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Accounting standards and insurer solvency assessment

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Contents

Executive summary 1

Section 1 – Introduction 3

Section 2 – IFRS 17 development and changes compared with IFRS 4 4

Section 3 – Overview of accounting approaches and intersections with prudential frameworks 6

Section 4 – Potential impact on insurers 12

Section 5 – Implementation challenges 15

Section 6 – Use of IFRS 17 for prudential frameworks 17

Section 7 – Regulatory and supervisory implications 19

Section 8 – Concluding remarks 21

Glossary 23

References 24

Annex 1 – List of supervisors that participated in the survey and the abbreviations used to represent them 25

Annex 2 – Comparison of US GAAP targeted improvements (ASU 2018–12) with IFRS 17 26

Annex 3 – Differences between IFRS 17 and IFRS 4 31

- Level of aggregation 31
- Use of premium allocation approach for contracts of one year or less 31
- Scope of application 31
- Current estimates – general 31
- Current estimates – future cash flows 32
- Current estimates – discount rate 32
- Current estimates – other material differences 32
- Risk adjustment for non-financial risk 32
- Contractual service margin 32
- Subsequent measurement and profit recognition 32
- Contract boundary 32

Annex 4 – Approaches to transposing IFRS into local standards 33

Annex 5 – Regulatory approaches to the use of accounting standards for prudential purposes 34

Accounting standards and insurer solvency assessment[1]

Executive summary

International Financial Reporting Standard (IFRS) 17 Insurance Contracts was published in May 2017 and is expected to come into force on 1 January 2023. Also, on 1 January 2023, IFRS 9 Financial Instruments will be implemented for insurers. This change to IFRS is one of the most significant developments in the insurance industry in recent years.

Overall, IFRS 17 is a welcome development. It is aimed at improving global comparability with respect to the structure of liability valuation and transparency in insurer balance sheets, thus benefiting policyholders, investors and, ultimately, financial stability. The current international accounting standards for insurance contracts permit a variety of approaches, which complicate comparison between insurers' financial results. Most of the 20 jurisdictions surveyed for this paper expect that IFRS 17 will contribute to financial stability through greater transparency.

IFRS provides a ready-made principles-based framework so that supervisors do not have to address a myriad of accounting issues in developing their own valuation approach. While the objectives of accounting and regulatory standards are different, there are overlaps. The different policy choices have led to and will continue to lead to a wide range of regulatory approaches to the use of existing accounting standards to assess insurers' solvency position. This paper highlights the different approaches based on a survey of 20 insurance supervisors.

Currently, few surveyed jurisdictions plan to use IFRS 17 for regulatory solvency purposes, mainly because IFRS 17 is not perceived to provide sufficiently comparable financial results. This can be addressed by supervisors specifying some aspects of implementation for regulatory reporting purposes. Where there are no plans to use IFRS 17, supervisors consider that the marginal regulatory implementation costs outweigh the marginal benefits from aligning their valuation bases with IFRS 17. Nevertheless, jurisdictions that have not yet adopted a valuation basis for their regulatory reporting may consider the use of IFRS generally and IFRS 17 in particular for insurance liabilities. Jurisdictions that plan to adopt the standard for solvency purposes mainly seek to benefit from auditing controls, avoid potentially conflicting financial signals from different financial statements and minimise cost for insurers.

Those jurisdictions that are not currently intending to implement IFRS 17 for regulatory solvency purposes should reconsider this position after some experience with IFRS 17. Most solvency systems go through periodic review processes which may provide an opportunity for alignment between regulatory solvency valuation and general purpose financial reporting. Aligning the implementation of IFRS 17 with the current specification of regulatory valuation approaches may result in a single set of financial statements that is usable for both general purpose financial reporting and regulatory solvency valuation. Greater specification of the techniques and inputs to be used in IFRS 17 should be developed through global coordination to avoid localised versions of IFRS 17 being created.

Despite the expected benefits of IFRS 17, there are significant challenges in implementing the new accounting standards, including in terms of their potential impacts on the prudential regulation and supervision of the insurance industry, which have not been well identified. IFRS 9 and IFRS 17 implementation is combined for the insurance industry to ensure that accounting for financial instrument assets and accounting for insurance contracts are coordinated for asset-liability management

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purposes. IFRS 17 is perceived as a complex standard requiring professional judgment and has significant implementation challenges, including an acute shortage of such expertise in many jurisdictions. The implementation challenges are not as significant for IFRS 9 Financial Instruments. This paper therefore focuses on IFRS 17,

Supervisors can play a role in helping to address the implementation challenges. Such a role includes encouraging insurers to start preparing early, engaging closely with the industry to better understand the issues, and potentially guiding choices made within the principles-based framework to achieve greater consistency. It is key to avoid jurisdictional versions of IFRS 17 implementation, as this could potentially thwart the goal of global consistency.

Supervisors are encouraged to undertake impact assessments of the introduction of IFRS 17 and IFRS 9 in their jurisdictions even if they do not have immediate plans to use IFRS for prudential purposes. IFRS 17 and IFRS 9 taken together result in restatement of the largest components of both sides of an insurer's balance sheet. These revised IFRS will shape the way senior management strategically drives the future business of insurers and will also shape the risk management practices of insurers. The potential financial impact of IFRS 17 is currently unclear, as most jurisdictions have not undertaken a quantitative impact study. Some jurisdictions plan to review their capital adequacy frameworks in response to IFRS 17. In that process, the guiding principles that supervisors use are to provide the right incentives for insurers to manage risks properly and to achieve appropriate prudential outcomes in terms of policyholder protection.

The new accounting standards will not be the top priority for insurance supervisors or insurers during the Covid-19 pandemic. However, the 2023 implementation date is looming. Supervisors and insurers can only afford a relatively short period of diverting resources from the implementation of IFRS 17 and IFRS 9 to address the pandemic. Initial impact analysis should ideally start by the beginning of 2021 at the latest.

Section 1 – Introduction

1. **This paper outlines the range of regulatory approaches to using accounting standards as valuation bases to assess the solvency of insurers.**[2] The paper also highlights the prudential implications of recent accounting developments. It is based primarily on a survey of 20 insurance supervisors covering diverse regulatory frameworks, geographical locations, economies and levels of industry sophistication (Annex 1). Given that many insurance supervisors are still considering how to react to recent accounting developments, and in particular to IFRS 17,[3] this paper should be useful in helping regulators make appropriate policy choices.

2. **This paper is being published as the impact of the Covid-19 pandemic is still evolving.** At the time of publication, there were significant impacts on the financial position of insurers due to the pandemic, but this has occurred from a position, in general, where insurer balance sheets and solvency are strong. On an industry-wide basis, the pandemic's impact is material but is not currently judged a major threat to viability. Some insurers, particularly those with weak solvency positions to start with or business areas particularly impacted by the pandemic, may nonetheless face serious challenges. This set of circumstances is naturally the focal point of insurers and supervisors at this time. Insurers and supervisors are also challenged by new working arrangements, with most staff forced to work from home. However, moving forward as the pandemic's impact becomes more stable and working arrangements normalise, some of the resources of supervisors and insurers currently dedicated to dealing with the pandemic can be reallocated to issues beyond the pandemic. IFRS 17 and IFRS 9 are important developments that have been subject to ongoing delays due to the challenging nature of the development of IFRS 17. While no deadline is immutable, the implementation of IFRS 17 and IFRS 9 should not be delayed further than the deferral for another year to 1 January 2023 recently announced by the International Accounting Standards Board (IASB).

3. **The value of insurance liabilities is one of the largest items on an insurer's balance sheet.** The way in which insurance liabilities are calculated and accounted for has a significant impact on the financial position of the firm and on how its board and senior management shape its business strategies. Most insurers apply some form of accounting standards for public financial reporting and, in some cases, for regulatory reporting.[4] In some jurisdictions, insurance supervisors adopt the local accounting standard as the basis for determining the value of insurance liabilities in assessing the solvency position of an insurer. In such a framework, accounting standards have direct prudential implications as they affect the solvency calculation of an insurer. In other jurisdictions, regulators may prescribe their own valuation basis, which may differ significantly from the local accounting standards. Even under such a regime, accounting standards could still have prudential implications.

4. **This paper is divided into seven further sections.** Section 2 covers the genesis of IFRS 17 and the changes it brings compared with IFRS 4. Section 3 outlines the range of approaches in the surveyed jurisdictions to the application of IFRS to different types of insurers for public financial reporting and prudential purposes. Section 4 examines the potential impact of IFRS 17 on insurers from a prudential perspective. Section 5 describes the implementation challenges faced by insurers and how insurance supervisors could help address some of those challenges. Section 6 outlines the different approaches to

[2] In this paper, unless otherwise specified, the term "solvency" refers to the ability of an insurer to meet its obligations to policyholders when they fall due based on measures as specified by the insurance supervisor.

[3] See IASB (2017a).

[4] In this paper, "standards" refers to standards issued by international or national standard setters.

the use of IFRS 17 for prudential purposes. Section 7 describes potential regulatory and supervisory implications arising from IFRS 17. Section 8 concludes with issues for further consideration by supervisors.

Section 2 – IFRS 17 development and changes compared with IFRS 4

5. **IFRS 17 has been more than 20 years in the making.** It began as a project to undertake a comprehensive review of accounting for insurance contracts. The predecessor of IFRS 17 was IFRS 4,[5] which was added to the IASB's agenda in 2001 – and was in turn a continuation of a project of the IASB's predecessor that began in 1997. IFRS 4, issued in 2004, was the first IFRS to cover insurance contracts. IFRS 4 was issued because the IASB saw a need for improved disclosures for insurance contracts, and some improvements to recognition and measurement practices, in time for the adoption of IFRS by listed companies in 2005. IFRS 4 was always intended to be an interim step in the comprehensive review. IFRS 4 did not aim for a uniform accounting policy and did not provide detailed valuation requirements. As a result, during most of its 16 years of development, the project to undertake a comprehensive review of accounting for insurance contracts was better known as "IFRS 4 Phase II".

6. **Insurance contracts were an item identified for a major joint project between the IASB and the Financial Accounting Standards Board (FASB) in the United States in 2008, but it was abandoned as a joint project in 2014.** When the project was abandoned, the FASB decided to focus on making targeted improvements to the insurance accounting models already existing under the US Generally Accepted Accounting Principles (GAAP), while the IASB carried on with the development of IFRS 17, on which agreement was reached in May 2017 for implementation at the beginning of 2021, and now, as noted above, deferred to the beginning of 2023 (Annex 2 describes key differences between IFRS 17 and the US GAAP project).

