size of liabilities and by number) at FY23



Source: PwC analysis and interpretation of FY23 accounts.

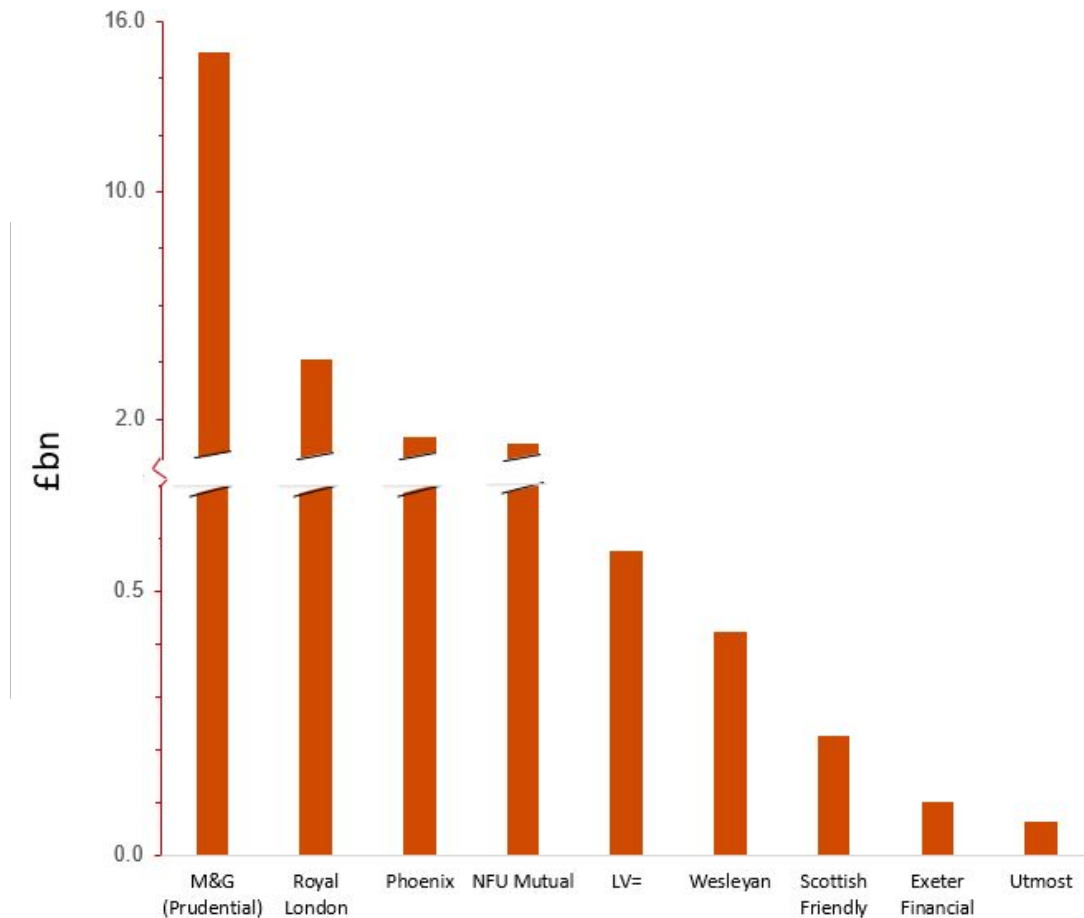
Note: Solvency I in the charts above means historical realistic balance sheet/FRS 27 approach for with-profits business and adjusted INSPRU for non-profit business.

As can be seen, the majority of companies use a valuation approach aligned to their Solvency II basis although, when weighted by insurance contract and investment contract with discretionary participation features ('DPF') liabilities, it is evident that the largest insurers reporting under UK GAAP use an approach based on Solvency I (typically aligned to their historical IFRS 4 reporting approach). Where a Solvency II approach is used, some companies use the Solvency II technical provisions without adjustment whereas others make adjustments. Importantly, in all cases where there is a with-profits fund, a Fund for Future Appropriation (FFA) liability is held in addition to the direct policyholder liabilities as required under the Act. Figure 3 shows the size of the FFA for a sample of the larger insurers at FY23.

¹² Our sample was based on: Prudential Assurance Company Limited, Phoenix (Phoenix Life Limited and ReAssure Limited), Utmost Life and Pensions Limited, Canada Life Limited, Royal London, LV, NFU Mutual, Wesleyan, Scottish Friendly, Exeter Friendly Society Limited, Shepherds Friendly Society Limited and One Family.

