TC Notes
Practical leadership & technical guidance from Toronto Centre

IFRS 17 Insurance Contracts – What Supervisors Need to Know

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TORONTOCENTRE
Global Leadership in Financial Supervision

Contents

Introduction[1]

After 20 years in development, on May 18, 2017, the International Accounting Standards Board[2] issued a new Insurance Accounting Standard, IFRS 17 Insurance Contracts (IFRS 17/the Standard). Subject to relevant endorsement or adoption procedures in IFRS jurisdictions[3], entities must apply the Standard for reporting periods starting on or after January 1, 2021. IFRS 17 will represent 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 will be recognized and additional operational complexity around data systems and processes.

Since the Global Financial Crisis, there has been a tremendous focus on policy measures to ensure stability of the global financial system. The Financial Stability Board (FSB), mandated by G20 Leaders, 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 is the achievement of a single set of high-quality global accounting standards[4] 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* on July 24, 2014, with a mandatory effective date of January 1, 2018, and subsequently IFRS 17 *Insurance Contracts*[5], in May 2017, effective for annual reporting periods beginning on or after January 1, 2021.

The IMF's October 2017 Global Financial Stability Report[6]reinforced the need for additional policy focus on the insurance sector. Highlighting its view of the current problems with insurance accounting, the report stated that "Policies are needed to ensure greater insurer resilience" and "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 current standard, IFRS 4, allows insurance companies and national and multi-national insurance groups to continue to use national accounting standards for insurance contracts. These national standards differ in principle, application and outcome. IFRS 4 allows multi-nationals to consolidate using multiple accounting standards within the same set of financial statements. Also, many jurisdictions prescribe 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, its components will be disaggregated to compute and disclose profit or loss from

[1] This note was prepared by Michelle Chong Tai-Bell F.S.A on behalf of Toronto Centre.
[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 so by promoting the convergence of national accounting standards and IFRS and the use and rigorous application of those standards.
[3] Pacter, IFRS ® Foundation Pocket Guide to IFRS® Standards: The Global Financial Reporting Language.
[4] FSB, "Meeting of the Financial Stability Board in London on 25 September - Financial Stability Board."
[5] FSB, "FSB Welcomes New Insurance Accounting Standard - Financial Stability Board."
[6] IMF, "Global Financial Stability Report October 2017: Is Growth at Risk?"

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.

Regulatory authorities, such as the Office of the Superintendent of Insurance (OSFI) in Canada, who align regulatory accounting standards with general purpose accounting standards will automatically adopt IFRS 17 once endorsed in their jurisdiction[7] for use in general purpose financial statements. The risk-based insurance capital standard (ICS[8]) proposed by the International Association of Insurance Supervisors (IAIS), includes consideration of GAAP Plus options for IFRS 17 and FASB's US GAAP[9]. Field testing and monitoring[10] of these two GAAP Plus options will begin from 2020. The European Insurance and Occupational Pensions Authority (EIOPA) has been granted observer status in the deliberations of the European Financial Reporting Advisory Group (EFRAG) concerning IFRS 17. EFRAG has been carrying out extensive consultation with the European insurance industry to inform its advice to the European Commission on endorsement. EIOPA and other regulators such as the German Federal Financial Supervisory Authority, BaFin, are actively analysing the interaction between Solvency II and IFRS 17[11]. A review of Solvency II is due to be undertaken in 2021. Many jurisdictions are monitoring progress toward implementation and have not yet made public statements of intent regarding IFRS 17 adoption for regulatory purposes.

The Standard itself is 82 pages long and is accompanied by 77 pages of illustrative examples and 117 pages explaining the IASB's basis for conclusions. IFRS 17 is a complex standard, which is not yet widely understood. The IASB has provided implementation support, including the establishment of a Transition Resource Group[12]. The International Actuarial Association (IAA) has been actively supporting its member associations by developing model actuarial standards and educational material.

This TC Note is based upon the Standard and a review of publicly-available resources to glean the insights of insurers and professionals involved in the implementation of IFRS 17. The note discusses:

- How the key features of the Standard have been designed to meet the IASB's objectives
- Potential implications for insurers applying IFRS 17
- Considerations for adoption of IFRS 17 for regulatory and supervisory purposes based on the guidance of the Insurance Core Principles (ICPs[13]) of the IAIS.

This note is intended to raise awareness[14] of the work required by authorities in IFRS jurisdictions, highlighting the need to take stock of the requirements and determine a supervisory action plan for the way forward.

[7] The Canadian Accounting Standards Board has endorsed IFRS 17 and it is now in Part I of the CPA Canada Handbook – Accounting. The Standard is effective in Canada for annual periods beginning on or after January 1, 2021.

[8] On October 9, 2013, the IAIS announced its plan to develop a risk-based global insurance capital standard (ICS). This is a part of the IAIS's work plan, endorsed by the FSB, to create a comprehensive group-wide supervisory and regulatory framework for Internationally Active Insurance Groups.