7. **The objective of IFRS 17 is to provide users of insurer financial statements with the information they require about an insurer's financial position, performance and risk exposure.** To that end, IFRS 17 will necessarily narrow the wide range of insurance accounting practices used under IFRS 4. Use of updated current cash flow assumptions and discount rates, and a market-consistent approach to determining the value of options and guarantees, will better reflect economic reality and more faithfully represent the underlying financial position and performance of insurance contracts. The principles underlying IFRS 17 measurement approaches result in a fundamental change to current practices, with an emphasis on market-based valuation. The requirements are different from most existing models in several aspects that are likely to change profit emergence patterns, encourage earlier recognition of losses on contracts that are expected to be onerous, and enrich valuation processes including through more detailed assumption-setting processes. Greater granularity in contract groupings will provide more relevant information about insurers' financial position and financial performance, but will create more complexity in the valuation models, data, systems and process requirements (Annex 3 provides a high-level overview of potential changes in the surveyed jurisdictions arising from IFRS 17). Table 1 highlights selected major improvements that IFRS 17 brings compared with existing practices.

[5] See IASB (2014).

Key enhancements of IFRS 17 compared with IFRS 4 Table 1

Aspect	Improvement in IFRS 17 compared with IFRS 4
Relevance and accuracy	Locked-in or outdated assumptions in many implementations of IFRS 4 will be replaced by regularly updated current assumptions in IFRS 17. The value of options and guarantees will be fully reflected through IFRS 17, which was not the case in many implementations of IFRS 4. Discount rates will reflect the nature of insurance contract liabilities under IFRS 17 rather than the nature of the assets held. Overall, IFRS 17 is expected to better reflect the economic reality and more faithfully represent the underlying financial position and performance of insurance contracts.
Profitability	IFRS 17 will introduce a revenue recognition approach that is more consistent with that of other industries. Revenue and profit are recognised over time as insurance services are provided rather than when premiums are received. Under certain current accounting regimes, revenue is recorded as premiums received on a cash basis for some life insurance contracts. Under certain current life insurance accounting regimes, profit drivers are unclear as a change in an insurance contract's liabilities line item could be the result of multiple drivers. IFRS 17 will distinguish between an insurance service result and a net financial result (and potentially an optional insurance finance expense in other comprehensive income). In addition, under IFRS 17, profit reporting will provide a more granular breakdown of profit sources in the profit and loss statement.
Comparability	Under IFRS 4, insurers could report insurance contracts using a variety of practices and, in consolidated financial reports, could consolidate that variety of practices. IFRS 17 will introduce a consistent framework for reporting insurance contracts. IFRS 4 allowed inconsistency with other industries, including the reporting of deposits as revenue and, in some jurisdictions, the reporting of life insurance revenue on a cash basis. Under IFRS 17, revenue is intended to reflect services provided in the same way as other industries.

Source: FSI and IMF staff.

8. **Rather than grandfathering the multiple existing measurement approaches under IFRS 4, IFRS 17 allows three measurement approaches.** The three approaches are:

- **The General Measurement Model.** This model is also known as the building block approach under which insurance contracts are valued as the sum of fulfilment cash flows and a contractual service margin (CSM). The fulfilment cash flows comprise probability-weighted future cash flows plus a risk adjustment for non-financial risk. The CSM removes any day-one gains on recognition and represents the profit the insurer recognises based on the transfer of services to policyholders over time.
- **The Premium Allocation Approach (PAA).** This is an alternative simplified approach for eligible contracts with a duration of one year or less or for other contracts where the PAA provides similar results to those of the General Model. The PAA is similar to the existing valuation approach for non-life insurance contracts except for the requirement to discount future cash flows (apart from claims payment due within a year) in calculating the incurred claims liability and using unearned premiums to simplify measurement of liability for remaining coverage.
- **The Variable Fee Approach.** This approach applies to contracts with direct participation features. Policyholders of such contracts share the profit from a clearly identified pool of underlying assets. The liability of the insurer is determined based on the obligation for the insurer to pay the policyholder an amount equal to the value of the underlying assets, net of a consideration charged for the contract – the "variable fee".

9. **Following the publication of IFRS 17 in 2017, the IASB published limited amendments to the standard in June 2020.**[6] The amendments were intended to reduce implementation costs, make the results easier to explain and ease the transition. The changes covered areas such as scope exclusions, allocation of acquisition costs to expected renewals, attribution of profit to investment activities, extension of the risk mitigation option, reduced accounting mismatches for reinsurance, simplified balance sheet presentation and additional transition relief.

10. **The implementation date of IFRS 17 has moved from the original effective date of 1 January 2021 to 1 January 2023.** The IASB's June 2019 Exposure Draft[7] proposed a delay from 1 January 2021 to 1 January 2022. However, based on consultation feedback, this date was extended by the IASB to 1 January 2023. Correspondingly, the implementation of IFRS 9 for insurers will be delayed until the same date.

11. **IFRS 9 is also relevant for insurers and, taken together with IFRS 17, represents a major accounting shake-up for the most significant items in an insurer's assets and liabilities.** IFRS 9 is not considered to have the same level of impact as IFRS 17 for insurers but will facilitate alignment of accounting on both sides of the their balance sheet. IFRS 17 provides for valuation based on current market inputs. It is expected that most insurers will make choices under IFRS 9 to move the majority of their assets backing insurance liabilities to fair value accounting in order to match the measurement approach in IFRS 17.

Section 3 – Overview of accounting approaches and intersections with prudential frameworks

12. **The way in which IFRS is introduced into local law varies.** For several major jurisdictions, the IFRS text is directly incorporated into jurisdictional accounting standards either by reference or automatic endorsement into local law. The European Union (EU) implements through endorsement but permits carve-outs. Every time a new standard is endorsed at EU level, the European Commission publishes an amending regulation that is directly applicable in all EU countries.[8] In the EU, listed companies have to draw up their consolidated account statements using IFRS, but local GAAP may be used for other entities. This is significant with respect to IFRS 17, as explained below. See Annex 4 for how IFRS is introduced into local law in surveyed jurisdictions. The scope of application in the surveyed jurisdictions can also differ, from all companies to a subset of companies (eg listed companies). In other jurisdictions, IFRS forms the basis of legal accounting standards, but modifications are made to account for the jurisdictional context. In some jurisdictions, reporting using IFRS is permitted, but not required. Some jurisdictions allow insurers to use a major accounting framework; accordingly, some may use IFRS and others US GAAP.

13. **Several jurisdictions have not yet decided whether to adopt IFRS 17 in their national accounting standards.** A major issue still to be resolved is the adoption of IFRS 17 by the EU based on the advice of the European Financial Reporting Advisory Group. The EU endorsement is considered key to the international success of the standard.

14. **In the United States, domestic public companies must file US GAAP financial statements and insurers file legal entity statutory financial statements with their state supervisors.** These legal entity statutory financial statements are based on US Statutory Accounting Principles (SAP) as set by the National Association of Insurance Commissioners (NAIC).[9] The US state insurance supervisors have

[6] See IASB (2020).

[7] See IASB (2019).

[8] See European Commission (2002).

[9] See NAIC (2019).

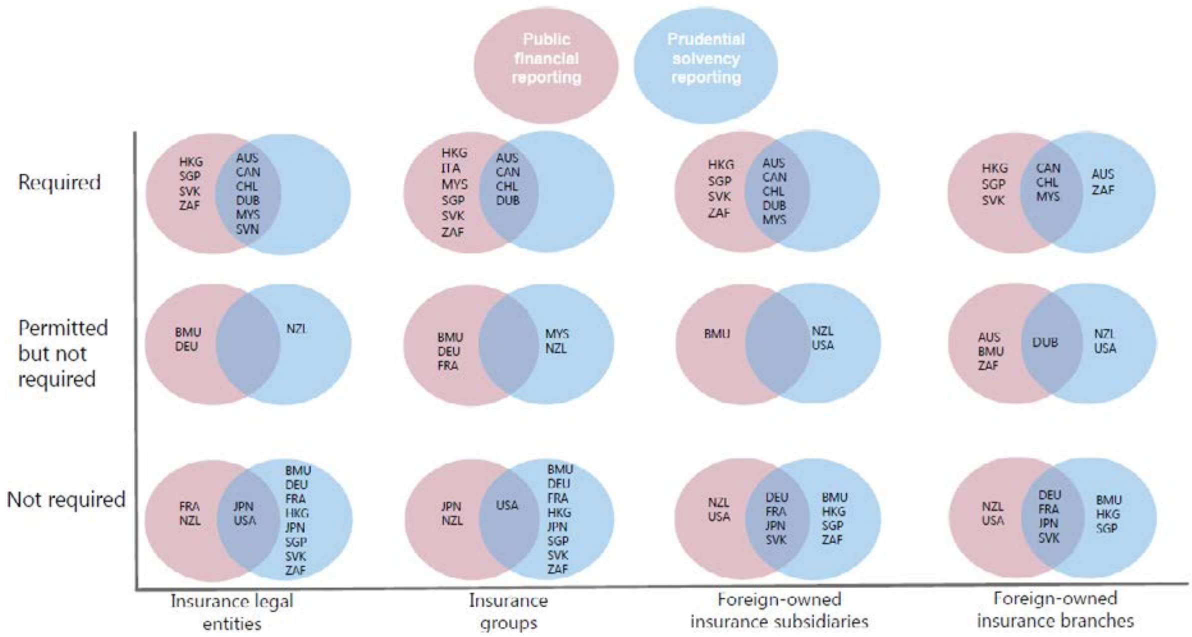
developed a comprehensive basis of accounting that all US insurers are required to follow by law. This accounting approach was developed in the course of a multi-year project that was based upon a Statement of Concepts appropriate for policyholder protection, but also leveraging US GAAP. The framework requires the NAIC to adopt, reject, or adopt with modification every US GAAP pronouncement issued by the FASB. It generally requires the adoption of some form of the US GAAP unless there is a compelling reason to differ. This approach allows US state insurance supervisors to react quickly to changes in the insurance industry that would otherwise not be taken up by an accounting standards body due to conflicting priorities. IFRS-based financial statements of foreign insurers are filed with US state insurance supervisors, as the NAIC Holding Company Model Act[10] requires all groups operating in the United States to file their group financial statements with the lead state supervisor.

15. **For most jurisdictions, the implementation of IFRS 9 for the insurance sector is aligned with the implementation of IFRS 17.** Aligning the implementation of these two standards is key for some of the jurisdictions surveyed, to avoid accounting mismatches that could convey misleading financial results from insurers. For example, the pricing of risk premia could affect asset valuation more than the value of liabilities, creating volatility in the reported equity (capital) of insurance companies. The following are examples of how some jurisdictions are dealing with these issues:

- Australia and Canada require the implementation of IFRS 9 and 17 to be aligned.
- For EU jurisdictions, as IFRS 17 is not yet endorsed, it is unclear if or how the implementation of IFRS 9 and 17 will be aligned. Subject to EU endorsement of a further deferral of IFRS 9, with its implementation aligning with that of IFRS 17, most insurers are likely to apply any such optional deferral of IFRS 9 until 1 January 2023 or later.
- Optional alignment of implementation of the two standards applies in Hong Kong SAR, Korea, Singapore and South Africa subject to conditions in the applicable accounting standard (eg an entity's predominant activity must be related to the issuance of insurance contracts within the scope of IFRS 4). Several insurers in South Africa have already adopted IFRS 9. In Hong Kong, it is expected that many insurers will defer IFRS 9 implementation to align with the adoption of IFRS 17.
- IFRS 9 is not aligned with IFRS 17 implementation in Chile, as IFRS 9 is already implemented there.
- Entities that are allowed to report under IFRS in Japan and insurers in New Zealand do not have the option of aligning IFRS 9 and IFRS 17 implementation.

