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.