3. Is there a need for change? (continued)

Figure 3: Fund for Future Appropriation (FFA) liability at FY23



Source: PwC analysis and interpretation of FY23 SFCRs and accounts¹³



Across insurers reporting under UK GAAP at FY23, the total Fund for Future Appropriation was in excess of £20bn, albeit this was mostly at Prudential and Royal London ”

¹³Note, Phoenix includes Phoenix Life Limited and ReAssure Limited only.

3. Is there a need for change? (continued)

Where adjustments are made to Solvency II, these vary but the most common are to remove the Solvency II risk margin and apply margins for adverse deviation to the best estimate assumptions, to adjust the discount rate for an illiquidity premium rather than the regulatory matching adjustment (for annuities), and to remove the Solvency II transitional measures. Various other adjustments are made where material to an insurer's business such as applying a surrender value floor, adjusting with-profits liabilities for non-guaranteed final bonuses and participation in pension scheme surpluses, and removing contract boundary restrictions.

Where unadjusted Solvency II results are used, this sometimes includes use of the Solvency II risk margin despite this being a net of reinsurance number in the regulatory basis whereas the UK GAAP liabilities are presented gross of reinsurance with separate reinsurance balances.

Since 2016 there have been two clear trends on the accounting for insurance contracts under UK GAAP:

- Firstly, a move by some to adopt or align more closely with Solvency II.
- Secondly, with the implementation of IFRS 17, some insurers converted from IFRS to UK GAAP where this was possible.

For Royal London and LV, the plan to convert to UK GAAP from IFRS was set out in the accounts in the year prior to transition (FY19 and FY22 respectively) with similar reasons noted: *'... UK GAAP is a more suitable basis for a UK mutual than IFRS ... allowing transparency of our financial performance and being widely recognised and understood by readers of accounts.'*¹⁴ In addition:

- Most life insurance subsidiaries within the Phoenix Group transitioned to UK GAAP from IFRS in their FY23 accounts¹⁵. Therefore IFRS 17 was only implemented for the purposes of the Phoenix Group accounts and the recently acquired Sun Life Canada UK. As an example of the practical benefits, the need to track two distinct Contractual Service Margins¹⁶ for the same group of contracts (i.e. at Group and subsidiary level) is avoided.
- Canada Life UK, writing non-profit business only, changed their accounting policy as at FY23 (previously a modified Canadian Asset Liability Method under IFRS 4) to UK GAAP applying an adjusted Solvency II approach and explicitly noted this as being *'due to the implementation of IFRS 17.'*



In the years leading up to implementation of IFRS 17, a number of insurers reverted back to UK GAAP, where possible.”

¹⁴Extract from Royal London FY19 report and accounts

¹⁵For example, Phoenix Life Limited and ReAssure Limited accounts at FY23: <https://www.thephoenixgroup.com/media/mbmk5liz/pll-2023.pdf> and <https://www.thephoenixgroup.com/media/cahids5m/reassure-limited-2023.pdf>

¹⁶In IFRS 17, the Contractual Service Margin (CSM) reflects the value of the deferred day 1 profit at the reporting period.

3. Is there a need for change? (continued)

It is not immediately clear whether the trend to align with Solvency II in some form has increased or decreased consistency in approaches under UK GAAP. The range of adjustments applied could be due to differences in the mix of business and therefore the significance of them to different insurers. Also, a similar approach could be articulated in different ways. That said, there are a couple of broad themes:

- For with-profits contracts, the liabilities (excluding the FFA) are typically based on asset shares plus a market consistent stochastic allowance for options and guarantees (on a risk neutral basis with no illiquidity premium applied).
- For annuity contracts, the liabilities are typically based on a projection of the expected benefits and expenses with an allowance for risk (either through prudent margins or by using the Solvency II risk margin) and discounted based on the yield arising from the supporting asset portfolio, making a deduction for credit default risk in the portfolio.

How is profit recognised under UK GAAP?

The FFA liability is fundamental in determining the profit before tax for mutual insurers (in general) and for proprietary-owned insurers which write with-profits contracts. In summary, there is a transfer to/from the FFA each period (explicitly presented in the income statement) which results in nil profit for a mutual insurer. For proprietary-owned with-profits funds, the profit is determined to be the shareholder share of bonuses in the period (or charges less expenses, where such relationships exist) with the FFA set to achieve this outcome, and so there is in effect a 'cash-based' approach to profit recognition.

For proprietary-owned non-profit funds, profit arises from the change in the fair value of the assets ('fair value through profit or loss' being how the vast majority of assets are accounted for under UK GAAP) and the change in the insurance contract liabilities over the period. Consequently, for annuities, there is usually a day 1 profit from writing new business and all changes in longevity assumptions flow to profit or loss in the period in which the change occurs. There are similar observations for protection and unit-linked insurance contracts, albeit it is common for acquisition costs relating to these contracts to be deferred through an explicit asset on the balance sheet and recovered through future profits.