[10] See NAIC (2014).

Figure 1: Applicability of IFRS for public financial reporting and prudential solvency reporting



Sources: Survey results; FSI and IMF staff.

16. **Accounting and prudential regulatory standards have different objectives, which could justify different valuation results.** Figure 1 shows the range of regulatory approaches to the use of IFRS in public financial reporting and/or regulatory solvency assessment (Annex 5 presents ways IFRS are implemented in the surveyed jurisdictions). The primary aim of accounting standards is to provide transparent and comparable financial information on firms to enable investors and other market participants to make informed decisions. On the other hand, regulatory solvency standards are aimed at assessing the ability of insurers to meet their obligations to policyholders. In the context of valuation of insurance liabilities, accounting standards seek to measure how much profit an insurer can recognise from an insurance contract in each reporting period. While such a purpose drives the balance sheet valuation, regulatory standards aim to establish the amount of funds an insurer should set aside to be able to meet its commitments to policyholders. Accordingly, it is understandable that accounting and regulatory standards may have somewhat different emphases and priorities that could manifest themselves in diverging technical requirements (Table 2). However, while emphases may be different, regulatory solvency standards and accounting standards have similarities in their objectives, as evident from the fact that some jurisdictions have aligned these two sets of reporting obligations.

Key differences between accounting and prudential standards — Table 2

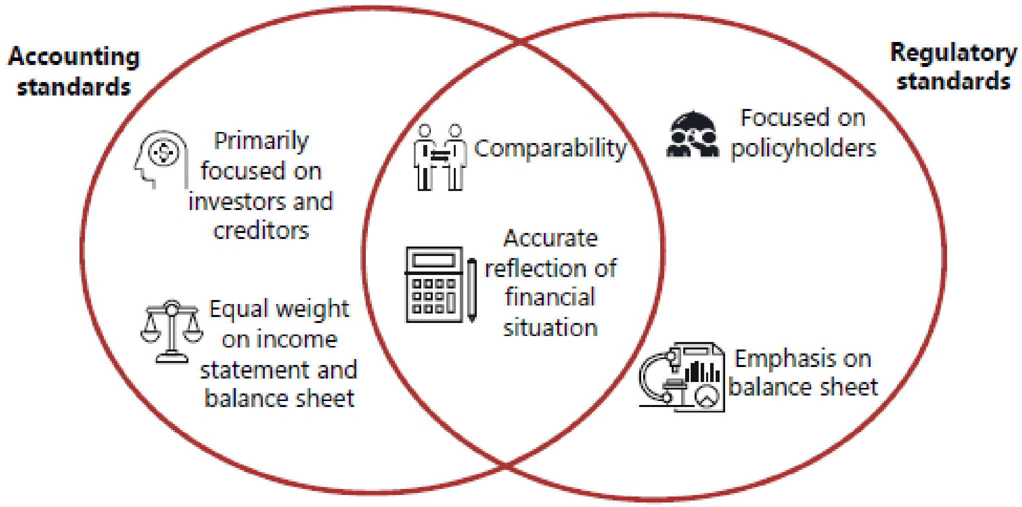
	Accounting standards	Prudential standards
Primary aim	Provision of useful information to market participants to enable informed decision-making	Protection of policyholders' interests
Focus	Financial performance	Regulatory solvency position
Key stakeholders	Investors, creditors and other stakeholders	Policyholders and supervisors
Key statements	Profit and loss account; and balance sheet	Balance sheet for solvency purposes
Typical form of requirements	Principles-based	Prescriptive

Source: FSI and IMF staff.

17. **Importantly, accounting and prudential regulatory standards share some common aims and features.** Both sets of standards aim to enable comparison of the financial results of firms, including insurers, and to provide useful information to users, which should include insurance supervisors. Given these common aims, significantly different accounting and prudential requirements may be difficult to reconcile. Accounting standards are usually principles-based, whereas regulatory standards are typically more prescriptive.

18. **Comparability is important to help ensure that all insurers are treated consistently, especially when supervisory actions are taken on the basis of balance sheet triggers.** Some supervisors take the view that accounting standards are more focused on performance measurement, which seems to imply that these are not relevant for supervisors. This is not necessarily the case, as supervisors should be interested in performance measures to assess the sustainability of an insurer's business model. Similarly, investors and other users of general purpose financial reporting are very interested in the financial position of an insurer. The basis for regulatory valuation traditionally tends to be conservative. However, increasingly, modern risk-based capital regimes are taking a so-called market-consistent approach, which in theory should remove any such conservatism (see discussion below of the total balance sheet approach to solvency assessment). That being so, the valuation approaches seem to share similar goals. (Figure 2 compares the primary focus and objectives of accounting and regulatory standards.)

Figure 2: Objectives of accounting and regulatory standards

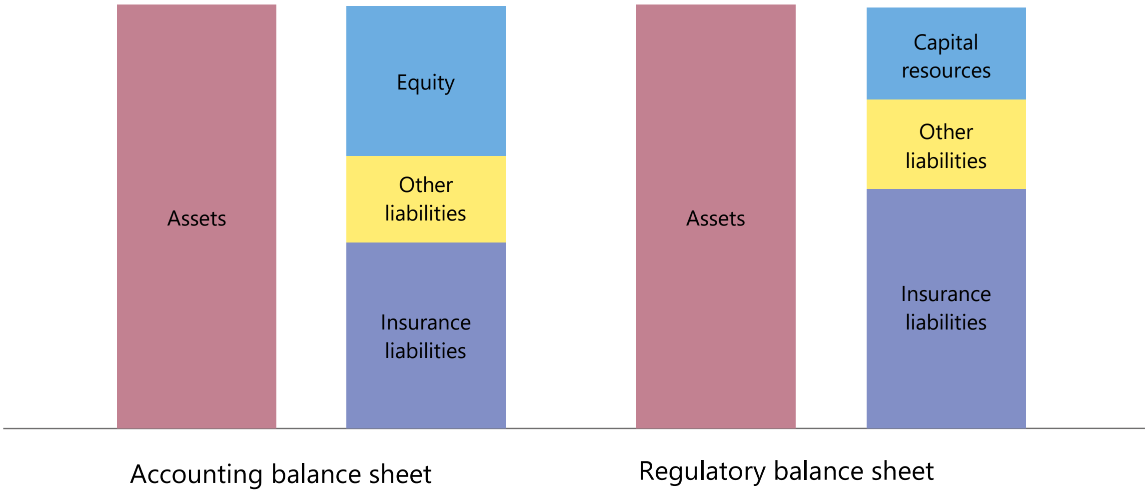


Source: FSI and IMF staff.

19. **To fully understand the prudential implications of accounting standards for insurance contracts, it is important to recognise the interaction between insurance liabilities and other components of regulatory and accounting balance sheets.** Figure 3 shows how different valuation bases for insurance contracts could result in different capital resources or equity positions, even though the underlying economics of an insurer are exactly the same. Figure 3, presents the regulatory balance sheet as having a more conservative valuation of liabilities than the accounting balance sheet. However, as noted in the previous paragraph, this may not always be the case. The valuation bases for assets and liabilities, including insurance contracts, can be specified by the insurance supervisor or be based on accounting standards (with or without adjustments). The difference between assets and liabilities is the amount of equity or capital available. From a regulatory perspective, this amount (known as capital resources) should be available to absorb losses, and therefore is subject to certain regulatory criteria that seek to ascertain its loss absorption capacity. An insurer's regulatory solvency position is determined by comparing the level of capital resources to its capital requirements. If its capital resources fall below capital

requirements, supervisors may take a range of actions to rectify the situation. Therefore, the value of insurance contracts plays a critical role in determining the solvency position of insurers.

Figure 3: Components[11] of accounting and regulatory balance sheet



Source: FSI and IMF staff.

20. **The valuation approach embedded in accounting standards also has prudential implications through its impact on strategic decisions of the board and senior management of insurers.** Certain valuation methods may produce results favourable to a particular kind of insurance product. For instance, valuation approaches that are based on locked-in assumptions can be favourable to longer-term life insurance contracts as compared with valuation approaches based on current assumptions. Thus, a change to the accounting basis could induce some insurers to reconsider their strategic priorities. There are also incentives for management to choose particular accounting policies within a valuation framework for public financial reporting. The disclosure and market conduct implications of these choices can be important for insurance supervisors.

21. **Regulatory valuation requirements interact with other components of a solvency framework.** A coherent solvency framework should be based on a total balance sheet approach that recognises interactions between the valuation of assets and liabilities, capital resources and capital requirements. Indeed, insurance supervisors typically require insurers to deduct intangible assets from capital resources, as these items are unlikely to have much loss-absorbing capacity in times of financial stress. The valuation requirements for assets and liabilities need to be consistent with capital requirements for the overall solvency results to be meaningful (eg capital requirements for life insurance risks can be established by stressing assumptions used in insurance liability valuation, in which case the valuation approach will have a direct impact on the capital requirements). In fact, some modern capital regimes may be less conservative than general purpose financial reporting, particularly with respect to recognising profits at the inception of a contract. In the context of a total balance sheet approach to solvency assessment, conservatism or lack of conservatism in balance sheets is not necessarily a concern, as adjustments can be made in capital requirements or recognition of capital resources to allow for the degree of conservatism of the valuation basis. A total balance sheet approach to solvency assessment should be forward-looking and calibrated to adequately protect policyholders without creating capital requirements so onerous that insurance becomes prohibitively expensive.

[11] In practice, insurance liabilities based on accounting standards could be higher than those calculated on a regulatory basis.

22. **The degree to which accounting standards are used in solvency frameworks affects the adjustments that prudential supervisors need to make to capital adequacy requirements.** Prudential supervisors that do not use accounting standards as the basis of prudential balance sheets do not need to make adjustments to the recognition of capital resources and capital requirements. Nevertheless, even where that is the case, supervisors should still be aware of the potential for indirect impact insofar as any component of their solvency framework relies on accounting results or indicators. Those supervisors that do use the accounting balance sheet as a basis will need to consider consequential changes to their solvency frameworks upon implementation of IFRS 17.

