TC NOTES

PRACTICAL **LEADERSHIP** AND **GUIDANCE** FROM **TORONTO CENTRE**

IFRS 17 INSURANCE CONTRACTS – WHAT SUPERVISORS NEED TO KNOW

UPDATED VERSION

NOVEMBER 2020

TORONTOCENTRE
Global Leadership in Financial Supervision

Global Affairs Canada
Affaires mondiales Canada

INTERNATIONAL MONETARY FUND

Sida
SWEDISH INTERNATIONAL DEVELOPMENT COOPERATION AGENCY

IFRS 17 INSURANCE CONTRACTS – WHAT SUPERVISORS NEED TO KNOW

UPDATED VERSION

TABLE OF CONTENTS

IFRS 17 INSURANCE CONTRACTS – WHAT SUPERVISORS NEED TO KNOW

UPDATED VERSION

Introduction[1]

After 20 years in development, the International Accounting Standards Board[2] issued a new Insurance Accounting Standard, IFRS 17 Insurance Contracts[3] (IFRS 17/the Standard) in May 2017. Subsequently, in June 2020, after a period of consultation, the IASB issued various amendments to IFRS 17.[4] The amendments were in response to concerns and implementation challenges raised by stakeholders. The amendments did not change the underlying principles of the standard and the benefits of IFRS 17 are unaffected. In a concession to the industry, and to increase the likelihood of contemporaneous global adoption, including by the European Union (EU), one of the amendments is to defer the original effective date for two years. Entities are therefore required to apply IFRS 17 and IFRS 9 for annual reporting periods beginning on or after January 1, 2023. Early adoption is permitted.

Now that the amendments have been finalized, insurers can continue with their implementation projects with certainty about the requirements of the Standard. IFRS 17 is a significant change to insurance accounting, requiring insurers to revamp financial reporting practices and financial statements. Furthermore, many insurers will be adopting IFRS 9 Financial Instruments at the same time. Life insurers will be particularly affected by changes to how profits are recognized and additional operational complexity around data systems and processes.

This updated Toronto Centre Note covers the amendments to IFRS 17 issued in June 2020 (see Appendix 1) and the plans that insurance supervisors need to develop and implement to facilitate a smooth transition to IFRS 17. It is based upon the final Standard as amended and a review of publicly-available resources to glean the insights of insurers and professionals involved in the implementation of IFRS 17. This Note discusses:

- how the key features of the Standard have been designed to meet the IASB's objectives;
- the potential implications for insurers applying IFRS 17;
- considerations of the adoption of IFRS 17 for regulatory and supervisory purposes based on the guidance of the Insurance Core Principles (ICPs) of the IAIS[5]; and
- the need for supervisors to understand the impact and steps to ensure preparedness and adequate supervisory oversight of transition and implementation.

---

[1] This Note was prepared by Michelle Chong Tai-Bell. It replaces an earlier version published in October 2018.

[2] The IASB is the standard-setting arm of the IFRS Foundation, a not-for profit, public interest organization with a constitutional objective "to develop, in the public interest, a single set of high-quality, understandable, enforceable, and globally accepted financial reporting standards based upon clearly articulated principles." The IASB seeks to do this by promoting the convergence of national accounting standards and IFRS and the use and rigorous application of those standards.

[3] IASB Foundation (2018).

[4] IASB Foundation (2020).

[5] International Association of Insurance Supervisors (2020).

Origins of IFRS 17

Since the global financial crisis, there has been a focus on policy measures to ensure stability of the global financial system. The Financial Stability Board (FSB) has been coordinating the development of policy measures to address systemic and moral hazard risks associated with systemically important financial institutions.

Among the objectives promoted by the FSB was a single set of high-quality global accounting standards[6] and closer collaboration between the International Accounting Standards Board and the US Financial Accounting Standards Board (FASB). Accordingly, high-priority IASB work streams included new accounting standards for expected loss and the completion of a consistent approach to the accounting for insurance contracts. These priorities culminated in the IASB's issuance of IFRS 9 Financial Instruments in July 2014, with a mandatory effective date of January 1, 2018, and subsequently IFRS 17 Insurance Contracts[7] in May 2017, effective for annual reporting periods beginning on or after January 1, 2021 (subsequently amended to 2023).

The IMF's October 2017 Global Financial Stability Report[8] reinforced the need for additional policy focus on the insurance sector, stating that "risk assessment in the insurance sector suffers from opaque and heterogeneous financial disclosure and deficiencies in the accounting and regulatory regimes." The IMF recommended that "policymakers must continue to strengthen regulatory frameworks and increase reporting transparency."

The previous standard, IFRS 4, allowed insurance companies and national and multi-national insurance groups to continue to use national accounting standards for insurance contracts. These national standards differed in principle, application, and outcome, so IFRS 4 allowed multi-nationals to consolidate using multiple accounting standards within the same set of financial statements. Also, many jurisdictions prescribed different accounting standards for regulatory reporting.

IFRS 17 is a major step forward. It improves comparability by introducing a consistent approach to all insurance contracts in jurisdictions applying IFRS. Relevance will be enhanced by measurement of insurance obligations using current values, updated regularly. The line item "change in reserves" or "change in technical provisions" will not be shown in the profit and loss/income statement. Instead, constituent elements will be used to compute and disclose profit or loss from underwriting activities (insurance service result) separately from financing activities (net financial result). Extensive note disclosures will improve transparency and help users better understand trends in profitability, changes in financial position, risk impacts, and the basis for significant judgments and changes in those judgments.

---

6 Financial Stability Board (2015).
7 Financial Stability Board (2017).
8 International Monetary Fund (2017).

Objectives of IFRS 17 and how to meet them

An IFRS reporting entity must apply IFRS 17 to insurance contracts issued, reinsurance contracts issued, and reinsurance contracts held. Investment contracts with discretionary participation features are also covered by the Standard if the entity issues insurance contracts. IFRS 17 has been designed to provide more useful financial information to intended users by meeting the following objectives:

- Improve global comparability
- Relevance
- Comparability with other industries
- Transparency and understandability

Improve global comparability

IFRS 17 will provide more consistent information, allowing users to compare results and trends with those of other insurers and industries in IFRS jurisdictions. This is achieved by the use of a consistent measurement model – the general model – for accounting for all insurance contracts issued (with simplification[9] for certain short-term contracts and modification for contracts with discretionary participation features[10]). The measurement model is applicable to all entities within a group on consolidation.

Relevance

The Standard should help to ensure that the financial information presented by an entity is relevant and faithfully represents the true underlying financial position and performance from its insurance contracts:

- The general model recognizes and measures groups of insurance contracts at a risk-adjusted[11] present value of fulfilment cash flows, in a manner incorporating consistent market information plus the contractual service margin (CSM). The CSM is the unearned profit in the group of contracts[12] and is included in the insurance contract liability.
- Regularly-updated unbiased estimates of fulfilment cash flows are to be used. The unbiased estimates are to be based on the probability-weighted mean of the full range of possible outcomes, considering available reasonable and supportable information. Updating of estimates based on more relevant current information, rather than using dated locked-in historical assumptions, achieves more relevance.

[9] Premium Allocation Approach.
[10] Variable Fee Approach.
[11] IFRS 17 Basis for Conclusions: "IFRS 17 requires the risk adjustment for non-financial risk to reflect 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."
[12] IFRS 17 Basis for Conclusions: the CSM is "the excess of the consideration charged for a group of insurance contracts over the risk-adjusted expected present value of the cash outflows expected to fulfil the group of contracts and any insurance acquisition cash flows incurred before the recognition of the group of insurance contracts."

- After initial recognition, the impact on the present value of fulfilment cash flows of changes in non-financial assumptions (i.e., actuarial basis changes) does not affect the total liability or profit and loss.[13] This is because under IFRS 17 there is an offsetting adjustment to the CSM balance that forms part of the total liability.
- All insurance contract cash flows, including for non-life (property and casualty) business are to be discounted to reflect the time value of money, as this gives more relevant information about the entity's financial position. IFRS 17 requires entities to discount cash flows using current, market-consistent discount rates that reflect the time value of money, the characteristics of the cash flows, and the liquidity characteristics of the insurance contracts.
- Embedded options and guarantees must be explicitly valued in a way that is consistent with market prices.