3. Is there a need for change? (continued)

How is profit recognised under UK GAAP? (continued)

Under IFRS 17 an entity recognises revenue in each period to depict the transfer of promised (insurance contract) services to the policyholder. This is consistent with the general principles in IFRS (e.g. IFRS 15 Revenue paragraph 2: ‘... an entity shall recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.’ Under FRS 103 (UK GAAP today) there is no such requirement and so it is unlikely that the recognition of profit directly reflects the services provided in each period. The wider UK GAAP framework is moving to a revenue model that is more aligned with IFRS 15 Revenue in the coming years.

What financial metrics do mutuals use?

The financial metrics used by mutual insurers fall into 3 broad categories, being those relating to one of UK GAAP financial statements, solvency or volume/other metrics. The most common UK GAAP metric is the transfer to (or from) the FFA in the period, which effectively reflects the accounting profit (or loss) to with-profits policyholders in the period. The larger mutuals also, typically, present an adjusted operating profit metric. Solvency-related metrics primarily reflect the coverage ratio (i.e. capital coverage or financial strength) while other metrics reflect volume (e.g. assets under management, premium measures) and returns to with-profits policyholders in the period.

The selection of financial metrics used by mutual insurers demonstrates that the UK GAAP accounts, and so the liability measurement basis, are used to assess performance to some level.



Most mutual insurers in the UK consider the change in FFA to be a key metric.”



3. Is there a need for change? (continued)

What are the tax implications?

For proprietary life insurers, the statutory accounts of the insurance company (rather than the group accounts) are the basis of the UK tax computations, and so then drive the insurer's current tax charge each year. For non-BLAGAB¹⁷ business (broadly, all life insurance business except life investment policies and 'old' protection policies), proprietary life insurers are subject to tax on their trading profits each year, which are broadly driven by the statutory accounting result. BLAGAB business is subject to tax on an 'I-E' basis (essentially investment income and gains less expenses), which is generally less impacted by the statutory accounting result and depends more on the specific tax profile of each organisation.

As a consequence, the statutory accounts are critical in determining the profits subject to tax each year for proprietary life insurers. Any future change to UK GAAP would therefore be expected to impact the tax profiles of these insurers.

For the adoption of IFRS 17, HMRC introduced a specific transitional rule to allow a 10 year spreading of the differences arising. Whilst we can expect engagement with HMRC if there were significant UK GAAP changes, under current tax law, any changes to insurance liabilities as a result of a change in UK GAAP would come into tax in full in the year of transition.

Mutual life insurers are generally only taxed on their I-E result for their BLAGAB business. As such, any future change to UK GAAP is likely to have less impact on their tax profiles, but care will still be required to ensure any secondary implications of these changes on I-E are fully understood and assessed.



Tax implications will be important for proprietary insurers especially if any changes to UK GAAP result in the first time recognition of shareholder equity for with-profits funds.”

So, is there a need for change?

Our analysis shows that there are a variety of approaches used by insurers to value insurance contract liabilities under UK GAAP, albeit cutting through the terminology there may be more comparability in terms of both approach and resulting profit recognition than you may initially think. Given the age of UK GAAP for life insurers, the implementation of IFRS 17 and the lack of a profit recognition pattern reflecting the services provided in each period, there is a clear need in the coming years to reassess the options to account for insurance contracts. Some would suggest that the misalignment between profit recognition and services provided under the insurance contract may be reason enough to reassess UK GAAP, indeed without addressing the pattern of profit recognition, there may be limited benefit of making changes at all.

¹⁷Basic Life Assurance and General Annuity Business (BLAGAB) is defined as being life assurance business not fitting within any other category of business, per s57 Finance Act 2012.

4. What are the potential options?

In the following sections, we identify and briefly consider 5 potential options to account for insurance contract liabilities in the future:

01 Retain FRS 103 without change

02 Adopt an adjusted Solvency II basis and retain the FFA

03 Adopt IFRS 17 in full

04 Adopt IFRS 17 'light'

05 Adopt another globally recognised insurance standard.

01

Retain FRS 103 without change

This would clearly be the easiest approach with no financial or operational implications for insurers. However, how sustainable is a patchwork legacy approach dating back nearly 40 years? Further, insurance is the only notable sector in the UK without a comprehensive measurement framework within UK GAAP and there is a general (but not complete) trend for UK GAAP to mirror and align to IFRS developments, where appropriate.

02

Adopt an adjusted Solvency II basis and retain the FFA

Adopting Solvency II (or Solvency UK, as recently reformed in the UK) would largely codify what many insurers are doing today, subject to which adjustments are permitted or required. It would bring alignment with regulatory reporting, as historically UK GAAP has tried to achieve, and so has potential operational and communication benefits. Further, it may more closely align accounting to the basis for dividends (for proprietaries) and the generation of cash.