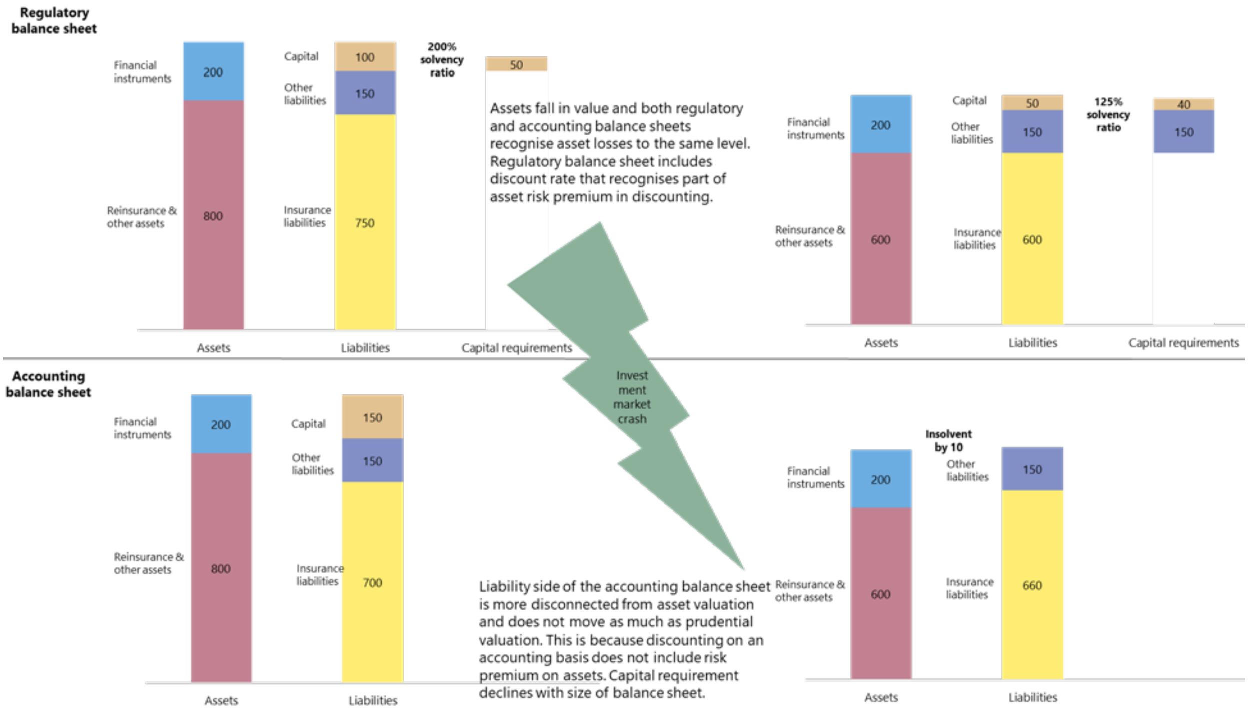
23. **Different measurement bases can give rise to the risk that the grounds for corporate insolvency could be met before regulatory intervention is triggered.** If Insurance Core Principle 17 Capital Adequacy[12] is observed in a jurisdiction, there should be a ladder of intervention defined by the supervisor that specifies the minimum capital requirement (MCR) as a solvency control level that, if breached, will trigger the strongest supervisory intervention. This strongest supervisory action may take several forms, eg withdrawal of licence leading to the insurer being put into run-off and ultimately proceedings to wind up the company

24. **Supervisory intervention levels will be determined in relation to regulatory balance sheets.** Ordinarily, at the point of the strongest supervisory intervention, an insurer is likely to have more assets than liabilities on an accounting balance sheet.[13] However, in unusual circumstances, it is possible that an insurer could have less assets than liabilities on an accounting basis but remain above the MCR even though the regulatory balance sheet is more conservative before market stress occurs. Figure 4 shows how diverging insolvency signals could appear after a market shock. In the example, the regulatory value of insurance liabilities falls more than the accounting value, as some risk premia from assets are recognised in the discount rate of the regulatory valuation of insurance liabilities, but under accounting a small illiquidity premium over the risk-free rate is applied. Assuming an MCR of 100%, this insurer's solvency ratio remains above the MCR but it has less assets than liabilities on an accounting basis. The problem with this situation is that the insurance supervisor may not have a legal basis to impose the strongest supervisory measures prior to a corporate insolvency triggered by a creditor in an insolvency regime that relies on accounting balance sheets.

[12] See IAIS (2019).

[13] Regulatory intervention should be designed to occur prior to the triggering of corporate insolvency laws.

Figure 4: Illustrative example of different insolvency signals from different balance sheets



Source: FSI and IMF staff.

25. **Some supervisors contend that a regulatory balance sheet should take a "gone concern" view, compared to the "going concern" view of the accounting standards.** This affects the types of assets the prudential supervisor may recognise for prudential purposes and how components of the valuation of liabilities are treated for prudential purposes. For example, some of the margins in insurance liabilities may be recognised as capital resources by a prudential supervisor because these margins are available to absorb losses in a gone concern. A variation on this theme is the attempt to align both sides of the balance sheet using fair value for assets and transfer value as a proxy for the fair value of liabilities. In that case, the gone concern view is taken through a lens of transfer value, reflecting that the resolution of an insurer may involve a transfer of liabilities and assets backing those liabilities in a commercial transaction. This contrasts with a fulfilment or run-off view of liability valuation, which would open the way to more insurer-specific valuation parameters, where a going concern view of valuation is applied. This does not necessarily mean that the resolution mechanisms in place in jurisdictions will perfectly align with the view of valuation, but these different views will colour the philosophy of the valuation basis and how components of assets and liabilities are viewed for prudential purposes.

Section 4 – Potential impact on insurers

26. **Most of the surveyed jurisdictions have not yet been able to assess the potential financial impact of IFRS 17 on their insurers.** This can be attributed to several factors, including insurers' need to further develop information technology (IT) systems and data to implement the standard, continuing development of technical expertise to undertake the valuation, and high implementation costs that need to be spread over time.

27. **Very few of the surveyed insurance supervisors have undertaken an impact assessment on their insurers.** Uncertainties, including the possibility of further revisions to the standard, could also contribute to supervisors' hesitation 'to launch impact assessments. However, without this, it is difficult to

anticipate how IFRS 17 could impact insurers' financial position and the corresponding influence this may have on their business strategy and risk management. Of those who have done impact studies, two jurisdictions expect similar valuation results and two others expect lower liability value under IFRS 17. One jurisdiction expects increased liability value for certain life insurance products that offer higher guaranteed investment returns than current interest rates. The low interest rate environment prevalent in several economies may exacerbate the problem due to the lower rates at which an insurer's future cash flows are discounted.[14]

28. **Some supervisors expect less significant impact on non-life insurers.** It is generally expected that there will be little change in the accounting for short-term contracts that qualify for the simplified PAA (see Box 1). There may be more wide-ranging implications for long-term insurance business. Some supervisors expect life insurers' measured profitability to suffer under IFRS 17, which may place greater pressure on insurers to improve operating efficiency to reduce cost, potentially taking advantage of technology such as artificial intelligence.

Box 1

IFRS 17 and non-life insurers – impact likely to be less significant

Valuation results under the PAA are generally in line with the "unearned premium" approach. This approach is currently used in many jurisdictions under IFRS 4 for short-term, non-life insurance business (IASB (2018)). Revenue is recognised by allocating the expected premium over the coverage period. Accordingly, the IASB expects relatively little change in the accounting for short-term contracts that qualify for the simplified PAA (IASB (2017b)).

The PAA simplification applies to the liability for remaining coverage (LRC) only. The computation for the liability for incurred claims (LIC), to be determined using the general measurement model (GMM), can also be less complex because discounting is not required if claims are expected to be paid in one year or less from the date the claims were incurred. Overall, complexities arising from CSM calculations are removed, as CSM is not required under the PAA. Longer contracts may also be eligible for the PAA if the LRC under the PAA is not expected to differ materially from that if the GMM had been applied.

For those non-life insurers for which discounting is not a feature of existing accounting practice, the requirement to discount in determining the LIC will reduce insurance contract liabilities. A risk margin must be included in the LIC. If there are higher risk margins under IFRS 17 than under IFRS 4, this will increase insurance contract liabilities and reduce reported equity and vice versa. The combined impact of any reduction due to discounting and the impact of the requirement to include explicit risk margins will also depend on the level of risk margin currently held under IFRS 4.

In many emerging market economies, non-life insurance dominates the insurance market while life insurance often accounts for a smaller share with relatively simple products. The impact of IFRS 17 on insurance markets dominated by non-life insurance is therefore likely to be less significant than on those markets dominated by life insurance.

29. **In jurisdictions that do not use accounting standards as a basis for assessing insurer solvency, IFRS 17 could still impact insurers.** This could be a cause of concern, as supervisors in those jurisdictions may not be aware of the potential consequences for insurers and, ultimately, their policyholders. Without adequate preparation for and consideration of greater alignment between general purpose financial reporting and regulatory solvency reporting, the new accounting standard could adversely impact insurers through several channels: (i) conflicting financial position signals from multiple valuation bases, making it difficult for insurers to navigate their business; (ii) misaligned incentives influencing insurers' behaviour and business strategy that may not be in their best interest in the long term or in the interest of their policyholders; (iii) non-compliance with the accounting standard leading to

[14] For more information on how low interest rates could impact insurers and possible supervisory responses to address the problem, see Löfvendahl, G and J Yong (2017).

qualified audit statements, which in turn could trigger capital flight from the insurance industry; (iv) the high costs of maintaining multiple systems and sets of accounts being passed on to policyholders through higher premium rates; (v) ill-prepared insurers becoming outliers and losing their competitive edge; and (vi) increased operational risks due to system changes to comply with IFRS 17, which could also affect the preparation of solvency figures if insurers draw on the same underlying system for common data.

30. **Managers may be unable to meet objectives based on prudential measure benchmarks while at the same time meeting objectives regarding the level of accounting-based earnings.** Earnings are linked to the ability to declare dividends. It is important for a healthy insurance industry that companies are profitable, but profitability be based on economic measures of income and not arbitrary conservatism or excessive optimism in accounting estimates. Regulatory and accounting balance sheets that diverge significantly will complicate management decision-making about where to allocate capital to generate earnings under accounting or regulatory capital measures.

31. **Despite the benefits associated with the implementation of IFRS 17, there are risks from such a fundamental transformation of the economic measurement of insurers' businesses.** Accordingly, supervisors should be aware of how insurers and policyholders could be impacted even if regulatory frameworks do not rely on IFRS 17. Supervisors that undertake assessment of the standard's impact on insurers will be better prepared to assess any such implications.

32. **In general, insurers are not expected to change their business strategy significantly during the transitional period prior to the implementation date of IFRS 17.** In the year preceding the implementation date, insurers need to value their insurance contracts as though IFRS 17 had always applied. In practice, this could result in a significantly different profit profile of insurance products underwritten by insurers. Those products would have been designed and priced based on existing accounting standards, which could have allowed upfront or earlier profit recognition, unlike under IFRS 17. Nevertheless, most of the surveyed jurisdictions do not expect insurers to significantly change their business strategy during the transitional period. Insurers are likely to select approaches that will have the least financial and operational impact.