Comparability with other industries and accounting standards applicable to those industries

IFRS 17 is applicable to insurance contracts, not insurance entities. Therefore (subject to some exceptions), non-insurance entities issuing contracts of the nature of insurance must also account for them in accordance with IFRS 17.

IFRS 17 reflects the thinking that an insurance contract combines features of both a financial instrument and a service contract. However, unbundling these interdependent components and requiring accounting under existing standards was not seen by the IASB to be a feasible approach. The alternative was to ensure, by design, that IFRS 17 is consistent with the requirements of standards such as IFRS 9 Financial Instruments and IFRS 15 Revenue Recognition and, moreover, is in keeping with IASB's Conceptual Framework for Financial Reporting. For example:

- Measurement at current value is in keeping with IFRS 9 requirements for similar financial instruments.
- Under IFRS 17, profits are not recognized upfront when a policy is sold. Profits are recognized over the insurance coverage period and as the entity satisfies its obligation to provide insurance cover, i.e., as the entity is released from risk. The CSM is the mechanism to ensure that there is no gain on initial recognition, and the amortization of the CSM based on a unit of account determines the subsequent year-by-year pattern of recognition of profits. This approach to the recognition of profits on insurance contracts is consistent with the principle underlying IFRS 15 that "an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services."[14]
- If a group of contracts is loss-making, which means that the CSM has been calculated to be negative, then the loss must be recognized immediately. This is consistent with the requirements of IAS 37 with respect to onerous contracts.

---

[13] Unless the assumption changes render the group of insurance contracts onerous.
[14] IASB Foundation (2018).

- Under IFRS 17, revenue must be recognized in keeping with the principles of IFRS 15. This means that the insurance revenue and investment components of the premium must be disaggregated, and insurance revenue recognized as the entity satisfies its obligation to provide insurance coverage under its contracts. The investment component is defined as "the amounts that an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur." In this way, accounting for deposits on insurance contracts will be in the same manner as bank deposits, i.e., as an item of cash flow and not revenue.

Transparency

The following presentation and disclosure requirements will enhance transparency and give users a better understanding of the sources and trends of earnings:

- Profit or loss from underwriting activities (insurance service result) will be reported separately from financing activities (net financial result).
- Contracts must be grouped based on common characteristics. Also, loss-making contracts, contracts with low probability of becoming loss-making, and profitable groups of contracts must be separated. Performance is separately disclosed for each group. This way, losses on one group of contracts will not be masked by profits on another group.
- Contracts issued more than twelve months apart may not be included in the same group, so that the profitability over time of annual cohorts will be readily evident.
- Extensive note disclosures covering items such as new business issued, reinsurance contracts held, cash flows, and the impact of changes in assumptions are required. The IFRS 17 disclosures will include:
  - Detailed reconciliations of the opening and closing balances of the present value of future fulfilment cash flows, risk adjustment, and contractual service margin
  - Projections for the run-off of the CSM (remaining unearned profit)
  - Information on onerous contracts issued during a year
  - Granular information on the sources of profit in a business line/segment
  - Details on cash flows such as premiums received, reinsurance premiums paid, acquisition cash flows, and claims paid
  - Effect of changes in the risk of non-performance of reinsurers
  - Transition amounts
- Management's judgments and changes in these judgments are required to be disclosed, including inputs, assumptions, and estimation techniques.
- The confidence level used in determining the risk adjustment for non-financial risk must be disclosed. This means that a user can compare the how different entities judge uncertainty using a common metric.
- IFRS 17 requires insurers to disclose quantitative and qualitative information about risk exposures, risk concentrations, risk sensitivity analyses, and risk management processes.
- Information about the effect of regulatory frameworks, for example minimum capital requirements or required interest rate guarantees, must be disclosed.

Also, under IAS 1, an entity is required to disclose its objectives, policies, and processes for managing capital, including (a) information about externally-imposed capital requirements and the nature of those requirements; (b) how the requirements are incorporated into the management of capital; and (c) whether during the reporting period the entity has complied with any externally-imposed capital requirements, and if not, the consequences of such non-compliance.

Implications for insurers

Not unsurprisingly, to date there is no publicly-available empirical information about the likely financial impact of IFRS 17 upon adoption. Given the diversity of existing accounting practices and insurer product mix, the business implications, the financial impact, and cost to implement will vary from insurer to insurer.

IASB's IFRS 17 insurance contracts effects analysis

IFRS (2017) expects relatively little change in the accounting for short-term contracts that qualify for the simplified Premium Allocation Approach. For those non-life insurers for which discounting is not a feature of existing accounting practice, the requirement to discount in determining the liability for incurred claims will reduce insurance contract liabilities.

Greater change is expected for companies writing long-term insurance products, especially if changing from an accounting regime where assumptions are determined at contract inception. For insurers writing long-term products or annuity business, insurance contract liabilities and the consequent timing of recognition of accounting profit and capital ratios are extremely sensitive to the level of the discount rate. Insurers that are likely to see reductions in reported equity are those where, prior to IFRS 17:

- discount rates were based on assets backing insurance contract liabilities;
- negative insurance contract liabilities were allowed (i.e., profits are recognized at contract inception);
- discount rates were determined at contract inception and locked-in;
- liability adequacy testing was performed at the entity level, so that the value of future losses on onerous groups of contracts was offset by future profits on viable contracts; and
- techniques used for determining the provisions for interest and other guarantees underestimated the true liabilities.

For both short-term and long-term business, the impact of the IFRS 17 risk margin will depend on the direction of the change in risk margins. Increases in risk margins will increase insurance contract liabilities and reduce reported equity. Reductions in risk margins will reduce insurance contract liabilities and increase reported equity.

IFRS (2017) also states that "IFRS 17 is not expected to affect insurance products as long as, in applying IFRS 4, insurers price and design contracts based on an accurate assessment of their underlying economics." The IASB's opinion is based on the premise that accounting does not change the underlying economics of the business or inherent risk or profitability; rather, it changes the timing of reporting of profits.

However, supervisors should keep in mind that certain regulatory decisions (particularly with respect to capital requirements, the decisions of the tax authorities, and any impacts on market sentiment and insurers' cost of capital consequent upon IFRS 17) can have a material impact on the economics of certain business lines.

Global surveys

Comparison of the results of two global surveys reveals common themes about how insurers are reported to be thinking about and preparing for the adoption of IFRS 17:

Table 1

Deloitte (2018)	KPMG (2018)
February and March 2018	Second quarter of 2018
320 insurers located across Canada, UK, France, Italy, Germany, Japan, Switzerland, Spain, China, South Korea, the Netherlands, and US.	160 insurers from over 30 countries.
29% non-life, 20% reinsurers, 18% composite, 18% life, 15% health.	34 large companies (premiums over US$10 billion) and 126 smaller companies.
"Just enough time to get ready." • Health insurers are most confident, life insurers least confident.	***"Time pressure is already becoming acute – there is a vast amount to do"*** ***"Smaller insurers have done the least to date."*** • 91% of smaller companies have not yet started design and implementation of IFRS 17. • Nearly half of the largest insurers are either not sure if compliance by the deadline can be achieved or are lobbying for an extension. • 8% will be implementing after 2020 because of later local adoption.
"Upgrading technology is necessary." • Particularly for life insurers, capturing data needed and running the calculations are the top two issues. • Tight timelines mean that they need to start implementing IT solutions in parallel with working through some of the technical issues. • "Technology and acquisition of specialist talent underpin implementation budgets."	***"Big decisions loom about the CSM engine."*** • Nearly four in ten insurers are undecided whether to position the CSM calculator in their actuarial systems or in the finance sub-ledger system. • "It will be important to bring actuarial and accounting teams closer together to combine their perspectives and expertise – and exercise appropriate governance and control."