However, the approach would maintain the status quo and provides no explicit basis for the recognition of profit linked to the services provided by the insurer. In addition, certain aspects would need to be developed, for example, the risk margin is a net of reinsurance concept and typically insurance and reinsurance contracts are accounted for separately.

It is also debatable whether the Solvency II Transitional Measure on Technical Provisions (TMTP) can be retained in an accounting standard, albeit the TMTP is now of less significance due to the 16 year run-off period (from 2016) and the revised calibration of the risk margin with the recent reforms to Solvency II in the UK.

Another consideration is how the approach is codified into UK GAAP, for example, through cross-referencing to the PRA regulatory requirements or by including explicit extracts into a revised FRS 103. The introduction of a direct linkage between the financial reporting and regulatory requirements may not be desirable, for example, regulatory requirements may be subject to change in the future to satisfy objectives that are not fully aligned with those used for financial reporting.

4. What are the potential options? (continued)

03

Adopt IFRS 17 in full

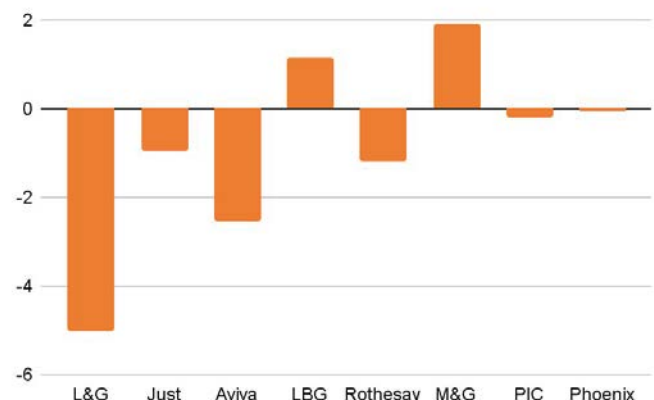
IFRS 17 provides a comprehensive accounting approach for insurance contracts including a defined profit recognition linked to the services provided to the policyholder (through the contractual service margin, CSM) and a clear method to determine the opening balance sheet on adoption. However, to adopt IFRS 17 would require legislative changes to the Act, for example, in relation to presentation of the balance sheet and income statement and the FFA. This is acknowledged in FRS 101¹⁸ Basis for Conclusions paragraphs 61B to 61F.

The experience of those insurers which have adopted IFRS 17 will be an important consideration, both from initial implementation and in the coming years as the standard is embedded in external reporting, communications and financial planning. It is too early to judge this fully, however it is clear that:

- Permitted interpretations of IFRS 17 are widely known and many system providers (e.g. for the CSM) have ready solutions. In theory, this would make any wider adoption of IFRS 17 in the UK easier.
- Many insurers, on reflection, underestimated the complexity of IFRS 17 notably the challenges over sourcing data in general and at the right granularity, aligning actuarial and accounting data, and ensuring the infrastructure is in place for this increased volume of data to flow automatically between systems. In our experience, some insurers are planning to invest further in remediation activities in the coming years.

- There were significant impacts on shareholder equity on adoption of IFRS 17, as can be observed from Figure 4. Key features were a reduction in shareholder equity for annuity contracts as the CSM was established, while conversely an increase for with-profits contracts due to the first time recognition of shareholder equity relating to the value for certain expected future shareholder transfers.

Figure 4: Change in equity (£bn) on adoption of IFRS 17 at 1 January 2022



Source: Analysis and interpretation of selected life insurer disclosures to FY 2023 including earlier public announcements. Note, the amounts exclude any impact from the adoption of IFRS 9 (Financial Instruments) at the same time.

- The IFRS 17 income statement is highly prescribed containing new calculated concepts, such as insurance revenue. There are no cash flow items, such as premiums, presented. Currently, no UK life insurers are using the new concept of insurance revenue as a key performance indicator.

¹⁸ <https://www.frc.org.uk/library/standards-codes-policy/accounting-and-reporting/uk-accounting-standards/frs-101/>

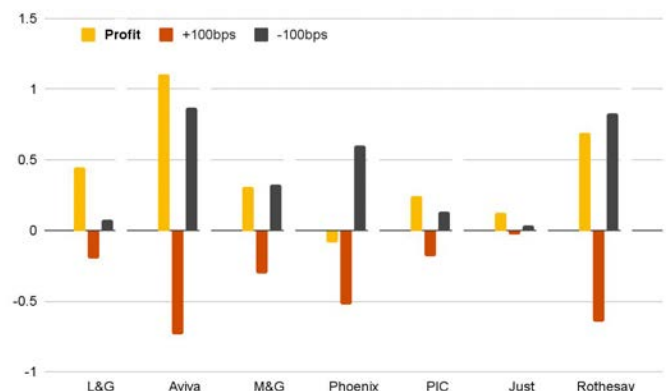
4. What are the potential options? (continued)