33. **In a few jurisdictions, insurers may need to review their asset-liability management strategy and the associated internal controls.** As a result, they could potentially shift their investments towards longer-duration assets to manage profit emergence, which will take longer. Some insurers could adjust their reinsurance arrangements to minimise accounting asymmetries that could arise due to differences in the valuation approach for reinsurance contracts held compared with the underlying insurance contracts.[15] From an operational perspective, insurers may start to fine-tune key performance indicators based on the new performance metrics under IFRS 17. The reason for this is that the traditional measure using premiums will no longer be a key feature as a performance metric in the statement of profit and loss under IFRS 17 and will only be secondary information available in the notes.

34. **While there may be short-term adverse implications for insurers' measured profitability, there could be a positive impact on the sustainability of their business model in the longer term as they discontinue economically unprofitable products that relied on upfront profit recognition.** Once IFRS 17 comes into force, insurers are likely to renegotiate contractual terms of certain types of insurance products and change their product range to maintain profitability targets. This is mainly driven by a significant change in how profits emerge under IFRS 17, the definition of the contract boundary, and improved disclosure and data availability to track the profitability of different groups of insurance policies. In general, any losses must be recognised upfront when a policy is underwritten, but profits should be

[15] The proposed amendments to IFRS 17 are expected to minimise any such accounting mismatch by allowing insurers to recognise income arising from the reinsurance contracts held to cover losses from the underlying insurance contracts.

recognised gradually as the insurance coverage is provided over the policy's duration. This effect is achieved through the CSM component of IFRS 17. Under previous accounting models allowed under IFRS 4, profit could emerge significantly on day one of recognition of the contract and more modest profit recognition in subsequent years.[16]

35. **From a market conduct perspective, IFRS 17 provides incentives to insurers that are in line with the regulatory objective of treating policyholders fairly.** Under certain accounting standards, an insurer may recognise profits upfront even though a policyholder may terminate the contract before it expires. This may not be fair to the policyholder, as the insurer has not provided insurance coverage beyond the termination date and yet is able to recognise profits for that period. Under IFRS 17, insurers will be incentivised to maintain insurance policies as long as possible, as they can only recognise profits as they emerge over the policy's duration.

36. **The impact of IFRS 17 on insurers' regulatory solvency position is unclear, regardless of whether the standard is used for prudential purposes.** In jurisdictions where insurance supervisors are considering using IFRS 17 for regulatory purposes, impact studies are planned or under way. One impact that is worth considering is the day-one transition impact on retained earnings and its effect on solvency where retained earnings are a key component of capital resources for an insurer or the insurance sector. In IFRS jurisdictions that will not use IFRS 17 for insurer solvency assessment, there could still be an impact to the extent any accounting metric is used in the capital adequacy framework. Given the significant change in how profits are measured under IFRS 17, this could have a significant impact on an insurer's capital resources and hence its overall solvency position. Some jurisdictions may mitigate this by recognising the CSM as capital resources.

37. **IFRS 17 is expected to contribute positively to enhancing insurers' enterprise risk management (ERM) frameworks mainly through stronger actuarial function and data governance controls.** As required under Insurance Core Principle 8 Risk Management and Internal Controls, insurers should establish actuarial functions to evaluate technical provisions or to undertake valuation of insurance contracts. Given that IFRS 17 is a principles-based standard, there will be heavy reliance on the accounting, auditing and actuarial professions to facilitate consistent implementation of the standard. In practice, this can be achieved through issuance of professional standards or guidance by the relevant bodies. The International Actuarial Association is developing International Actuarial Notes on IFRS 17 that will serve as educational material for actuaries.[17] IFRS 17 is also expected to prompt insurers to improve other aspects of their ERM frameworks, including the internal audit function and risk management function, and to enhance collaboration among various control functions.

Section 5 – Implementation challenges

38. **Supervisors in the surveyed jurisdictions saw IT changes, costs, and lack of actuarial and accounting expertise as the most challenging aspects of IFRS 17 implementation for insurers.** In particular:

- **On IT changes, the data needed to undertake the valuation of an insurance contract based on IFRS 17 may not be available or readily available in an insurer's IT system.** For example, IFRS 17 requires insurance contracts to be grouped according to their expected level of profitability when they first fall within the scope of the standard. Some policies may have been issued decades earlier, and the valuation basis may not have been adequately recorded.

[16] See IASB (2017a).

[17] See International Actuarial Association (2019a).

- **Costs can increase given the significant task of reconstructing history in order to satisfy the transition requirements of the standard (even if some changes to transitional arrangements could alleviate these).** In June 2020, the IASB agreed on some amendments to the transitional provisions that may provide some relief, but the economic consequences of choosing one of the new options will not be clear until companies analyse the options or conduct pilot studies. This further emphasises the progress that needs to be made in organising projects for the transition to IFRS 17 and conducting industry-wide impact studies.
- **The other implementation challenges cited by the surveyed supervisors stem from the lack of expertise with the standard.** These include difficulties in interpreting the standard, communicating the accounting results to certain parties such as the board of directors, and the short time frame for having the necessary infrastructure up and running. Some of the surveyed supervisors expect smaller insurers to face more challenges in implementing the standard.

39. **Given the principles-based nature of IFRS 17, there will be heavy reliance on professionals.** Professionals such as actuaries and accountants may be able to facilitate consistent implementation of the standard to achieve its objective of providing comparable financial results across insurers. In this context, the shortage of actuarial and accounting professionals, particularly in emerging market economies, constitutes a serious obstacle to the successful implementation of the standard.

40. **Actuarial and accounting professionals are bound by their technical and professional standards, which adds a layer of assurance to their work.** Without such safeguards, the financial results insurers report may be inaccurate (this may have already been an issue but will become more significant due to the complexities of IFRS 17). If the results serve as a basis for solvency assessment purposes, inaccuracies may impact supervisors' solvency assessments. Note that this is not a criticism of the standard, but an observation on the operational risks of getting the implementation of IFRS 17 wrong if fully qualified professionals are not engaged to assist with the transition. Although some of the surveyed supervisors acknowledged that professional actuarial and accounting standards can help promote consistent implementation of the standard, not many felt the need to provide additional regulatory guidance in these areas. This can be attributed to the fact that most of the surveyed supervisors think that existing oversight of actuaries, accountants and auditors is adequate.

41. **According to the surveyed supervisors, the most challenging technical aspects of IFRS 17 are the required level of aggregation of insurance contracts; the treatment of reinsurance contracts; and determination of contract boundary, discount rates and annual cohorts.** It is expected that the industry will build capacity and experience in these areas over time. There could be some uncertainty on these issues at the initial stage of implementation of the standard, which could lead to some volatility in the accounting results. Over time, practices are expected to become more stable and so will the reported financial statements.

42. **Supervisors can play a role in addressing the implementation challenges by encouraging insurers to start preparing early and engaging closely with the industry to better understand the issues.** Specific examples provided by the surveyed supervisors of such support include: (i) requiring insurers to provide pro forma financial statements; (ii) closely liaising with the national and international accounting standard setters to monitor discussions on the application and interpretation of the standard; (iii) regular monitoring of implementation progress, eg through industry surveys; (iv) organising industry roundtables to encourage the exchange of views on how to address common implementation challenges; (v) organising training for the industry, possibly in conjunction with the relevant professional actuarial or accounting bodies; and (vi) setting up a dedicated task force at the national level to answer queries from the industry.

43. **Consultation on adjustment of any regulatory requirements that are posing implementation challenges should occur as early in the transition phase as possible.** This will allow sufficient time for insurers to prepare themselves for implementation proper. However, some of the

surveyed jurisdictions did not think that it is the role of supervisors to help address implementation challenges.

Section 6 – Use of IFRS 17 for prudential frameworks

44. **Most regulatory regimes do not currently use inputs consistent with general purpose financial reporting standards, with or without modification, to assess the solvency of insurers.** Instead, insurers value their insurance liabilities based on specifications prescribed by insurance supervisors. The valuation requirements are typically prescriptive (more so than accounting standards) so as to achieve the prudential objective of enabling insurance supervisors to compare solvency positions across insurers. Current shortcomings under IFRS 4 and postponement of the implementation date of IFRS 17 could explain the continuation of such a regulatory approach. Interestingly, one of the surveyed jurisdictions only requires life insurers (and not non-life insurers) to use accounting standards for regulatory solvency purposes, while another jurisdiction uses the regulatory valuation results for financial reporting. Neither approach is common in practice.

45. **Despite the publication of IFRS 17, few of the surveyed jurisdictions plan to adopt it, with or without modification, for regulatory solvency purposes[18] (see Annex 5 for more detail).** Most of the surveyed jurisdictions do not see compelling reasons to change existing regulatory valuation requirements that have served prudential objectives well. Other reasons cited are presented in Table 3.

Reasons reported for maintaining existing valuation requirements — Table 3

Comparability	IFRS 17 is principles-based, which could result in non-comparable valuation practices on the part of insurers (although a stated objective of IFRS 17 is to enhance comparability of insurers' financial results). On the other hand, regulatory valuation requirements are more prescriptive so as to enable solvency comparison across insurers, which is a key prudential objective.
Stability	An insurer's solvency position should not change if its risk profile does not change. To achieve this objective, some regulatory frameworks do not require the use of updated valuation assumptions every year, unlike IFRS 17.
Differing objectives	Some supervisors regard the main purpose of IFRS 17 as serving as a measure of insurers' earnings performance and that it lacks the necessary prudential features, such as safeguarding policyholders' interests under a wide range of possible future circumstances.
Cost	Supervisors are not currently convinced that the benefits of transitioning regulatory valuation to IFRS 17 outweigh the costs.
Materiality	In jurisdictions where only a small number of insurers are subjected to IFRS, supervisors do not see the benefit of creating a whole different regulatory solvency system for one type of insurer. For instance, there may be both large listed insurers that apply IFRS and large mutual insurers that do not have to apply IFRS and will continue under local GAAP. Having two systems for competing insurers does not make sense to those supervisors, who see worth in a differentiated solvency valuation not linked to either set of accounting standards in that context.

Source: FSI and IMF staff based on responses to survey.

46. **A very small number of jurisdictions have decided to use IFRS 17 for regulatory solvency general purpose financial reporting.** Common reasons cited for this approach are to avoid potentially conflicting financial signals from multiple sets of financial statements and minimise cost to insurers. It is currently unclear if other jurisdictions will follow suit, even though some supervisors plan to review their

[18] At the time of publication, the IASB is consulting on a limited number of targeted amendments to the IFRS 17, which are not expected to change fundamental aspects of the standard.

existing regulatory approaches and may consider using IFRS 17 for solvency assessment. Some jurisdictions are likely to consider adopting IFRS 17 if larger jurisdictions do so, especially if the regulatory frameworks are similar. In the EU, there is currently no clear indication as to whether IFRS 17 will be adopted as an accounting standard. Even if it is adopted, the prevailing regulatory framework in the Union, Solvency II, currently specifies valuation requirements that are not based on IFRS. Those jurisdictions considering whether IFRS 17 should be the basis for their solvency valuation should consider the arguments set out in this paper by advocates and non-advocates of using IFRS 17. Two key points are to be borne in mind in this connection: is there a viable current solvency valuation framework distinct from current accounting standards and how comprehensive is the application of IFRS to insurers in the jurisdiction?