Table 1	
Deloitte (2018)	**KPMG (2018)**
• There are concerns about the untested nature of vendor solutions – only prototypes so far.	
"Significant implementation costs have been budgeted." • 35% expect to spend more than 30M euro on systems, external consulting, internal resources, contractors to implement technology.	***"Expected costs are rising though many have not yet secured their full budget."***
"Actuarial, accounting, and collaboration skills will be in high demand." • 68% of companies with NWP of more than 5B euro have teams of 51 or more. • "Companies are also trying to create new regular opportunities for cross functional communication, stronger cultures of collaboration, restructured departments, and cross-functional teams and processes."	***"The challenge is finding the right people with the right skills, including detailed knowledge of current systems and processes, not simply finding enough people."*** • Half of the largest insurers (premiums of over US$10B) have implementation teams of 50 or more.
"Insurers are still assessing the impact…. expectations appear uncertain in some areas." • Overall, most expect lower equity, less profit volatility, and slower profit emergence. • However, 32% of life insurers remain concerned about volatility. • Lower initial profitability is expected because losses on onerous contracts taken up front while profits are spread. • Concerns remain about changes in financial statement presentation, calculating the CSM unlocking and coverage units, unbundling embedded derivatives, and other non-insurance components. • Concerns about double counting of profits for tax purposes.	***"Insurers beginning to make working assumptions."*** Current status: • Identifying portfolios – 48% have decided to use existing lines of business. • Identifying groups of onerous contracts – 75% understand the issue but need to do further investigation. • Approach to determining the discount rate – 41% have not decided which approach. • Method to calculate the risk adjustment – 54% have not decided which method. • Expected approach to retrospective application – 31% do not know yet. • Assessing the granularity of data requirements for disclosures – 60% not yet addressed.

Table 1	
Deloitte (2018)	**KPMG (2018)**
"When asked if the stakeholders in their organization were clear on what needed to be done and spent to be IFRS 17 compliant, only 37% strongly agreed." • Initial communications will be qualitative. • Aiming to be parallel running so as to communicate quantitative impacts by 2020.	***".. the majority of insurers so far have delivered training only for members of the actual implementation teams, and only 39% have initiated training for the board."*** • Only 56% are envisioning being able to do at least one year of parallel running in order to assess and communicate the impacts in advance.

"Seeing more benefits vs costs."
 	
• "Overall, the top three expected improvements cited by respondents are:
    o financial statements that better reflect the results of business performance;
    o easier access to capital markets for mergers and acquisition and fundraising activities; and
    o improved information to support product design."
• IFRS 17 will have an impact:
    o on product design – 82% agree
    o on KPIs – 80% agree
    o on corporate culture – 66% agree
	"Insurers looking to reap wider business benefits."
	
	• 97% of the largest companies are taking the opportunity to modernize systems, optimize processes, and enhance actuarial systems.
	• Much more than "just an accounting or actuarial change." Top four business impacts expected to be:
	    o product design and pricing (71%)
	    o investment policy (49%)
	    o risk management (45%)
	    o cost and cost allocation (42%)
	• "Those charged with governance need to be aware of business impacts, accounting policies, and positions."

"The standard will also impact insurers' relationships with regulators." • Hope has been expressed for more streamlined regulatory compliance and capital planning since IFRS 17 can facilitate more consistent capital adequacy regimes across countries. • 23% reported that aligning compliance of IFRS 17 standards with other local regulatory frameworks was one of their top three challenges.	

Other reactions

In a survey of 20 regulatory authorities carried out by the IMF and BIS,[15] supervisors in surveyed jurisdictions saw IT changes, costs, and a shortage of actuarial and accounting expertise as posing the most challenges for insurers' IFRS 17 implementation. Some supervisors expected changes to product offerings and pricing while others cited no material impact. Most of the surveyed jurisdictions agreed that IFRS 17 should contribute positively to financial stability due to added transparency.

Given the lack of consistency in IFRS 4, many IFRS jurisdictions where IFRS is used for general purpose financial reporting do not also use IFRS 4 for regulatory purposes. They instead specify supervisory methods for the determination of insurance contract liabilities. For example, in the European context, solvency assessment is not based on IFRS but on balance sheets using the Solvency II framework. The extent to which IFRS 17 will affect financial markets and financial stability has been a key concern for the European Insurance and Occupational Pensions Authority (EIOPA).

In its analysis of the benefits of IFRS 17, EIOPA (2018) opined that by providing better insights into insurers' business models, exposures, and performance and by supporting efficient risk management, IFRS 17 has the potential to strengthen financial stability. EIOPA acknowledged the significant improvements to financial reporting from applying IFRS 17, notably that IFRS 17's current, market-consistent, risk-sensitive, and forward-looking measurement for insurance obligations reflects economic reality. EIOPA also acknowledged the advantages of a principles-based standard, as is IFRS 17. However, it expressed reservations about the scope for interpretation and judgment in the provisions related to risk adjustment and discount rates and the implications for comparability and relevance. Aspects cited by EIOPA as not necessarily reflective of the true economics of the business were the treatment of reinsurance and the level of aggregation. The subsequent amendments by the IASB addressed the treatment of reinsurance, although the IASB did not change the level of aggregation required.[16]

Unlike in Solvency II jurisdictions, certain other regulatory authorities, by policy or legislation, align regulatory accounting standards with accounting standards used for general purpose financial statements. One such authority is the Office of the Superintendent of Insurance (OSFI) in Canada, where IFRS standards are automatically adopted for regulatory reporting once the standard is endorsed in their jurisdiction for use in general purpose financial statements. The Canadian Accounting Standards Board has endorsed IFRS 17 and it is now in Part I of the CPA Canada Handbook – Accounting. OSFI's (2020) activities to support a robust implementation of IFRS 17 include:

- a consultative process including capital impact assessments to align the capital framework (LICAT and MCT) with IFRS 17;
- consultation with the industry on IFRS 17 Accounting Policy choices to understand positions taken and determine if there is consistency and/or comparability of IFRS 17 application across the Canadian industry:
- consultation with the industry on new regulatory returns; and

[15] International Monetary Fund (2020).
[16] Hoogervorst (2020).

- monitoring of IFRS 17 implementation plans and level of preparedness through semi-annual progress reports from insurers.

The Australian Prudential and Regulatory Authority (APRA) (2020) also intends to integrate IFRS 17 (named AASB 17 in Australia) into the capital and reporting frameworks applicable to life insurers and general insurers, with departure as needed to ensure sound prudential outcomes and to accommodate specific requirements of the Life Insurance Act, 1995. Other jurisdictions adopting IFRS 17 (modified as appropriate) for regulatory purposes include Chile and Dubai.

The risk-sensitive insurance capital standard (ICS) proposed by the IAIS includes consideration of GAAP Plus options for IFRS 17 and FASB's US GAAP. Field testing and monitoring of these two GAAP Plus options will begin from 2020.

Developments in parallel

After public consultation in 2007, FASB pursued a joint project with the IASB to develop a comprehensive standard on accounting for insurance contracts. However, in February 2014 FASB instead decided to focus its efforts toward making targeted improvements to its US GAAP insurance accounting model. These efforts culminated in the issuance of an Accounting Standards Update[17] in August 2018, intended to improve financial reporting for insurance companies that issue long-duration contracts such as life insurance, annuities, and long-term care. It incorporates a more current measure of insurance liabilities and a market-based approach to determining the value of options and guarantees.

Implications for supervisors

The scope and extent of change, the complexity of the issues, and – most importantly for supervisors – the level of uncertainty around the impact and what IFRS 17 means for the management of insurance businesses is unprecedented. Educational materials and guidance are under development by various parties. In many jurisdictions, uncertainty is amplified because the critical question of how regulators and the tax authorities will respond is as yet unanswered.

Regulatory and supervisory use of general purpose accounting standards

The following insurance core principles (ICPs) reinforce the benefits (reduced costs, less effort, consistency, etc.) of aligning regulatory accounting standards with general purpose accounting standards:

[17] FASB (2018).