Adopt IFRS 17 in full (continued)

- There is now increased variability in the classification and measurement of financial assets backing annuity liabilities. In particular, Legal & General and Just Group designated significant asset portfolios at amortised cost, previously at fair value through profit or loss, in order to better match the 'locked-in' nature of the CSM for their annuity portfolios. Specifically, Legal & General reclassified c. £5bn of assets to amortised cost on adoption of IFRS 17 and IFRS 9 at 1 January 2022, while Just Group purchased c.£2.5bn of long-dated gilts in 2023 which were designated separately from the existing portfolio at amortised cost.
- There are now more adjustments from IFRS profit to determine Adjusted Operating Profit ('AOP', a key Alternative Performance Measure). This may suggest challenges in using IFRS 17 to assess in-period performance. In particular, the adjustments include new items to remove IFRS 17 'mismatches' typically arising from the locked-in nature of the CSM (general model) and the application of the variable fee approach to with-profits contracts. For example, the extent of these two mismatches at M&G resulted in an impact on profit in 2022 of over £240m¹⁹ while at Legal & General the impact in 2023 was over £300m²⁰ (relating to the locked-in CSM only).
- There remains a continued focus by UK life insurers on cash, dividends and solvency coverage and there has been no increased use of IFRS to explain performance, at least to date.

- For some insurers the interest rate exposure is higher under IFRS 17 than IFRS 4. Figure 5 shows the IFRS interest rate sensitivities at FY23. The exposure arises primarily due to a combination of commonly hedging on a Solvency II rather than IFRS basis and mismatches in IFRS 17, notably, as mentioned earlier, the locked-in nature of the CSM for annuities.

Figure 5: Profit after tax (£bn) interest rate sensitivity at FY23



Source: PwC analysis and interpretation of FY23 accounts. Note, to aid comparison the disclosed sensitivities have been scaled where these are calibrated differently to +/-100bps and where a pre-tax profit impact only is published.

For further consideration of IFRS 17 FY23 (Year 1) reporting for the UK life insurance market, please see our deep dive report:

<https://www.pwc.co.uk/financial-services/assets/pdf/ifrs-17-fy23-uk-reporting-analysis-april-2024.pdf>



¹⁹Page 237 of M&G FY23 accounts

(<https://www.mandg.com/~media/Files/M/MandG-Plc/documents/investors/2024/mgplc-ara23-interactive-4-4-24.pdf>)

²⁰Page 169 of Legal & General FY23 accounts

(<https://group.legalandgeneral.com/media/o4harb42/legal-and-general-2023-annual-report-and-accounts.pdf>)

4. What are the potential options? (continued)

There were also two notable developments relating to IFRS in September 2024:

- The FRC published their thematic review on the FY23 IFRS 17 disclosures²¹ (a follow-up to their HY23 interim report). The FRC noted that they “*were pleased with the overall quality*” and they made a limited number of key observations. These included reiterating the importance of entity-specific accounting policies, significant judgements and estimates, and explanations around Alternative Performance Measures.
- The Canadian Accounting Standards Board presented their IFRS 17 experience to date at the IASB’s Accounting Standards Advisory Forum²². This is the first such event and many of the challenges noted will be familiar to UK life insurers.



How does IFRS 17 apply to mutual insurers?

As UK GAAP is applied to the mutual sector in the UK, how IFRS 17 applies to with-profits contracts and specifically mutual insurers would be important if IFRS 17 were to be used as the basis for UK GAAP:

- The experience of proprietaries is that most, if not all, with-profits contracts are accounted for under the variable fee approach in IFRS 17, that the approach is complex (more so for open funds with unattributed inherited estates than for closed funds), and that mismatches can arise in profit or loss. The most notable mismatch arises due to the accounting for underlying items at fair value when valuing with-profits liabilities. Underlying items often include items such as non-profit business in the with-profits fund or pension scheme surplus/deficits and the return on these is shared across with-profits contracts. However, these items cannot be measured under IFRS at fair value and so there is a mismatch between the accounting for them and the amount recognised in the with-profits liabilities.
- For a mutual insurer, there are specific implications as noted by the IASB in IFRS 17²³ and related education material, ‘Insurance contracts issued by mutual entities’ (June 2018)²⁴. In particular:
 - Non-profit contracts issued by a mutual insurer apply IFRS 17 as if they were issued by a proprietary company, so the insurance contract liabilities include a full risk adjustment and CSM.