47. **Some jurisdictions are planning to use IFRS 17 as a starting point and modify the standard for regulatory solvency purposes.** Examples of components of IFRS 17 that may need to be modified include: (i) level of aggregation of insurance contracts; (ii) contract boundary; (iii) discount rates; (iv) risk adjustment; and (v) CSM. Some of the modifications are relatively straightforward (eg allowing only the bottom-up approach instead of choosing between bottom-up and top-down approach as permitted under IFRS 17 to determine discount rates).[19] Others are more significant (eg combining reinsurance with the underlying insurance contracts and valuing them together).

48. **Care should be exercised when comparing regulatory and accounting standards, as the level at which such a comparison is carried out may yield different conclusions.** Some supervisors view their regulatory valuation basis as being consistent with IFRS 17, albeit at a high level. This may well be the case, as most modern risk-based solvency frameworks will consist of the key components of IFRS 17 (ie contract boundary, current estimate, and margin over current estimate). However, the concept of contractual service margin would be less common. Drilling down to further details may reveal more divergences.

49. **The surveyed jurisdictions were divided on whether it is important for insurers to implement IFRS 17 so that financial positions are comparable across jurisdictions.** A concern among the surveyed jurisdictions is the principles-based nature of the standard that allows a wide range of accounting practices, which may lead to some differences in valuation results. On the other hand, an international standard such as IFRS 17 is usually principles-based in order to be adaptable to local markets, products and circumstances. Several jurisdictions (Australia, Canada, Chile, Korea, New Zealand and South Africa) plan to review their capital adequacy frameworks in response to IFRS 17. Table 4 sets out potential changes to regulatory requirements as a result of IFRS 17.

Potential changes to regulatory requirements — Table 4

Component	Examples of potential changes
Capital requirements for insurance risk	Revise risk-based capital factors that are applied to technical provision or earned premium measures. Move from factor-based to stress-based approach. Allow insurance contracts to be combined with reinsurance component.
Capital requirements for other risks	Change methodology to calculate market risk capital requirement.
Capital resources	Change to minimise potential industry-wide capital impacts. Make adjustments to reflect new way of calculating retained earnings.

Source: FSI and IMF staff based on responses to survey.

[19] In general, a bottom-up approach involves starting with the risk–free yield curve and adjusting the rates to reflect differences between the liquidity characteristics of the insurance contracts and the financial instruments underlying the rates. Alternatively, a top-down approach uses the yield curve that reflects market rates of return implicit in a fair value measurement of a reference portfolio of assets.

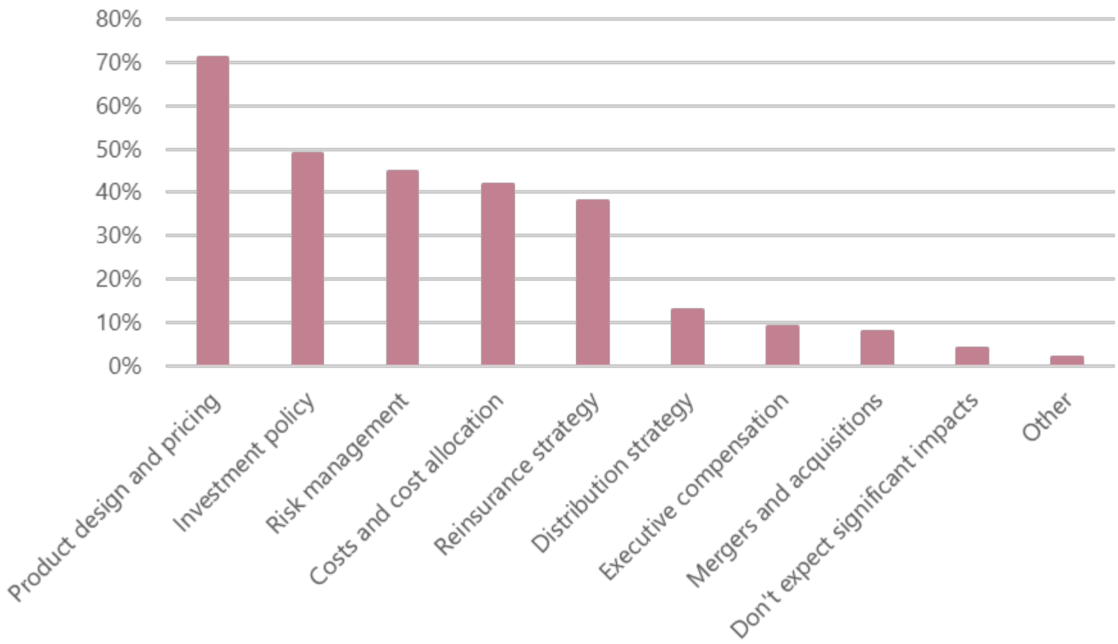
50. **Most supervisors follow two main guiding principles when reviewing capital adequacy frameworks in relation to IFRS 17.** These principles are: (i) provide the right incentives to insurers to manage risks properly; and (ii) achieve appropriate prudential outcomes in terms of policyholder protection. Factors considered by supervisors to a lesser extent are maintaining conceptual consistency, minimising the regulatory burden on insurers and maintaining a consistent level of overall industry capitalisation are factors to consider. One of the surveyed jurisdictions mentioned that adherence to the Insurance Core Principles and maintaining equivalence with other solvency regimes are also important considerations.

Section 7 – Regulatory and supervisory implications

51. **Most of the surveyed jurisdictions expect that IFRS 17 will contribute positively to financial stability.** Some jurisdictions have not established a view on this, while several smaller jurisdictions expect no positive or negative impact on financial stability. The IASB (2017c) expects that improved transparency will contribute positively to financial stability by making useful information available to enable the relevant parties, including insurance supervisors, to take appropriate actions in a timely manner. More specifically, IFRS 17 can contribute positively to financial stability in the following ways (in order of consensus among the surveyed jurisdictions): (i) allows investors to judge the performance of an insurer more easily; (ii) provides better information on profitability trends and enables immediate recognition of an insurer's losses; (iii) provides proper and regularly updated measurement of insurance liabilities, including the cost of options and guarantees; (iv) ends upfront profit-taking and revenue recognition; and (v) provides comparable financial information on insurers reporting on an IFRS basis within and across jurisdictions.

52. **Views of supervisors are mixed on the potential impact of IFRS 17 on policyholders, ranging from no material impact to higher premiums and withdrawal of certain product types.** Some supervisors expect insurers to change their product range due to the technicalities of IFRS 17. For example, IFRS 17 requires insurers to separately identify portfolios of insurance contracts that are managed together and bear similar risks. Within each portfolio, insurers should group contracts according to their expected level of profitability. The valuation is then conducted on each group of contracts. Crucially, contracts issued more than a year apart should not be included in the same group. This could require a significant change in the way insurers design and price their products. For instance, life insurers typically price their products by spreading fixed expenses across different generations of policyholders to be able to offer competitively priced policies. They may need to change such a pricing approach to reflect the constraints imposed by IFRS 17. Products that rely heavily on cross-subsidisation between different generations of policyholders (eg participating or with-profits contracts) may need to be redesigned or repriced to fit within the IFRS 17 framework. Figure 5 shows the results of an industry study on the business areas that are expected to be impacted the most by IFRS 17.

Figure 5: Potential impact of IFRS 17 on business areas – proportion of times selected in the top four



Source: KPMG (2018).

53. **Supervisors may need to revise their supervisory reporting requirements on account of IFRS 17 and, correspondingly, the financial indicators or ratios derived from such reporting.** This is due to the new performance and profitability measures introduced through IFRS 17, which will no longer provide the explicit information on premium income that is available from the existing financial indicators used by supervisors. One of the surveyed supervisors plans to review the expected values of insurance contracts as reported under IFRS 17 against actual materialisation of profit or loss. Most of the surveyed supervisors are still in the process of reviewing which new financial indicators to introduce or which existing indicators need to be revised; see eg APRA (2019). Besides supervisory reporting, a few of the surveyed jurisdictions expect changes to requirements on own risk and solvency assessment, and stress testing, as well as supervisory risk rating frameworks.

54. **IFRS 17 disclosure is expected to provide new sets of information that will be useful for supervisory monitoring of insurers.** Table 5 provides examples of new indicators that will be available through IFRS 17 disclosure. IASB (2017c) outlines a mapping of current indicators to the new indicators that will be reported under IFRS 17.

Examples of new indicators or indicators modified by revised inputs from IFRS 17 reporting

Table 5

Measure	Indicator
Profitability and ongoing viability of business	Insurance service expense, insurance finance income or expense, CSM
Accessibility to capital markets	Return on equity, combined ratio, operating margin
Growth and market share potential	Present value of future cash flows

Source: FSI and IMF staff based on responses to survey.

55. **To alleviate the complexities of IFRS 17, a small number of the surveyed supervisors are planning to allow a proportionate application of the standard by certain insurers.** The PAA under IFRS 17 is cited as an example of a possible simplification, as it removes the complexity arising from

discounting future cash flows and calculating the CSM. Although under IFRS 17 the PAA is only allowed for certain short-term contracts, supervisors in a small number of jurisdictions may broaden the scope and allow this approach for smaller insurers with less risky business models and simpler products.

Section 8 – Concluding remarks

56. **IFRS 17 is expected to bring positive benefits to the insurance industry in the long term as well as to financial stability.** However, there will be significant implementation and upfront costs. Improved transparency will contribute positively to financial stability by making useful information available to enable the relevant parties, including insurance supervisors, to take appropriate actions in a timely manner. Implementation of the standard can also enhance insurers' ERM frameworks and better align insurers' financial reporting with policyholders' interest by ensuring that profit recognition matches insurance service provision. While the positive aspects of IFRS 17 cited in this paper are the broad conclusions of the survey conducted, it must be noted that not all supervisors share these views and some either do not see any benefits or see more muted benefits due to the range of different practices within the application of IFRS 17.

57. **More work needs to be done to fully understand the potential impact of IFRS 17, the most significant development in the insurance industry in recent years.** This standard may well be a game-changer in the insurance industry, affecting a range of business activities from product offerings and pricing to solvency of insurers. Without undertaking quantitative impact studies of the standard, it will be impossible for supervisors to understand how the financials of their insurers may change and the corresponding impact on their measured solvency.

58. **The prudential implications of IFRS 17 need to be fully appreciated, regardless of whether regulatory frameworks use the accounting standard to assess the solvency of insurers.** Independently of whether a regulatory regime relies (or plans to rely) on the standard for solvency purposes, insurers and policyholders will be affected by the standard. Failure to understand its potential implications could limit the ability of supervisors to react effectively.