EXTRACTS FROM INSURANCE CORE PRINCIPLES	
ICP 9.4	The supervisor…. requires that an external audit opinion is provided on annual financial statements.
ICP 9.4.4	In setting the requirements, the supervisor should strike a balance between the need for information for supervisory purposes and the administrative burden it puts on insurers.
ICP 14.0.1	The IAIS considers it is most desirable that the methodologies for calculating items in general purpose financial reports can be used for, or are substantially consistent with, the methodologies used for regulatory reporting purposes, with as few changes as possible to satisfy regulatory requirements. However, the IAIS also recognizes that this may not be possible or appropriate in all respects, considering the differing purposes. The IAIS believes it is essential that differences between general purpose financial reports and published regulatory reports are publicly explained and reconciled.

In less developed markets, many boards and senior managements of insurers focus on accounting results for decision making. Regulatory capital may also be considered, especially when it can become a constraint on the payment of shareholder dividends. Such decision-making practices include:

- basing product pricing, portfolio profitability and growth, and product mix strategies on accounting profit and projections of distributable earnings after required regulatory capital, which may or may not align with the underlying riskiness and economics of the business;
- assessing the viability and riskiness of investment strategies using accounting numbers;
- assessing the adequacy of capital (and the appropriateness of shareholder dividend policy) against regulatory targets rather than sophisticated economic capital assessments; and
- not routinely using non-GAAP actuarial analyses, such as sources of earnings or embedded value added, for decision making.

In these circumstances, the laudable goal of IFRS 17 to enhance transparency and give users and management better insight into the profitability and risks inherent in an insurer's product portfolios can be beneficial and a step in the right direction. Alignment of general purpose accounting standards with regulatory reporting will reduce costs, minimize the need for complex reconciliations, better align risk-based supervisory assessments with the financial management of insurers, and facilitate consolidated supervision.

Decision usefulness of IFRS 17 for solvency and capital adequacy assessments

General purpose financial statements prepared under IFRS or national accounting standards are designed to meet the information needs of a wide range of users: shareholders, creditors, employees, and the public at large. The objective of general purpose financial statements to provide useful financial information for economic decision making is somewhat different than for solvency and capital adequacy purposes. In assessing the decision usefulness of a valuation approach for solvency purposes, the guidance of ICP 14 applies. ICP 14.4 calls for the valuation of policyholder liabilities to be an economic valuation and defines an economic valuation to be "a valuation such that the resulting assessment of an insurer's financial position is not obscured by hidden or inherent conservatism more optimism in the valuation." With the adoption of IFRS 17, IFRS standards will be compatible with the objectives and standards of ICP 14.

ICP 17.1	The supervisor requires that a total balance sheet approach is used in the assessment of solvency to recognize the interdependence between assets, liabilities, regulatory capital requirements, and capital resources, and to require that risks are appropriately recognized.
ICP 17.3.4	The criteria used by the supervisor to establish solvency control levels should be transparent. This is particularly important where legal action may be taken in response to an insurer violating a control level. In this case, control levels should generally be simple and readily explainable to a court when seeking enforcement of supervisory action.
ICP 17.8	The supervisor sets appropriate target criteria for the calculation of regulatory capital requirements, which underlie the calibration of a standardized approach. Where the supervisor allows the use of approved, more tailored approaches such as internal models for the purpose of determining regulatory capital requirements, the target criteria underlying the calibration of the standardized approach are also used by those approaches for that purpose to require broad consistency among all insurers within the jurisdiction.
ICP 17.8.1	The level at which regulatory capital requirements are set will reflect the risk tolerance of the supervisor.

Fundamentally, the need for insurers to hold assets derives from the characteristic of insurance products, whereby policyholders pay premiums in advance in return for benefits in the future upon occurrence of an insured event. Risk-sensitive solvency and capital adequacy assessment therefore focuses on the adequacy of assets to settle present and future insurance benefits and other claims, even under adverse circumstances. Capital adequacy, the adequacy of assets in excess of liabilities, cannot be looked at independently of an assessment of the adequacy of assets supporting the liabilities. The total balance sheet approach to capital adequacy (ICP 14.0.4 and ICP 17.1) is therefore based on the determination of the total margin for risk that is needed, regardless of whether the margin is held in liabilities or capital. The margin for risk that is needed will be determined by the supervisor's risk tolerance.

Application of the principles of ICP 17 to establish capital adequacy requirements using a total balance sheet approach can be accommodated using IFRS 17 accounting standards through judicious use of prudential filters, careful design and calibration of required capital and/or solvency control levels, allowing internal models under certain conditions, appropriate transition arrangements, and other measures. Box 1 discusses certain technical considerations when designing or adapting capital adequacy requirements based on financial statements prepared using IFRS 17.

Supervisors and regulators should heed lessons from the past that capital adequacy requirements, if not derived from a particular insolvency probability standard, could be arbitrary, mask the true level of insolvency probability, and create incentives for regulatory arbitrage. Insolvency probability standards include the EU Solvency II Directive, which articulates the supervisory risk tolerance equivalent to an insolvency probability of 0.5%, and the Canadian Life Insurance Capital Adequacy Test, which used a confidence level of 99% Conditional Tail Expectation (CTE) over 1 year.

The advent of IFRS 17 creates an opportunity for regulatory authorities who have not yet done so to develop or update risk-sensitive capital adequacy frameworks in keeping with the principles of ICP 17, while aligning regulatory accounting standards with general purpose accounting standards.

Box 1 – Technical considerations

Margins for risk

The IFRS 17 Basis for Conclusions (BC209) states that the IFRS 17 risk adjustment "should not represent… an amount that would provide a high degree of certainty that the entity would be able to fulfil the contract. Although such an amount might be appropriate for some regulatory purposes, it is not compatible with the Board's objective of providing information that will help users of financial statements make decisions about providing resources to the entity." Furthermore, under IFRS 17 the confidence level of the risk adjustment is to reflect the risk tolerance of the entity. However, regulatory capital requirements determined in keeping with ICP 17 are to be calibrated based on the supervisor's risk tolerance. Also, the risk adjustment under IFRS 17 is only in respect of non-financial risk – it reflects 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.

Discount rates

The principles-based top-down and bottom-up options for determining market-consistent discount rates in IFRS 17 do not take the expected return on the backing assets into account unless the asset cash flows affect the liability cash flows. There is no margin for reinvestment risk.

Regulators should consider the IFRS 17 approach to risk margins and discount rates and design the capital framework so as to ensure that total margins (in liabilities and capital) meet their target criteria and that all risks are covered.

CSM

The addition of the CSM to the risk-adjusted present value of fulfilment cash flows (except under the simplified approach) is a deviation from the concept of an economic valuation. The CSM is a mechanism that affects the measurement and reporting of an insurer's profit over time.

Regulators and supervisors should consider the extent to which the CSM could be included in capital resources.

Transition

The IFRS 17 Basis for Conclusions (BC372 and BC373) states that "in the light of the diversity in previous insurance accounting practices, and the long duration of many types

of insurance contracts, the Board decided that retrospective application of IFRS 17 provides the most useful information to users of financial statements by allowing comparisons between contracts written before and after the date of initial application of the Standard." One of two alternatives (the modified retrospective approach and the fair value approach) may be used when the full retrospective approach is impracticable. IFRS 17 also requires restated comparative information for at least one reporting period. ***Depending on the impact on liabilities and capital of applying the Standard for the first time, transitional adjustments to regulatory capital requirements may be warranted, particularly for long-term insurance business.*** These technical considerations are by no means exhaustive. Other aspects to be considered include the scope of insurance contracts included, contract boundaries, level of aggregation, treatment of overhead expenses, IFRS 9 interaction, and treatment of participating fund surplus.

Improving supervisory review and reporting

ICP 9	The supervisor takes a risk-based approach to supervision that uses both off-site monitoring and on-site inspections to examine the business of each insurer; evaluate its condition, risk profile, and conduct; the quality and effectiveness of its corporate governance; and its compliance with relevant legislation and supervisory requirements.

Whether or not a supervisory authority decides to adopt IFRS as its regulatory accounting standard, post-IFRS 17, risk-based supervisory reviews of general purpose financial statements and disclosures will potentially give supervisors a more comprehensive understanding and inform judgments about:

- an insurer's business model, its sustainability, and its vulnerabilities;
- sources and drivers of profitability and trends and the likely path of earnings;
- sources of risk and volatility;
- the plausibility of an insurer's forecasts and risk assessments;
- the risk tolerance of an insurer (IFRS 17 disclosures about risk margins and assumptions will provide valuable data for analysis and benchmarking); and
- factors contributing to the changes and trends in earnings and available capital from year to year.