²¹FY23: https://media.frc.org.uk/documents/IFRS_17_Insurance_Contracts_Disclosures_in_the_First_Year_of_Application.pdf and HY23: https://media.frc.org.uk/documents/IFRS_17_Insurance_Contracts_Interim_Disclosures_in_the_First_Year_of_Application.pdf

²²<https://www.ifrs.org/content/dam/ifrs/meetings/2024/september/asaf/ap6-acsb-ifrs-17-implementation.pdf>

²³See IFRS 17 paragraphs BC264-BC269C, 2, B16 and B67-B71. The implications are also confirmed in questions 8.25 and 17.32 in International Actuarial Note 100 (IAN 100 – Application of IFRS 17 Insurance Contracts) published by the International Actuarial Association (IAA), see:

https://www.actuaries.org/IAA/Documents/Publications/IANs/IAA_IAN100_31August2021.pdf

²⁴<https://www.ifrs.org/content/dam/ifrs/supporting-implementation/ifrs-17/ifrs-17-and-mutual-entities.pdf>

4. What are the potential options? (continued)

How does IFRS 17 apply to mutual insurers? (continued)

- With-profits policyholders would likely be viewed as having two identities, that is both as a policyholder and as an owner with the ‘residual interest’ in the mutual insurer. The IFRS 17 insurance contract liability would consist of cash flows allowing for both interests and a risk adjustment relating to the compensation the mutual requires for bearing uncertainty from each individual policyholder. There is no CSM.
- In principle, given the two identities, there would be no equity arising. However, due to the mismatches arising as noted above, equity for IFRS reporting purposes could arise and could be positive or negative.
- The IASB notes that, on the balance sheet and income statement, amounts relating to the two identities of with-profits policyholders could be presented separately (IFRS 17 paragraph BC269).
- The IFRS 17 experience for mutual life insurers outside of the UK is mixed²⁵. In some countries, there is no experience as, like in the UK, mutual insurers do not account under IFRS and this outcome was achieved through various routes. Where mutual insurers have adopted IFRS 17, the existence of equity for the reason noted can be observed, to the extent applicable given the nature of the mutual.

²⁵We examined a limited number of mutual insurers across a limited number of countries. We observed that mutuals in the following countries do not apply IFRS: France (e.g. Aéma Groupe FY23: [Aéma Groupe – 2023 ANNUAL REPORT](#)), Germany, Japan (e.g. only limited insurers are preparing to adopt IFRS including IFRS 17 around 2025/26), Sweden (e.g. Alecta FY23: [Alecta's Annual and Sustainability Report 2023](#) which states ‘As Alecta transitioned to legally restricted IFRS in the Group from 2022, Alecta does not need to apply IFRS 17 Insurance Contract, which entered into force 1 January 2023.’) and the US (where US GAAP rather than IFRS is applied). Conversely, we observed examples of mutuals applying IFRS 17 in Norway (e.g. KLP Group FY23: [Annual Report 2023](#)) and South Africa (e.g. PPS FY23 : [PPS 2023 INTEGRATED REPORT](#)).

4. What are the potential options? (continued)

04

Adopt IFRS 17 ‘light’

The adoption of certain parts of IFRS 17 into FRS 103 could provide a more proportionate approach to accounting for insurance contracts in the UK. This could take many forms, such as:

- Using the fulfilment cash flows (being the best estimate of future cash flows and risk adjustment) as a basis for insurance (and reinsurance) contract liability measurement, while also retaining the FFA for with-profits funds.
- If the IFRS 17 CSM was included in UK GAAP to provide a basis for profit recognition, then a simplified application could be adopted. For example (amongst many options), consideration could be given to align to European Union amended IFRS 17 (as set out in Commission Regulation (EU) 2021/2036²⁶) where the annual cohort requirement ‘for intergenerationally-mutualised and cash flow matched contracts’ is made optional. The EU amendment would be expected to apply to UK with-profits and annuity contracts.
- The approach to determine the opening CSM (if included in UK GAAP) could be simplified to require a fair value assessment of the insurance contract liabilities at the point of transition. This would avoid any retrospective calculations which can be operationally onerous, as observed in IFRS 17 implementation experience to date. Conversely, there is considerable judgement in determining this fair value, also as observed from IFRS 17 implementation experience.

“

An IFRS 17 ‘light’ model would require careful consideration of the various components to ensure it was coherent and fit for purpose.”