59. **New accounting standards will not be the top priority for insurance supervisors or insurers during the Covid-19 pandemic.** However, the 2023 implementation date is looming. Supervisors and insurers can only afford to give a lower priority to the implementation of IFRS 17 and IFRS 9 for a short period. Initial impact analysis should start no later than the end of 2020 or beginning of 2021.

60. **There is likely to be a wide range of regulatory approaches to the use of IFRS 17 or other accounting standards for insurance contracts for regulatory solvency purposes.** There are reasons for the different regulatory approaches. Nevertheless, supervisors should satisfy themselves that the cost of a separate regulatory approach does indeed outweigh the benefits of using a single valuation basis for solvency assessment purposes and general purpose financial reporting. New or developing risk-based regulatory regimes have more scope to seize the opportunity of basing their solvency framework on accounting standards. If IFRS 17 is to be used for regulatory solvency purposes, further consideration should be given to achieving the desired comparability of results and addressing the unintended consequences that could arise from volatility of solvency results.

61. **Those jurisdictions that are not currently intending to implement IFRS 17 for regulatory solvency purposes should reconsider this position, in the medium term, after gaining some experience with IFRS 17.** Most solvency systems are reviewed periodically, and that may provide an opportunity for alignment between regulatory solvency valuation and general purpose financial reporting. This would have the benefit of reducing the number of accounting systems that insurers need to maintain and any confusion between outcomes of regulatory solvency systems and general purpose financial reporting.

62. **One way forward would be to specify aspects of IFRS 17 implementation where currently a wide range of techniques and inputs may be used.** The specification could mirror what is provided in current regulatory valuation approaches (eg specified discount rate methodologies or published discount curves could be applied in the IFRS 17 context). This may also lead to a consistent implementation of IFRS 17 within jurisdictions to the benefit of all stakeholders.

63. **Greater specification of the techniques and inputs to be used in IFRS 17 for regulatory solvency purposes should be developed through global coordination to avoid local versions of IFRS 17 being created.** Significant regional and global consultation with the insurance industry, professional bodies, investor stakeholders and consumer groups would be required to achieve this outcome. Jurisdictions with insurance groups that have considerable business outside their borders may find merit in coming together to work on such a project. Such jurisdictions would derive the most benefit from a globally consistent approach to regulatory solvency calculation within IFRS jurisdictions and more consistency of general purpose financial reporting.

Glossary

CSM	contractual service margin
ERM	enterprise risk management
EU	European Union
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GMM	general measurement model
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standard(s)
IT	information technology
LIC	liability for incurred claims
LRC	liability for remaining coverage
MCR	minimum capital requirement
NAIC	National Association of Insurance Commissioners
PAA	Premium Allocation Approach
SAP	Statutory Accounting Principles

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Annex 1 – List of supervisors that participated in the survey and the abbreviations used to represent them

1. Australian Prudential Regulation Authority (AUS)
2. Central Bank of Malaysia (MYS)
3. Bermuda Monetary Authority (BMA)
4. Comisión para el Mercado Financiero, Chile (CHL)
5. Dubai Financial Services Authority (DUB)
6. Federal Financial Supervisory Authority (BaFin), Germany (DEU)
7. French Prudential Supervision and Resolution Authority (ACPR), France (FRA)
8. Insurance Authority, Hong Kong SAR (HKG)
9. Insurance Supervision Agency, Slovenia (SVN)
10. Istituto per la Vigilanza sulle Assicurazioni, Italy (ITA)
11. Financial Services Agency, Japan (JPN)
12. Financial Supervisory Service and Financial Services Commission, Korea (KOR)
13. Monetary Authority of Singapore (SGP)
14. National Association of Insurance Commissioners, United States (USA)
15. National Bank of Slovakia (SVK)
16. Office of the Superintendent of Financial Institutions, Canada (CAN)
17. Prudential Authority, South Africa (ZAF)
18. Prudential Regulation Authority, United Kingdom
19. Reserve Bank of New Zealand (NZL)
20. Swiss Financial Market Supervisory Authority

Annex 2 – Comparison of US GAAP targeted improvements (ASU 2018–12) with IFRS 17[20]

After a public consultation in 2007, the FASB pursued a joint project with the IASB to review the accounting for insurance contracts. In February 2014, rather than continuing to work with the IASB on a new accounting model, the FASB instead decided to focus its efforts on making targeted improvements to its US GAAP insurance accounting model. On 15 August 2018, the FASB issued an Accounting Standards Update, ASU 2018–12, intended to address shortcomings in financial reporting for insurance companies that issue certain long-duration contracts. Three of the main shortcomings of the FASB's current accounting model are:

- the current use of locked-in assumptions about non-participating traditional and limited-payment long-duration contracts;
- non-market-based approaches to valuation of market-based benefits of long-duration contracts that expose the insurer to capital market risk; and
- under the existing FASB standard, the limited requirements to disclose information about long-duration contracts.

The 2018 update from the FASB addresses these shortcomings. It does so by incorporating updated current cash flow assumptions and discount rates in measuring insurance liabilities for certain long-duration contracts; a market-based approach to determining the value of options and guarantees; and more extensive note disclosures. Insurers' financial statements prepared under IFRS 17 and those under the updated requirements of ASU 2018–12 are expected to better reflect economic reality and more faithfully represent the true underlying financial position and performance of insurance contracts. Table 6 compares key features of the US GAAP targeted improvements for long-duration contracts with the requirements of IFRS 17.

Comparison of key features of the US GAAP targeted improvements for long-duration contracts with the requirements of IFRS 17 — Table 6

Item	US GAAP	IFRS 17
1. Implementation date	Fiscal years beginning after: • 15 December 2022 for public business entities • 15 December 2024 for other entities Early adoption is permitted.	Annual periods beginning on or after January 2023. Early adoption is permitted once IFRS 9 and IFRS 15 have been implemented.
2. Scope	Applicable to all insurance entities that issue long-duration contracts such as traditional and limited-payment life, universal life and annuity, participating contracts and market risk benefits. (A market risk benefit is defined as a contract or contract feature in a long-duration contract issued by an insurance entity that both protects the contract holder from other-than-nominal capital market risk and exposes the insurance	Applicable to insurance contracts issued, reinsurance contracts issued, and reinsurance contracts held whether or not by an insurance entity. Investment contracts with discretionary participation features are also covered by IFRS17 if the entity also issues insurance contracts.

[20] See FASB (2018)

	entity to other-than-nominal capital market risk.)	
3. Level of aggregation Under the existing FASB standard, to determine if a premium deficiency exists, insurance contracts are to be grouped consistent with the entity's manner of acquiring, servicing and measuring the profitability of its insurance contracts.	Under the update, when an insurer measures the liability for future policy benefits related to non-participating traditional and limited-payment long-duration contracts, insurers may group contracts issued in the same quarter or year but may not group contracts from different issue years.	The level of aggregation under IFRS 17 deals with grouping of individual insurance contracts for the purposes of recognising losses when a group of contracts is onerous and impacts the timing of profits arising from a group of profitable contracts. Profits from one group may not offset losses from another group. A portfolio comprises contracts subject to similar risks and managed together. IFRS 17 subdivides each portfolio into groups of (i) contracts onerous at initial recognition, if any; (ii) contracts at initial recognition having no significant possibility of becoming onerous subsequently, if any; and (iii) remaining contracts in the portfolio, if any. Contracts issued more than one year apart shall not be included in the same group.
4. Measurement model	For non-participating traditional and limited-payment long-duration contracts, the net premium model will continue to be used to measure the liability for future policyholder benefits. Under this model, an insurer computes a net premium ratio (which is computed as the present value of insurance contract benefits and expenses divided by the present value of gross premiums) and uses that ratio to compute the liability for future policy benefits.	Gross premiums are included in the fulfilment cash flows.
a. Cash flow assumptions Under the existing FASB standard, original cash flow assumptions used to measure the liability for future policy benefits are locked at contract inception and held constant over the term of the contract. The liability includes a provision for risk of adverse deviation, and assumptions are unlocked if a premium deficiency arises.	For non-participating traditional and limited-payment long-duration contracts, best estimate future cash flows based on updated assumptions (reviewed at least annually in the same period each year) are to be used.	Unbiased estimates of expected future cash flows arising as the entity fulfils its obligations based on current assumptions (reviewed each reporting period) are to be used.

b. For non-participating traditional and limited-payment long-duration contracts: • upper-medium grade (low-credit risk) fixed income instrument yield that maximises the use of current market observable inputs and reflects the duration characteristics of the liability • rates to be updated each reporting period.	For non-participating traditional and limited-payment long-duration contracts: • upper-medium grade (low-credit risk) fixed income instrument yield that maximises the use of current market observable inputs and reflects the duration characteristics of the liability • rates to be updated each reporting period.	Current market-consistent discount rates that reflect the time value of money (risk-free), the characteristics of the cash flows and excluding factors that are not relevant to the liability, eg market and credit risk. Rates to be updated each reporting period.
c. Risk margin	No explicit risk margin.	Explicit adjustment for non-financial risk.*
d. Market risk benefits Under the existing FASB standard, certain market-based options or guarantees associated with deposit (or account balance) contracts share common risk characteristics that expose an insurance entity to capital market risk, but two different measurement models exist (a fair value model and an insurance accrual model).	Market risk benefits such as variable contract guarantees are to be measured at fair value, including risk margins.	Embedded options and guarantees** are included in the measurement of the fulfilment cash flows and valued in a way that is consistent with observable market prices (if any) for such options and guarantees.
e. Unearned profits	Included in the present value of the difference between the gross and net premiums.	Represented by the contractual service margin (CSM). The initial CSM is the amount needed to prevent recognition of profit at contract inception.
f. Acquisition expenses Under the existing FASB standard, multiple amortisation methods exist, some of which are complex and require numerous inputs and assumptions.	The update simplifies the amortisation of deferred acquisition costs. Acquisition expenses are to be explicitly deferred and amortised on a constant-level basis over the expected term of the related contracts. Acquisition costs are those that are related directly to the successful acquisition of new or renewal insurance contracts.	Included in fulfilment cash flows, thereby reducing the CSM and implicitly deferred. Acquisition expenses included must be directly attributable to the portfolio of contracts to which a group belongs.***
5. Profit recognition	The net premium model results in profits recognised as a level percentage of premiums over the life of the contracts. For limited payment contracts, profits are recognised in a constant relationship with the insurance in force for life insurance contracts or with the amount of expected future benefit payments for annuity contracts. No profit is recognised at contract inception.	Profit is recognised from a group of insurance contracts over the period the entity provides insurance cover,**** and as the entity provides insurance services. If a group of contracts is or becomes loss-making, the loss must be recognised immediately. No profit is recognised at contract inception.
6. Onerous contracts	The net premium ratio is limited to 100%, so that premium deficiency testing is no longer needed for non-participating traditional and limited-payment contracts. Loss recognition testing continues to be applicable for	If a group of contracts is loss-making, which means that the CSM of the group has been calculated to be negative, whether at inception or