Beyond the traditional balance sheet focus of supervisors, the information presented in the general purpose financial statements such as earnings trends are vital to supervisory assessments of an insurer's business model, sources and sustainability of earnings, and detecting vulnerabilities. Earnings are the insurer's source of internally-generated capital needed to fund normal operations and business growth. Earnings trends can indicate problems to come. Earnings assessment is fundamental in a forward-looking risk-based approach to assessing the resilience of an insurer and the riskiness and viability of its business model.

The new level of transparency around sources of earnings and product profitability under IFRS 17 should allow boards and senior management to make better decisions. IFRS 17 should drive more discipline around pricing processes, expense management, commission structures and distributor compensation, and better risk management.

Insurers may continue to disclose certain non-GAAP measures (for example, embedded value metrics) for a time to track trends. Once enough years of IFRS 17 data have been compiled and users (including supervisors) become familiar with the new information, trends based on IFRS 17 metrics may replace them (for example, CSM rather than embedded value).

Supervisors will need to update metrics and incorporate the new information from IFRS statements when evaluating an insurer.

ICP 14.02	The IAIS considers that differences between technical provisions for general purpose financial reports and published regulatory reports should be publicly explained and reconciled in terms of differences in data, discount rate, methodology, and assumptions used, together with the rationale for why any different approach is appropriate for solvency purposes.

Jurisdictions that do not intend to move to IFRS 17 as their regulatory accounting standard may need to redesign:

- Returns reconciling and explaining the difference between the top-down approach to determining capital resources and the bottom-up approach, which sums up individual items of capital to derive the overall amount of capital resources (ICP 14.0.1 ICP 17.10.7 and ICP 17.10.20).
- Returns reconciling and explaining the difference between the bottom-up approach on the regulatory basis and the bottom-up approach on the IFRS basis (including the differences in technical provisions) (ICP 14.0.2).

More granular and relevant reconciliations may give supervisors added insights into the factors contributing to the changes and trends in available capital from year to year.

Actuarial models will be used to compute the actuarial liabilities, and the output from these models (requiring multiple runs and seamless interface with CSM and other financial systems) will include revenue and other items for the profit and loss statement and information to support complex reconciliations and disclosures. Insurers will require new or updated systems and data warehouses to keep track and store CSM and other information about groups of contracts at different levels of granularity. The system and other requirements for budgeting, forecasting, stress testing, and capital planning under IFRS 17 will not be straightforward.

Effective data management, model validation, and model governance and control frameworks will be critical in ensuring reliable outputs from these models and other systems.

IFRS 17 will heighten model risk and operational risk. Protocols for senior management's and the board's reliance on experts might need to be strengthened. Stronger supervisory oversight over these risks may be warranted.

Use of insurers’ stress and scenario testing in making supervisory judgments

ICP 16.1	The supervisor requires the insurer’s enterprise risk management framework to provide for the identification and quantification of risk under a sufficiently wide range of outcomes using techniques that are appropriate to the nature, scale, and complexity of the risks the insurer bears and adequate for risk and capital management and for solvency purposes.
ICP 16.15	*Own risk and solvency assessment (ORSA) – continuity analysis* The supervisor requires the insurer, as part of its ORSA, to analyze its ability to continue in business, and the risk management and financial resources required to do so over a longer time horizon than typically used to determine regulatory capital requirements.
ICP 16.16	*Role of supervision in risk management* The supervisor undertakes reviews of an insurer's risk management processes and its financial condition including the ORSA. Where necessary, the supervisor requires strengthening of the insurer’s risk management, solvency assessment, and capital management processes.
ICP 16.16.8	Forward-looking stress testing, scenario analysis, and risk modelling of future capital positions and cash flows (whether provided by the insurer’s own continuity analysis or in response to supervisory requirements) is a valuable tool for supervisors in assessing the financial condition of insurers. Such testing informs the discussion between supervisors and insurers on appropriate planning, comparing risk assessments against stress test outcomes, risk management, and management actions and enables supervisors to consider the dynamic position of insurers and to form a high-level assessment of whether the insurer is adequately capitalized to withstand a range of standardized and bespoke stresses.

Aside from assessing the impact of IFRS 17 on insurers’ financial position and capital adequacy at the time of transition, supervisors will need to assess the impact on future capital resources and future capital adequacy arising from changes in earnings patterns, business plans, pricing practices, dividend policies, taxes, etc.

Standardized risk-sensitive capital adequacy requirements are not always a good proxy for the true economic capital needed to be held by an insurer to cater for its idiosyncratic risks at a given insolvency probability. Therefore, the results of stress testing performed by an insurer, including reverse stress tests and/or ORSA continuity analyses, can be extremely useful to the supervisor in making judgments about the insurer’s capital adequacy and resilience to withstand adverse conditions. In making these judgments, supervisors will also need to consider:

- the impact of IFRS 17 on the cost of capital and an insurer’s ability to raise capital resources in the future; and
- how the new level of transparency of current and projected financial results and risks will influence the incentives and behaviour of boards and senior managements.

Reliability of the financial statements

ICP 14.3.2	Objectivity is an important aspect of valuing assets and liabilities in a reliable manner, so that a valuation is not influenced inappropriately by an insurer's management. The valuation of assets and liabilities typically involves judgment, e.g., expert judgment in assessing the relevance of data and deriving assumptions. Consistent with reliability of outcome, subjectivity in valuation should be reduced as far as practicable. This may be achieved by using information available from effective internal control processes, market valuations, and other relevant current or factual information, by applying professional standards, and by subjecting valuations to independent review. The supervisor should require a valuation methodology that uses information provided by the financial markets and generally-available data on insurance technical risks. Company-specific information may be appropriate, for example, where the insurer's business model and practices are sufficiently substantiated as representative of the portfolio and similar information is used in market valuations.

The principle-based nature of the Standard leaves ample room, if improperly implemented, to undermine the usefulness of the information. The IASB (2018) states that "if financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely, and understandable."

The Standard as written leaves room for a wide range of practices with respect to areas requiring judgment, such as the determination of discount rates and the risk adjustment, the approach to determining coverage units for amortization of the CSM and transition. Under IFRS rules, management is responsible for the preparation and fair presentation of the financial statements and this includes the exercise of judgment and choice of accounting policies. IFRS rules do not require an actuary to value the insurance contract liabilities or provide an opinion on the valuation. However, actuaries are often used as professional experts in the valuation of policyholder liabilities. Most regulatory regimes require actuarial opinions on the adequacy of liabilities filed for regulatory purposes and/or compliance with regulatory requirements.

Supervisors should continue to monitor IFRS 17 interpretations and areas where judgment is to be used by management, auditors, or actuaries, and determine what additional guidance may be necessary to address local circumstances (for example, illiquid capital markets, definition of risk-free, and lack of data).

Ensuring that audit standards are fit for purpose

ICP preconditions	A system of independent audits for companies to ensure that users of financial statements, including insurers, have independent assurance that the accounts provide a true and fair view of the financial position of the company and are prepared according to established accounting principles, with auditors held accountable for their work.

A revised standard on Auditing Accounting Estimates and Related Disclosures (ISA 540) was released by the International Auditing and Assurance Standards Board (IAASB) in October 2018. The revised ISA will be effective for audits of financial reporting periods beginning on or after December 15, 2019. Early adoption is permitted and encouraged.

In its July 2017 comments[18] on the exposure draft of this standard, the IAIS:

- observed that the principles-based nature of the standard did not allow for detailed audit consideration of relevant aspects of complex estimates of insurance contract liabilities;
- acknowledged that, given the timing, IFRS 17 implications would not have been fully assessed in the development of ISA 540; and
- emphasized the consequent need to give priority to the development of more detailed and specific application guidance with respect to the auditing of insurance contract liabilities.

Supervisors should assess gaps in local guidance dealing with the auditing of insurance contract liabilities determined according to IFRS 17 and should work with audit entities and standard setting bodies in the jurisdiction to address any shortcomings. Supervisors should also evaluate how audit firms are building their capacity to audit financial statements prepared in accordance with this complex standard.