05

Adopt another globally recognised insurance standard

The only other alternative in this category would be US GAAP, the US accounting standards. In 2018, the FASB (the US equivalent of the IASB) issued Accounting Standards Update 2018-12, Targeted Improvements to the Accounting for Long-Duration Contracts (‘LDTI’). This made revisions, in some places significant, to the accounting for life insurers in the US with an effective date of 1 January 2023 (for filers with the US Securities and Exchange Commission, SEC) or 1 January 2025 (for others). The market experience of LDTI is therefore similar to IFRS 17 given the same effective date. Given that there is limited to no post-implementation experience of LDTI or US GAAP more broadly in the UK, it seems unlikely that this would be a proportionate or credible option.

²⁶<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32021R2036>

4. What are the potential options? (continued)

What criteria could be used to assess options?

Having identified potential options, the question then turns to the criteria which could be used to assess them.

The FRC has an overall objective in setting accounting standards to *'enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs'*²⁷. This is further expanded: *'In achieving this objective, the FRC aims to provide succinct financial reporting standards that:*

- a. *have consistency with global accounting standards through the application of an IFRS-based solution **unless an alternative clearly better meets the overriding objective;***
- b. *balance improvement, through reflecting up-to-date thinking and developments in the way businesses operate and the transactions they undertake, with stability;*
- c. *balance consistent principles for accounting by all UK and Republic of Ireland entities with proportionate and practical solutions, based on size, complexity, public interest and users' information needs;*
- d. *promote efficiency within groups; and*
- e. *are cost-effective to apply.*²⁸

In relation to (a) there are clear examples where the FRC has adopted simplified proposals, including recently how the IFRS 15 Revenue requirements have been translated into the new amendments to FRS 102. This highlights that proportionality is important in assessing any changes in IFRS and how they are considered and translated into UK GAAP.

We also draw out a few considerations:

- **Sustainability and codification:** If changes are required to the Act then significant engagement with the Government and its ongoing legislative programme would be required. In addition, if a Solvency II based measure is proposed then consideration will be required as to how the PRA's regulations are codified and, where required, updated in a financial reporting standard.
- **Profit recognition pattern:** To the extent that changes revise the recognition of profit, does this better reflect the services provided by the insurer in the period than the current requirements?
- **Implications for policyholders:** The value to policyholders will be important as they are likely to bear the cost associated with adopting any new accounting standard given the prevalence of with-profits funds and mutual insurers, including the very smallest ones. The cost of adopting IFRS 17 has been significant for UK listed life insurers, so assessing the tangible benefit to with-profits policyholders both financially and in terms of security will be important.
- **Taxation:** As set out earlier this will require careful assessment and potential discussion with HMRC over transition measures (as when IFRS 17 was adopted). A key area will be the accounting for the FFA liability in proprietaries as any amounts recognised in shareholder equity for the first time may be taxable. As an example, on adoption of IFRS 17 by M&G plc (containing Prudential Assurance), shareholder equity increased by approximately £2bn²⁹.

²⁷FRS 102 Basis for Conclusions paragraph A.1.

²⁸FRS 102 Basis for Conclusions paragraph A.2.

²⁹Page 196 of M&G plc FY23 accounts:

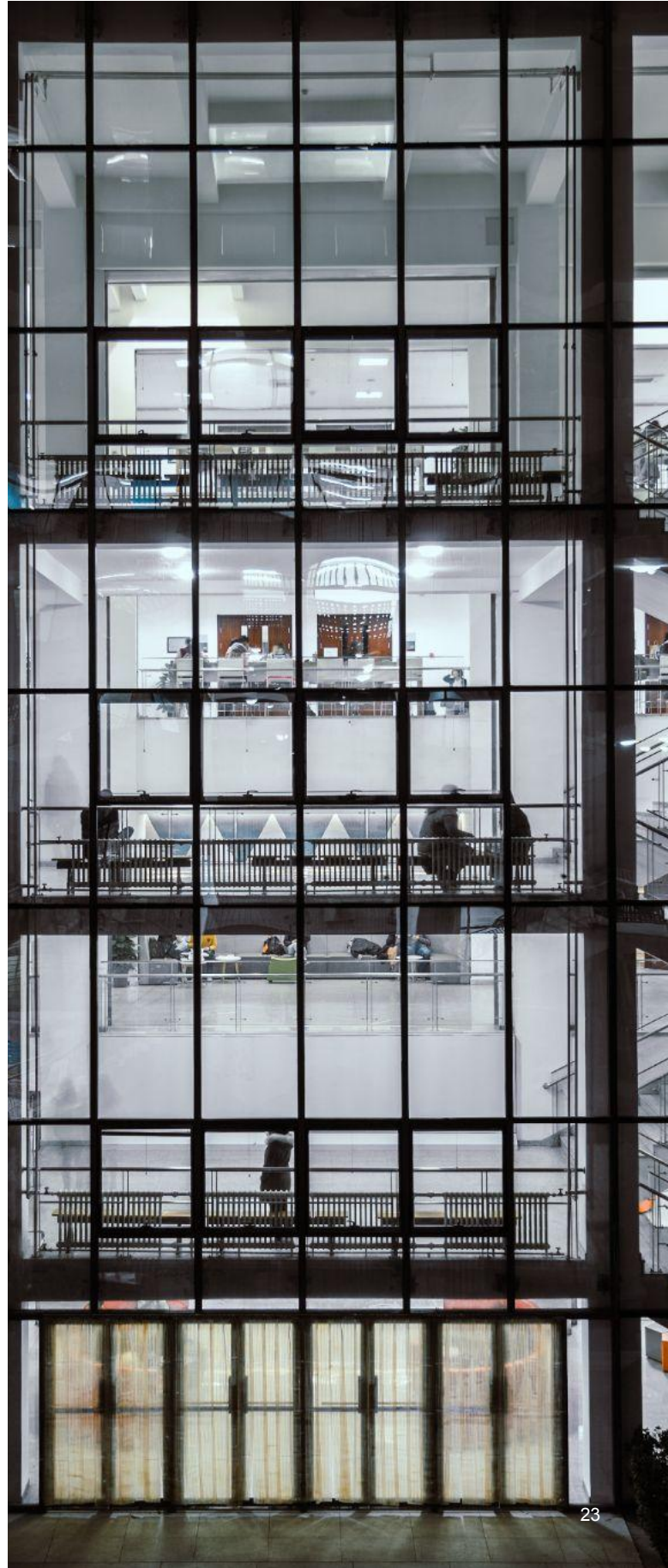
<https://www.mandg.com/~media/Files/M/MandG-Plc/documents/investors/2024/mgplc-ara23-interactive-4-4-24.pdf>