	universal life-type contracts. Under these approaches, losses are recognised immediately.	subsequently, then the loss must be recognised immediately.
7. Impact of assumption changes – non-financial assumptions	Net premiums as of contract inception are recalculated at least annually (more frequently, if warranted) based on updated future cash flow assumptions (while including actual historical cash flows). The revised net premiums are used along with the updated future cash flow assumptions to derive an updated liability for future policy benefits. Insurers will recognise a portion of the effect related to prior periods as a cumulative catch-up adjustment in income and a portion of the effect of the assumption changes in future periods.	After initial recognition, the impact on the present value of fulfilment cash flows of updates to non-financial assumptions does not entirely affect the total liability or profit and loss (unless the assumption changes render the group of insurance contracts onerous). This is because there is an offsetting adjustment to any CSM balance forming part of the total liability.
8. Impact of assumption changes – financial assumptions	The impact of updating the discount rate assumption is to be recognised immediately in other comprehensive income.	Changes in the time value of money and changes in financial risk, included in insurance finance income or expenses, may be recognised in profit or loss or other comprehensive income under certain circumstances. The choice of approach by the entity generally corresponds to the treatment of backing investments in order to minimise accounting mismatches.
9. Transition	Measurement of the liability for future policyholder benefits and deferred acquisition cost is required to be applied on a modified retrospective basis to contracts in force as of the beginning of the earliest period presented, with the option of electing a retrospective application. Measurement of market risk benefits is required to be applied retrospectively.	Full retrospective application is required unless impracticable. If and only if full retrospective application is impracticable, either a modified retrospective approach or a fair value approach may be used. The choice between the modified retrospective and fair value approaches is made for each group of insurance contracts for which it is impracticable to apply the full retrospective approach. However, if an entity cannot obtain reasonable and supportable information to apply the modified retrospective approach, it must use the fair value approach (which provides that the entity must maximise the use of information that would have been used to apply a fully retrospective approach, but need only use information available without undue cost or effort. The purpose is to determine the CSM to be included in insurance contract liabilities at transition.
10. Revenue recognition	Under US GAAP, for traditional long-duration contracts, premiums are recognised as revenue over the premium-paying periods of the contracts when due from	Accounting for deposits and premiums on insurance contracts will be done in the same manner as for bank deposits, ie they will be treated

	policyholders. This remains unchanged by the update.	as an item of cash flow and not revenue. Insurance revenue is recognised as the entity satisfies its obligation to provide insurance coverage under its contracts. Insurance revenue excludes any investment components (the amounts that an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur) and is the consideration to which the entity expects to be entitled in exchange for insurance services.
11. Presentation and disclosure Under the existing FASB standard, there are limited requirements to disclose information about long-duration contracts.	More granular and enhanced note disclosures such as: • roll-forwards of beginning to ending balances of the liability for future policy benefits, policyholder account balances, market risk benefits, separate account liabilities, and deferred acquisition costs • significant inputs, judgments, assumptions, and methods used in measurement, including changes in those inputs, judgments and assumptions, and the effect of those changes on measurement.	Profit or loss from underwriting activities (Insurance Service Result) will be reported separately from financing activities (Net Financial Result). Extensive and granular note disclosures covering items such as: • detailed reconciliations of the opening and closing balances of the present value of future fulfilment cash flows, risk adjustment and contractual service margin • management's judgments and changes in these judgments, including inputs, assumptions and estimation techniques.

* Risk adjustment for non-financial risk is aimed at reflecting the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.

** Includes derivatives that have not been separated from the host insurance contract (after applying IFRS 9).

*** A proposed amendment would allow an insurer to allocate, on a systematic and rational basis, insurance acquisition cash flows that are directly attributable to a group of insurance contracts: (i) to that group; and (ii) to any groups that include contracts that are expected to arise from renewals of the contracts in that group.

**** Allocation of the CSM based on a unit of service determines the year-by-year pattern of recognition of profits. No day-one gains. The allocation is revised for remaining CSM as the expectations for the pattern of service are updated.

Source: IMF staff.

Annex 3 – Differences between IFRS 17 and IFRS 4

This Annex lists the key differences that the surveyed jurisdictions expect between the current accounting standard for insurance contracts, IFRS 4, compared with IFRS 17.

Level of aggregation

This is one of the most significant changes between the two standards. This is because currently, in most of the surveyed jurisdictions, there is no such requirement and the valuation is mostly undertaken at the individual contract level. In some jurisdictions, current accounting standards require insurers to group policies based on their risk profiles rather than profitability as required under IFRS 17. It is expected that insurers will need to segment their insurance contracts into more categories than currently.

Use of premium allocation approach for contracts of one year or less

Some life insurers are expected to use the premium allocation approach for their short-term business, but it is not expected to result in significantly different valuation than the current approach. The main difference is that, under IFRS 17, insurers need to fulfil the specified criteria before they can use this approach to value eligible insurance contracts. Only one of the surveyed jurisdictions stated that none of its life insurers will use the premium allocation approach. Most of the surveyed jurisdictions expect non-life insurers to use the premium allocation approach for the majority of contracts that they underwrite. They do not expect material differences in the accounting results compared with the existing approach.

Scope of application

In most jurisdictions, the definition of an insurance contract is largely the same under IFRS 17 and IFRS 4. That being the case, the scope of application of IFRS 17 is not expected to be significantly different. Examples of contracts underwritten by life insurers currently accounted for under IFRS 4 but not to be included under IFRS 17 are fixed fee service contracts, unbundled service contracts and pension contracts. In one jurisdiction, it is likely that more unit-linked contracts will be captured under IFRS 17. For non-life insurers, the scope of application is expected to remain broadly the same.

Current estimates – general

There is currently some form of current estimate component in most jurisdictions. For life insurers, differences include existing prescription of discount rates and mortality rates (effectively requiring historical, instead of current, information to be used), treatment of discretionary benefits, implicit risk margins, and mechanism to smooth release of future profits. The way current estimate is disclosed under IFRS 17 may be different, mainly due to the introduction of the contractual service margin. For non-life insurers, the liability adequacy test currently required in a few jurisdictions effectively introduces the concept of current estimate in the valuation of non-life contracts.

Current estimates – future cash flows

No major differences expected. For life insurers, differences arise from timing of revenue recognition, explicit allowance for surrenders, future attribution of discretionary benefits, explicit allowance for expenses, and allowance of tax treatment. For non-life insurers, differences are mainly due to a wider range of cash flows that will be captured under IFRS 17, eg future expense cash flows.

Current estimates – discount rate

There could be significant differences, as some jurisdictions currently require life insurers to use risk-free rates or place limits on reference to risk-free rates. At the other extreme, in certain jurisdictions, life insurers currently use yields of their existing assets to determine the discount rates without adjusting for characteristics that are not reflective of the insurance obligations. In a few of the surveyed jurisdictions, non-life insurers currently do not apply discounting. In several other jurisdictions, similar requirements for life insurers using risk-free rates also apply to non-life insurers.

Current estimates – other material differences

Other material differences include different ways to assess loss recognition, disallowance of negative technical provision, minimum value based on contractual surrender value, recognition of acquisition costs and treatment of reinsurance.

Risk adjustment for non-financial risk

Although this is not currently an explicit requirement in most jurisdictions, it is not expected to have significant impact because of hidden conservativism in current valuation approaches that effectively achieves the same result as a risk adjustment. In some jurisdictions, no difference is expected as the concept currently applies.

Contractual service margin

This is a new concept in most jurisdictions and could have significant impact, especially during transition and in terms of profit emergence patterns. However, existing hidden conservatism may already partially achieve similar effects, which may lessen the impact of the introduction of a contractual service margin. Moreover, in certain jurisdictions, day-one profit is currently not recognised, which achieves a similar effect at initial recognition.

Subsequent measurement and profit recognition

Not a concept in current accounting approaches. Currently, in most jurisdictions, any profit or loss due to valuation assumption changes is recognised immediately, instead of the more controlled way profit emerges under IFRS 17.

Contract boundary

The criteria will most likely differ, which could have significant impact due to different capture of future cash flows. In some jurisdictions, expected future premiums currently excluded may be captured under IFRS 17.

Annex 4 – Approaches to transposing IFRS into local standards

Regulatory approaches to the use of accounting standards for prudential purposes — Table 7

Approach	Jurisdiction
IFRS text is directly copied into jurisdictional law	CAN, DEU, KOR, SVK, SVN, ZAF
IFRS text is directly copied into jurisdictional professional accounting standards	HKG, KOR, MYS, ZAF
IFRS forms the basis of legal accounting standards but modifications are made for jurisdictional context	AUS, NZL, SGP
Professional actuarial standards are drafted based on IFRS but do not use identical text	SVK
Not directly adopted as IFRS is only permitted but not required for some entities	JPN

Source: FSI and IMF staff based on responses to survey.

Annex 5 – Regulatory approaches to the use of accounting standards for prudential purposes

Regulatory approaches to the use of accounting standards for prudential purposes — Table 8

Use of IFRS for public financial reporting	Jurisdiction	Use of IFRS for prudential solvency reporting*	Planned use of IFRS 17 for valuation of insurance liabilities for regulatory solvency purposes
Required for all insurance companies	AUS	Yes	Will continue to use general purpose accounting standards for prudential reporting (with some regulatory adjustments).
	CAN	Yes	Will continue to use general purpose accounting standards for prudential reporting.
	CHL	Yes	Will continue to use total or partial application of general purpose accounting standards, depending on impact assessment results.
	DUB	Yes	Will continue to use general purpose accounting standards for prudential reporting.
	HKG	No	Will continue to specify supervisory method.
	KOR	No	Will change and adopt the Market-Adjusted Valuation (MAV) approach, consistent with Solvency II and global insurance capital standard (ICS).
	NZL	Yes	Not yet decided. Modification of some IFRS 17 items is likely, however, given that solvency has a risk focus rather than a performance reporting focus.
	SGP	No	Will continue to specify supervisory method.
	SVK	No	Solvency II.**
	SVN	No	Solvency II.
	ZAF	No	Will continue to specify supervisory method, but in future may consider incorporating IFRS 17 methods.
Permitted but not required for any insurance legal entities	BMU	No	Will continue to specify supervisory method.
Required for publicly listed insurance companies	FRA	No	Solvency II.
	DEU	No	Solvency II.
	ITA	No	Solvency II.
Permitted but not required for publicly listed insurance companies	JPN	No	Will continue to specify supervisory method.
Permitted but not required for foreign-owned insurance subsidiaries and branches only	USA	No	Will continue to specify supervisory method.

* "Yes" may include prudential adjustments application. "No" means not permitted or not required.

** Solvency II, implemented in 2016 before finalisation of IFRS 17, is mandatory under EU law and is not within the remit of individual prudential regulators to change. Any changes will depend upon the review of the regulation.

Source: FSI and IMF staff based on responses to survey.