Ensuring adequate professional standards and guidance

ICP preconditions	The availability of skilled, competent, independent, and experienced actuaries, accountants, and auditors, whose work complies with transparent technical and ethical standards set and enforced by official or professional bodies in line with international standards and is subject to appropriate oversight.

The International Actuarial Association developed ISAP 4,[19] a model actuarial standard of practice dealing with IFRS 17. ISAP 4 is intended to provide useful and high-quality guidance to actuaries providing actuarial services in relation to IFRS 17, to facilitate widely accepted convergence of principle-based actuarial standards within and across jurisdictions. This standard will only be binding on actuaries when the model standard is adopted by local actuarial standard setting bodies.

ISAP 4 is principle-based and is not designed to address unique country-specific issues. Accordingly, supervisors should ensure that local actuarial standard setting bodies adopt adequate standards that are fit for purpose in their jurisdiction.

Standards should also cover minimum professional standards for the performance of the work in areas such as qualifications to perform the work, peer review and quality control, model management, documentation, actuarial reports, communication between the actuary and the

[18] IAIS (2017).
[19] International Actuarial Association (2019).

auditor, and the actuarial opinion. Supervisors might also wish to issue supplementary implementation guidance to address identified gaps in international and national guidance.

Ensuring adherence to professional standards and codes by actuaries and auditors

In jurisdictions where actuaries and auditors are self-regulated (i.e., they set their own standards and discipline themselves), supervisors should independently monitor the differences in interpretation and range of judgments, and assess the quality of the work and effectiveness of self-regulation (including of cross-border work). Supervisors should formalize protocols (for example, through memoranda of understanding) for engagement with professional bodies and regularly engage with them to promote and ensure alignment of interests.

Ensuring preparedness and adequate oversight of transition and implementation

The challenge of carrying on business as usual, while undertaking a radical transformation of financial and actuarial systems needing to interface with legacy administration systems, cannot be underestimated, particularly for smaller resource-constrained insurers. Integration of data management (currently handled separately by actuarial, accounting, and administrative areas) cannot be done effectively without cross-functional collaboration and effective project and change management and oversight. Most insurers will be implementing IFRS 17 and IFRS 9 at the same time and may not yet fully appreciate the impact of the interaction. Many will find that their project plans do not give enough time for an adequate period of parallel running to assess the impact. Time pressures may force some to rely initially on manual controls, heightening operational risks, and increasing cost.

Supervisors must ensure adequate oversight of insurers' IFRS 17 implementation projects. Supervisors should:

- ensure that adequate processes are in place to escalate issues and that material risks, including project risks, are brought to the attention of the board on a timely basis;
- be willing to have hard discussions with insurers' boards and senior managements about IFRS 17 projects;
- understand the extent to which key resources are being diverted to the IFRS 17 project and any attendant risks;
- understand proposed post-implementation organizational changes at insurers and their impact on controls and independence;
- evaluate processes surrounding key IFRS 17 policy decisions and judgments and, in particular, management's consideration of the advice of experts, such as actuaries;
- understand how cyber and other risks related to new technologies to be deployed, such as cloud computing, will be managed; and
- ensure that external advisors are truly independent and there is little risk of subsequent self-review.

When insurers apply IFRS 17 for the first time, the transition provisions of the Standard require full retrospective application.[20] This means that the CSM at the date of transition to IFRS 17 will be based on an assessment of the CSM (unearned profits) for each group of contracts at inception of the group and a roll-forward of those amounts to the transition date. The CSM at transition will be an important aspect of the capital impact on transition and on future accounting earnings. Accordingly, insurers are evaluating the transition requirements and assessing alternative transition strategies to mitigate the impact of IFRS 17 on their future accounting earnings. These strategies might include reinsurance or divestiture of onerous blocks of business or certain assets. In many instances, the feasibility of these strategies will depend upon the regulatory and tax environment post-transition.

Supervisors should monitor insurers' transition decisions and strategies and be in a position to assess the impact on true economic earnings and solvency. Factors such as an insurer's available capital, earnings capacity, level of shareholders' dividends, level and fungibility of capital in subsidiaries, and corporate taxes will impact an insurer's current and likely future capital resources. Supervisors should expect to have a view of how IFRS 17 will affect these areas well before 2023.

Supervisors should monitor insurers' assessments of the financial impact on transition both at a group and solo level (including the impact on any financing covenants and reinsurance arrangements) and ensure that these assessments are being reported to the insurers' boards on a timely basis.

Policy reform project

At many authorities, COVID-19 has diverted resources away from IFRS 17 projects. However, there is much work to be done to ensure preparedness and to understand the impact before the new January 2023 effective date. Those authorities who have been waiting for the confirmation of the effective date and finalization of the Standard should begin planning and impact assessment as soon as possible.

Supervisory authorities deciding to align with general purpose financial reporting standards by adopting IFRS 17 for regulatory reporting and risk and capital adequacy assessment should be adopting a structured action plan and project governance approach to:

- carry out effective oversight of IFRS 17 implementation by each insurer;
- assess the potential financial, operational, and business impact of IFRS 17 on insurers;
- recalibrate capital adequacy/solvency regimes for IFRS 17, including quantitative impact assessments (for jurisdictions without proportionate risk-based approaches in place, IFRS 17 could be a catalyst for modernization);
- monitor IFRS 17 interpretations and areas where judgment is to be used by management, auditors, or actuaries and determine what additional guidance may be

[20] A modified retrospective approach or a fair value method are allowed under circumstances where the full retrospective approach is impracticable.

necessary to ensure reliability and comparability[21] or to address local circumstances (for example, illiquid capital markets, definition of risk-free, and lack of data);
- adapt their risk-based supervisory policies and practices for an IFRS 17 environment (for example, review of reporting requirements and forms, metrics/financial soundness indicators/benchmarks/risk-assessment criteria, solvency and statutory fund requirements, capital adequacy and stress testing requirements and guidelines, and information systems);
- reassess the role of the actuary and audit professionals within the context of the regulatory framework in contributing to the reliability of financial statements;
- update policies and legislation as appropriate; and
- ensure that new and existing supervision staff are properly equipped to carry out their roles using the modified supervisory policies and practices (for example, through development and delivery of a comprehensive training curriculum).

The project should incorporate adequate consultation and collaboration with the industry, auditors, actuaries, home/host supervisors, and other stakeholders. This will be essential to ensure that the issues and risks involved in implementing IFRS 17 are properly addressed. Regulators and supervisors should keep in mind that their decisions – particularly with respect to solo and consolidated capital requirements, the decisions of the tax authorities, and any impacts on market sentiment and insurers' cost of capital consequent upon IFRS 17 – can have a material impact on the economics of certain business lines. Many of the issues are more critical for life insurers. However, insurers writing general insurance/P&C business will also need to adapt. If implemented properly, IFRS 17 can also facilitate more rigor in pricing, claim reserving, and capital management by general insurers.

The complexity of IFRS 17 has implications for the qualifications and training of those supervisors who will be involved in the review of actuarial reports, the design and review of capital adequacy frameworks, the design and review of financial statements and returns, and in the risk assessment process, particular in the assessment of actuarial risk. Many authorities will need to obtain specialized expertise who can support supervisors during three key phases – in developing the IFRS 17 project plan; executing the plan; and after the effective date of IFRS 17.

In jurisdictions where IFRS is not used by the authority for regulatory reporting, IFRS may however be used for general purpose financial statements and/or by overseas parent companies or subsidiaries domiciled in IFRS jurisdictions. Even for those jurisdictions, the importance of supervisory assessment of the impact and prudential implications of IFRS 17 on insurers and insurance groups cannot be overstated. Many of the elements of the above-mentioned project plan would be equally relevant.

---

[21] Many smaller insurers may have not started their implementation projects and supervisors will need to play an active role along the way. Although the start date for IFRS 17 is now January 2023, ideally, parallel running should start from 2022 or even earlier. Regulators too will need just as much time to prepare their new forms, procedures, and IT systems, recalibrate capital requirements etc.