4. What are the potential options? (continued)

Are there other considerations?

Yes! In this publication, we have only explored certain considerations that would be needed when assessing whether to update FRS 103. The following, not exhaustive, list of technical matters would also need to be considered:

- How will insurance acquisitions or Part VII transfers be accounted for?
- Will an explicit deferred acquisition cost asset for business written in non-profit funds (as originally set out in the ABI SORP) continue?
- Will an allowance for the value from non-profit contracts in with-profits funds (as originally set out in FRS 27) continue and in what form?
- How will outstanding claims be accounted for and presented?
- Would the provisions in FRS 103 on changes in accounting policies (paragraph 2.2 to 2.11) be retained? These were originally from IFRS 4, but do not exist in IFRS 17.
- Will the FRS 102 definition of an insurance contract be updated for IFRS 17? Although the assessment of significant insurance risk is largely unchanged in IFRS 17 compared to IFRS 4, the scope exclusions have been updated. For example, IFRS 17 para 8A permits insurers under certain conditions to value lifetime mortgages (or equity release mortgages) under IFRS 9 and not IFRS 17, despite the existence of the No-Negative Equity Guarantee (NNEG).
- The interaction of any changes in insurance contracts with the current recognition and measurement principles for financial assets under FRS 102, and whether any consequential changes in these areas of accounting would also be required.



5. Concluding thoughts

Any change to UK GAAP will require careful consideration as life insurers from the largest to the very smallest in the UK and Ireland use this as a basis for accounting. Key topics to consider will include the cost versus benefit not only for shareholders, but also for policyholders, due to the prevalence of with-profits funds and mutuals applying UK GAAP, and the tax implications, including how HMRC may view any accounting changes.

Given UK GAAP dates back nearly 40 years, the recent implementation of IFRS 17 and the lack of a profit recognition pattern reflecting the services provided in each period, there is a clear need in the coming years to reassess the options to account for insurance contracts under UK GAAP. The IASB's IFRS 17 standard may seem an obvious option, especially as UK GAAP typically aligns with IFRS, however, the experience of those who have implemented this standard, especially for with-profits contracts, may suggest this is not the right or proportionate answer.

We look forward to engaging in the debate in the coming years on the future of UK GAAP for life insurers!

Key takeaways

1. It is clear that there is a need in the coming years to reassess the options to account for insurance contracts under UK GAAP. However, any changes will require careful consideration as the largest to the smallest life insurers in the UK and Ireland apply UK GAAP.
2. With the various IFRS 17 post-implementation reviews reporting around 2028, any significant revisions to UK GAAP are likely to be five or more years away.
3. UK GAAP is used as the basis of accounting for most with-profits funds and all mutual insurers. Consequently any changes need to balance the cost versus benefit for policyholders, provide a meaningful basis to account for with-profits contracts and be proportionate to this market.
4. Tax implications will be important for proprietary insurers especially if any changes to UK GAAP result in the first time recognition of shareholder equity for with-profits funds.

6. Key contacts

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RITM0098455