BANK FOR INTERNATIONAL SETTLEMENTS

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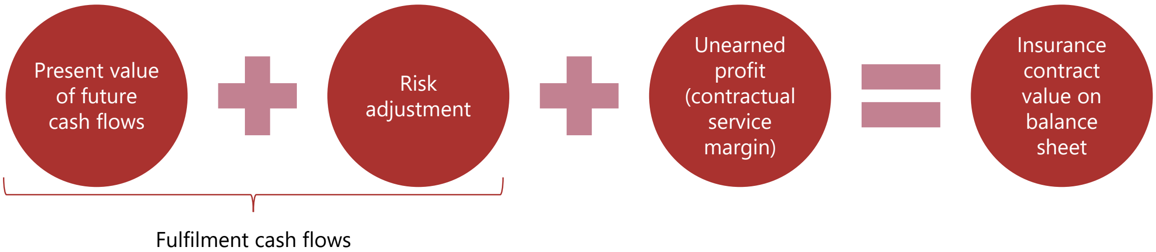
Supervisory implications of IFRS 17 insurance contracts – Executive Summary

Significance of IFRS 17

After almost 20 years in the making, the final International Financial Reporting Standard (IFRS) 17 *Insurance Contracts* was released in May 2017, marking one of the most significant developments in the insurance industry in recent years. IFRS 17 sets out how companies should value issued insurance (including reinsurance) contracts, typically an insurer's largest balance sheet items. Therefore, the standard is hugely significant in the determination of an insurer's financial position. IFRS 17 is expected to improve the usefulness, transparency and cross-jurisdictional comparability of insurers' financial reports. As the international standard for the accounting of insurance contracts, IFRS 17 will be used by the majority of global insurers for general purpose financial reporting and, in some cases, for prudential reporting as well.[*]

Main elements of IFRS 17

At a very high level, the value of an insurance contract based on the IFRS 17 core requirements is as follows:



IFRS 17 will require many affected insurers to significantly change the way they currently value and report their insurance contracts. The following are some of the major changes expected:

- for life insurers, the requirement to value insurance contracts using fully updated information to better reflect insurers' true underlying financial positions
- for non-life insurers, the requirement to discount future cash flows and to set up explicit risk adjustment for incurred insurance claims

IFRS 17 will become effective on 1 January 2021, with early adoption allowable in certain circumstances. To give effect to IFRS 17, the standard needs to be transposed into local accounting rules. The national accounting bodies may decide to adopt IFRS 17 with or without adjustments, and jurisdictional requirements will determine if IFRS 17 will be applicable only to listed companies or to all.

Interlinkages with prudential requirements

In the banking sector, the regulatory treatment of accounting provisions relies primarily on accounting standards. In contrast, there is a spectrum of regulatory approaches in the insurance sector covering the extent to which accounting standards are relied upon in the valuation of insurance contracts. At one end

[*] IFRS 17 considerations are relevant in jurisdictions adopting IFRS financial reporting. Some jurisdictions with large insurance industries, such as Japan and the United States, have not adopted IFRS and require insurers to report using local accounting standards.

of the spectrum, an insurance supervisor could adopt IFRS 17 with few, if any, adjustments for prudential purposes. At the other extreme, an insurance supervisor could prescribe a completely different valuation standard for insurance contracts for prudential purposes, independent of IFRS 17 or any other local accounting standards.

Note that, in the past, the international supervisory community, as represented by the International Association of Insurance Supervisors, stated publicly that it is most desirable for general purpose financial reporting to be as consistent as possible with prudential reporting.

There are many reasons why local insurance supervisors have adopted different approaches, including:

Factor	Description
Differing objectives	Prudential requirements are aimed at policyholder protection and financial stability objectives, whereas IFRS aims at providing useful information to users of general purpose financial statements.
Accounting divergence	The current interim accounting standard for insurance contracts (IFRS 4) allows insurers to largely follow their previous local accounting requirements, which reinforced globally divergent accounting practices and non-comparable balance sheets.
Historical legacy	In many jurisdictions, current prudential requirements have been in place for many years, and both insurers and supervisors are used to that system.
Cost	Recently introduced or overhauled solvency frameworks imposed significant costs on insurers, and so there may be little appetite to introduce a new system that will incur additional costs.

Supervisory issues

The implications of IFRS 17 for supervisory frameworks depend on the different regulatory approaches. In jurisdictions where IFRS 17 will also be used for prudential purposes, supervisors will need to introduce the necessary legislative or regulatory changes in order to implement the standard. In other jurisdictions, supervisors will need to decide if they will continue to prescribe diverging prudential requirements or to adopt IFRS 17. Factors that may affect this decision include:

Factor	Description
Cost	Requiring insurers to prepare two different sets of financial reports could give rise to financial and operating inefficiencies.
Impact uncertainty	It is difficult to estimate the potential impact of IFRS 17 on individual insurers, the insurance industry or the financial system as a whole without undertaking a thorough assessment, but this would require the outlay of significant time, effort and cost by insurers.
Competitiveness	IFRS 17 may put some insurers at a competitive disadvantage compared with other insurers that are not subjected to the standard due to changes in profitability reporting and/or product design.
Comparability	IFRS 17 still leaves open certain options for insurers to select, which, to a certain extent, could result in continued non-comparable financial reporting.
Volatility	A major concern for insurers and some supervisors is volatility of an insurer's profit or loss arising from accounting mismatch, when assets and liabilities respond differently to changes in economic conditions due to the way they are measured.
Market transparency	Improved understanding of insurers' financial statements could facilitate an increased investor pool for insurers, potentially lowering their cost of capital.

IFRS 17 could also have financial stability implications. The International Accounting Standards Board expects IFRS 17 to contribute to long-term financial stability by revealing useful information about insurers that will enable actions to be taken in a timely way. From a supervisory perspective, this could be achieved, for example, if IFRS 17 is used as a valuation basis incorporated in a jurisdiction's regulatory solvency control framework and this results in an earlier trigger for appropriate supervisory intervention.

This Executive Summary and related tutorials are also available in FSI Connect, the online learning tool of the Bank for International Settlements.