Conclusion

COVID-19 has highlighted the importance of the insurance sector's role in economic development and in strengthening the resilience of businesses and individuals. At the same time, the economic fallout of the COVID-19 pandemic has heightened financial risks to insurers. For example, low interest rates trending lower for longer poses a huge challenge for the global industry, arguably threatening the business model in some jurisdictions. Currently, many insurance financial reporting regimes – in particular those still using historical cost accounting and locked-in discount rates – may not reveal the true cost of options and guarantees and may mask the impact of low interest rates. These faulty approaches not only delay corrective action by management, but can also lead to imprudent dividend distribution, excessive risk taking, and other harmful business practices.

It is therefore even more important now for insurance supervisors to take steps to ensure that the financial reporting framework upon which they assess the capital adequacy, resilience, future financial condition, and claim paying ability of insurers:

- is relevant, grounded upon sound economic principles, reliable, transparent, and consistent with the key goals of the International Accounting Standards Board (IASB) when developing IFRS 17; and
- facilitates an effective early intervention regime that is adequately risk sensitive and incorporates coherent solvency control levels and associated corrective action.

Globally, the scope and scale of the changes required for insurers to transition to IFRS 17 is unprecedented and more complex than IFRS 9 was for banks. The business and financial impact, insurers' responses, and the risk implications of IFRS 17 are as yet unknown. Given the diversity of existing accounting practices and insurer product mix, the business and financial implications and cost to implement will vary from insurer to insurer and by market/jurisdiction.

Implementation is expected to be challenging for many in the insurance industry. The cost of IFRS 17 implementation may be prohibitive for smaller insurers. Some supervisors in IFRS jurisdictions have been monitoring IFRS 17 implementation projects to ensure that Boards and senior management are exercising proper governance and to assess insurers' ability to meet the timeline including a reasonable period for parallel runs. Supervisory oversight of these projects includes assessment of the impact on solvency, risk implications, and how insurers are resolving issues around data and systems, modelling, capacity and resource constraints, and internal control processes. Supervisors also need to understand how insurers see the potential impact on products, pricing, investment policy, reinsurance, risk and capital management, dividend policy, and regulatory compliance.

However, IFRS 17 is expected to benefit the industry by improving transparency and comparability, thereby facilitating risk assessment and timely decision making. The information presented in the financial statements is expected to give supervisors a clearer understanding of an insurer's business model, its sustainability and vulnerabilities and, therefore, to facilitate timely action.

Regulators and supervisors must ensure that their teams are prepared for the transition. This has implications for the qualifications and training of those who will be involved in the review of actuarial reports, the design of capital adequacy frameworks, and the design and review of financial statements and returns.

Transitioning to IFRS 17 will be a resource-intensive undertaking for regulators and supervisors, who must ensure that regulation and supervision are appropriately adapted and effective, while avoiding imposing unnecessary costs on the industry. They should collaborate with accounting bodies, actuarial associations and the industry toward a common understanding and to address the issues and risks involved in implementing IFRS 17. This will be essential to ensure successful transition and implementation.

It would also be beneficial for regional groups of supervisors to collaborate, share resources, and undertake joint projects, such as standardizing forms and capital adequacy requirements and developing model wording. Regional adoption of IFRS 17 for regulatory accounting would be one step toward achieving convergence of capital adequacy and solvency regimes and would facilitate consolidated supervision of regional insurance groups and conglomerates.

IFRS 17 may also have significant implications for other projects particularly where supervisory authorities are in the process of enhancing their risk based supervisory frameworks or modernizing their approach to capital adequacy assessment and/or stress testing. These authorities would be well advised to take an integrated approach to these initiatives. Moreover, supervisory authorities using stress testing and/or ORSA to assess the potential impact of COVID-19 should consider the implications of IFRS 17 on future financial resources and future financial condition. Time is short and supervisors in many jurisdictions will need to take a proactive approach and provide guidance to the insurance industry. Authorities should begin planning and impact assessment as soon as possible.

References

APRA. *New accounting standard – AASB 17 Insurance contracts*. 2020. https://www.apra.gov.au/new-accounting-standard-%E2%80%93-aasb-17-insurance-contracts

Deloitte. *2021 Countdown Underway I Insurers Prepare for IFRS 17 Implementation*. 2018. https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Financial-Services/gx-fsi-global-ifrs-ins-survey-2018.pdf.

European Insurance and Occupational Pensions Authority. *EIOPA analyses the benefits of IFRS 17 Insurance Contracts.* October 2018. https://www.eiopa.europa.eu/content/eiopa-analyses-benefits-ifrs-17-insurance-contracts_en#:~:text=EIOPA%20carried%20out%20the%20analysis,interplay%20between%20insurers'%20financial%20and

Financial Accounting Standards Board. *Targeted improvements to the accounting for long duration contracts.* August 2018. https://www.fasb.org/cs/ContentServer?c=FASBContent_C&cid=1176171054425&d=&pagename=FASB%2FFASBContent_C%2FCompletedProjectPage

Financial Stability Board. *Meeting of the Financial Stability Board in London on 25 September – Financial Stability Board.* September 2015. http://www.fsb.org/2015/09/meeting-of-the-financial-stability-board-in-london-on-25-september/

Financial Stability Board. *FSB Welcomes New Insurance Accounting Standard*. July 2017. http://www.fsb.org/2017/07/fsb-welcomes-new-insurance-accounting-standard/

Hoogervorst, Hans. *IFRS 17 Insurance Contracts – Why annual cohorts?* April 2020. https://cdn.ifrs.org/-/media/project/amendments-to-ifrs-17/inbrief-ifrs17-factsheet-april2020.pdf

IAASB. *ISA 540 (revised), auditing accounting estimates and related disclosures*. October 2018. https://www.iaasb.org/publications/isa-540-revised-auditing-accounting-estimates-and-related-disclosures-9

IASB Foundation. *IFRS Standards (Red Book).* January 2018. https://www.ifrs.org/news-and-events/2018/01/new-required-ifrs-standards-books/

IASB Foundation. *IFRS 17 incorporating Amendments*. June 2020. https://cdn.ifrs.org/-/media/project/amendments-to-ifrs-17/ifrs-17-incorporating-the-june-2020-amendments.pdf?la=en

IFRS. *IFRS Standards Effects Analysis*. May 2017. https://www.ifrs.org/-/media/project/insurance-contracts/ifrs-standard/ifrs-17-effects-analysis.pdf

International Accounting Standards Board. *IFRS 17 Insurance Contracts IFRS Standards Effects Analysis.* 2017. https://www.ifrs.org/-/media/project/insurance-contracts/ifrs-standard/ifrs-17-effects-analysis.pdf?la=en&hash=941E01899DF8823049940FFB511CEB6990D81D35

International Actuarial Association. *ISAP 4 International Standard of Actuarial Practice 4 IFRS 17 Insurance Contracts*. November 2019.
https://www.actuaries.org/IAA/Documents/CTTEES_ASC/Final_ISAPs_Posted/IAA_ISAP4_ApprovedFinal_21Nov2019.pdf

International Association of Insurance Supervisors. *Comments on IAASB's Exposure Draft of the revised ISA 540, Auditing Accounting Estimates and Related Disclosures.* July 2017.
https://www.iaisweb.org/page/supervisory-material/comment-letters/file/67940/iais-comments-on-iaasb-ed-isa-540-accounting-estimates-july-2017

International Association of Insurance Supervisors. *Insurance Core Principles*. 2020.
https://www.iaisweb.org/page/supervisory-material/icp-on-line-tool

International Monetary Fund. *Global Financial Stability Report October 2017: Is Growth at Risk?* 2017.
https://www.imf.org/en/Publications/GFSR/Issues/2017/09/27/global-financial-stability-report-october-2017

International Monetary Fund. *Accounting Standards and Insurer Solvency Assessment*. July 2020.
https://www.imf.org/en/Publications/WP/Issues/2020/07/31/Accounting-Standards-and-Insurer-Solvency-Assessment-49616

KPMG International. *In It to Win It.* 2018.
https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2018/08/ifrs-17-in-it-to-win-it.pdf.

OSFI. *Update on OSFI's Activities with respect to IFRS 17 – Insurance Contracts*. August 2020.
https://www.osfi-bsif.gc.ca/Eng/fi-if/in-ai/Pages/ifrs17-let20.aspx

Appendix 1: amendments to IFRS 17

IFRS 17, first issued in May 2017, is a complex financial reporting standard with fundamental actuarial aspects and potentially significant implications for how insurance businesses are evaluated and managed. In June 2020, after a period of consultation, the IASB issued various amendments to IFRS 17. The amendments were in response to the concerns and implementation challenges raised by stakeholders. The amendments did not change the underlying principles of the standard and the benefits of IFRS 17 are unaffected.

Effective date

In a concession to the industry and to increase the likelihood of contemporaneous global adoption, the IASB agreed to amend the Standard to defer the effective date for two years. Entities are now required to apply IFRS 17 and IFRS 9 for annual reporting periods beginning on or after January 1, 2023. The temporary exemption from applying IFRS 9 was also extended by two years. Companies may early adopt IFRS 17 if they also apply IFRS 9. The date of initial application is the beginning of the annual reporting period in which an entity first applies IFRS 17 and the transition date is the beginning of the annual reporting period immediately preceding the date of initial application. Many companies prepare interim (quarterly or half-yearly) financial statements. Those with a December 2021 year end, whose date of initial application is January 1, 2023, may first report using IFRS 17 for the interim period ending March 2023. By then, they must be in a position to produce the following on the new IFRS 17 basis:

- the statement(s) of financial performance for the 3-month period ending March 31, 2023
- the statement(s) of financial performance for the 3-month period ending March 31, 2022
- the March 31, 2023 statement of financial position
- the December 31, 2022 statement of financial position
- the March 31, 2022 statement of financial position
- the December 31, 2021 statement of financial position

As such, for many insurers, the transition date from which transactions need to be captured in a manner compatible with IFRS 17 is effectively the end of 2021. Entities should be aiming to begin parallel runs on the old and new bases ideally by December 31, 2021 and certainly no later than mid-year 2022.

Purpose

The IASB (2020b) identified three main purposes for the amendments – to reduce costs, to make the results easier to explain, and to ease transition.

Amendments to reduce costs

Certain[22] credit cards and similar contracts such as charge cards that provide insurance coverage will now be excluded from the scope of the Standard. Also, an entity may apply either IFRS 17 or IFRS 9 to certain loans, for example loans with death waivers. These scope exclusions provide significant implementation relief to banks and other financial entities who otherwise would have had to apply IFRS 17 to those product lines.

IFRS 17 as originally issued required an entity to present on the balance sheet groups of insurance contracts that are assets separately from groups of insurance contracts that are liabilities. To do this, the entity needs to identify premiums received and premiums receivable for each group of insurance contracts. The amendment requires an entity to present insurance contract assets and liabilities on the balance sheet in a less granular basis by portfolio. The new presentation will show separately portfolios of insurance contracts that are assets, portfolios of insurance contracts that are liabilities, portfolios of reinsurance contracts held that are assets, and portfolios of reinsurance contracts held that are liabilities.

For companies that prepare interim financial statements, an amendment now provides an option for an entity to change the estimates made in previous interim financial statements when applying IFRS 17 subsequently. This option would allow entities the option to treat interim financial statements in a manner consistent with IAS 34 Interim Financial Reporting, which states that the frequency of an entity's reporting should not affect the measurement of its annual results. The choice of option is made at the level of the reporting entity. As such, a subsidiary need not make the same choice for its financial statements as made at the level of the consolidated financial statements that includes the subsidiary.

Amendments to make results easier to explain

Under IFRS 17, contracts issued and reinsurance contracts held are treated separately. For insurance contracts expected to be loss making, IFRS 17 requires an entity to recognize losses immediately. Under IFRS 17 as originally issued, recoveries from related reinsurance contracts could not be used to immediately offset the loss on the underlying reinsured contract but would be recognized as profit over time as the entity receives reinsurance coverage. The amendment to the accounting for reinsurance contracts[23] requires an entity that recognizes losses on insurance contracts on initial recognition to recognize at the same time expected recoveries of those losses from reinsurance contracts held that the entity entered into before or at the same time as the loss-making insurance contracts were recognized. This gives considerable relief to insurers who routinely price insurance contracts taking into consideration the value of reinsurance cover.

Some insurers pay non-refundable commissions and incur other acquisition costs on sale of a policy in anticipation of future renewal business. IFRS 17 as amended now allows a portion of acquisition cash flows[24] to be allocated to related expected contract renewals. This amendment

[22] The scope exclusion applies only when the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the credit card contract with that customer.
[23] The accounting for the underlying insurance contracts issued is unaffected by the amendment.
[24] Insurance acquisition cash flows are cash flows arising from the costs of selling, underwriting, and starting a group of insurance contracts (issued or expected to be issued) that are directly attributable to

reduces the likelihood that affected groups of contracts would be determined to be loss making at initial recognition.

Under the general model, IFRS 17 as originally issued required an entity to recognize profit as the entity provides insurance coverage.[25] However, many insurance contracts without direct participation features, to which the general model applies, deliver investment services to the policyholder in addition to insurance coverage. This is the case for example for accumulation annuities where there may be no insurance coverage during the initial savings/accumulation phase. Profits would have to be deferred many years into the future until annuity payments start, i.e., when mortality and longevity insurance risks are covered. IFRS 17 was amended to allow profits to be recognized based on the amount of insurance contract services comprising both insurance coverage and services relating to investment activities.[26] This amendment will result in earlier recognition of profit for many insurance contracts with investment/savings components.

Companies that use derivatives to mitigate financial risks on contracts where the variable fee approach applies (insurance contracts with direct participation features), have the option of recognizing changes in mitigated financial risks in profit or loss[27] instead of adjusting the contractual service margin. An amendment was made to enable an entity to also apply the risk mitigation option when mitigating financial risks using reinsurance contracts held or non-derivative financial instruments measured at fair value through profit or loss. This amendment is expected to reduce accounting mismatches.

Amendments to ease transition

IFRS 17 was amended to permit an entity, in certain circumstances, to account for a liability for claims settlement of a contract acquired before the date of transition to IFRS 17 as a liability for incurred claims, instead of as a liability for remaining coverage. The effect of this is that the difference between consideration received or paid at the date of transaction and fulfilment cash flows does not go to CSM and is instead recognized in the net equity at transition. No insurance revenue is recognized in subsequent periods. At transition only, companies will not need to split its liabilities for claims settlement into those it issued versus those it acquired. The amendment applies only on transition to IFRS 17. For insurance contracts acquired after transition to IFRS 17 the risk of adverse claims development is included in the liability for remaining coverage (and thereafter as revenue).

---

the portfolio of insurance contracts to which the group belongs. Such cash flows include cash flows that are not directly attributable to individual contracts or groups of insurance contracts within the portfolio.

[25] Through the release of CSM (unearned profit) in profit or loss in each period based on coverage units, a measure of the insurance contract services is provided in that period. The computation of coverage units and release is done for each group.

[26] Insurance contract services are defined as: (a) coverage for an insured event (insurance coverage); (b) for insurance contracts without direct participation features, the generation of an investment return for the policyholder, if applicable (investment-return service); and (c) for insurance contracts with direct participation features, the management of underlying items on behalf of the policyholder (investment-related service).

[27] Use of the option would offset changes in fair value of derivatives.

IFRS 17 was also amended to:

- permit the risk mitigation option prospectively (avoiding the use of hindsight) from the transition date, which is one year earlier than previously permitted;
- permit the use of the fair value transition approach for a group of insurance contracts with direct participation features to which it could apply IFRS 17 retrospectively. However, this option is only available if the entity chooses to apply the risk mitigation option prospectively from the transition date and it has used derivatives, non-derivative financial instruments, or reinsurance to mitigate financial risk before the date of transition; and
- permit an entity that does not have reasonable and supportable information needed for the full retrospective approach to use information available at the date of transition to IFRS 17 instead of at inception or initial recognition of a contract in order to assess whether a contract is an investment contract with discretionary participation features within the scope of IFRS 17.