[9] On August 15, 2018, FASB issued an Accounting Standards Update intended to improve financial reporting for insurance companies that issue long-duration contracts such as life insurance, annuities and long term care

[10] International Association of Insurance Supervisors, "Risk-Based Global Insurance Capital Standard Version 2.0 Public Consultation Document."

[11] BaFin, "BaFin - Accounting - Annual Report 2017: Accounting."

[12] https://www.ifrs.org/groups/transition-resource-group-for-insurance-contracts/

[13] International Association of Insurance Supervisors, Insurance Core Principles.

[14] This note is not intended to be a substitute for detailed study and/or obtaining the advice of subject matter experts.

Objectives of IFRS 17 and How Met

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 also 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[15]
- Relevance
- Comparability with other industries
- Transparency and understandability.

The following sections[16] describe how the key recognition, measurement, presentation and disclosure requirements of the principle-based standard have been designed to meet these objectives.

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 following key features of the Standard:

- Consistent measurement model, "the general model", for accounting for all insurance contracts issued (with simplification[17] for certain short-term contracts and modification for contracts with discretionary participation features[18])
- The measurement model is applicable to all entities within a Group on consolidation.

Relevance

The following features of the Standard 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[19] 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[20] 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

[15] While IFRS has been adopted by 126 jurisdictions, notably the United States and Japan, jurisdictions with large insurance markets, have not adopted IFRS

[16] International Accounting Standards Board, International Financial Reporting Standards (IFRS's): Including International Accounting Standards (IAS's) and Interpretations.

[17] Premium Allocation Approach.

[18] Variable Fee Approach.

[19] 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."

[20] From 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."

estimates based on more relevant current information, rather than using dated locked-in historical assumptions, achieves more relevance.

- 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[21]. This is because under IFRS 17 there is an equal and opposite 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 recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services."[22]
- 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.
- Currently, most insurance accounting regimes recognize premiums and deposits as revenue. 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 dis-aggregated 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

[21] Unless the assumption changes render the group of insurance contracts onerous.
[22] IFRS 15 Revenue from contracts with Customers, Basis for Conclusions.

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[23].
- 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, e.g., 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 (1) information about externally imposed capital requirements and the nature of those requirements; (2) how the requirements are incorporated into the management of capital; and (3) whether during the reporting period the entity has complied with any externally imposed capital requirements, and if not, the consequences of such non-compliance.

Many important aspects of IFRS 17 have been described above. For more comprehensive publicly-available summaries, see Appendix 1: Links to certain Documents Summarizing the Mean Features of IFRS 17.

[23] Scott, "Investor Perspectives Insurance Contracts-Accounting to Reflect Economics."

Implications for Insurers

Not unsurprisingly, to date there is no publicly-available empirical information about the likely financial impact of IFRS 17 upon adoption. Of course, given the diversity of existing accounting practices and insurer product mix, the business implications, financial impact and cost to implement will vary from insurer to insurer. The following sections provide highlights of qualitative assessments published by various parties.

IASB's IFRS 17 Insurance Contracts Effects Analysis[24]

According to its report "IFRS 17 Insurance Contracts Effects Analysis" ("Effects Analysis"), the IASB 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 who are likely to see reductions in reported equity are those where currently:

- Discount rates are based on assets backing insurance contract liabilities
- Negative insurance contract liabilities are allowed (i.e., profits are recognized at contract inception)
- Discount rates are determined at contract inception and "locked-in"
- Liability adequacy testing is performed at the entity level, so that the value of future losses on onerous groups of contracts is offset by future profits on viable contracts
- Techniques for determining the provisions for interest and other guarantees under-estimate 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.

The Effects Analysis also opines 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, regulators and 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.

[24] International Accounting Standards Board, IFRS 17 Insurance Contracts IFRS ® Standards Effects Analysis.

Global Surveys

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

<table>
<tr><th colspan="2">Table 1</th></tr>
<tr><th>Deloitte's Report
"2021 countdown underway
Insurers prepare for IFRS 17
Implementation"[25]</th><th>KPMG's Report
"In it to win it
Feedback from insurers on the journey to IFRS 17 and IFRS 9 implementation one year in"[26]</th></tr>
<tr><td>February and March 2018</td><td>Second quarter of 2018</td></tr>
<tr><td>320 insurers located across Canada, UK, France, Italy, Germany, Japan, Switzerland, Spain, China, South Korea, the Netherlands and US</td><td>160 insurers from over 30 countries</td></tr>
<tr><td>29% non-life, 20% reinsurers, 18% composite, 18% life, 15% health</td><td>34 large companies (premiums over US$10 billion) and 126 smaller companies</td></tr>
<tr><td>"Just enough time to get ready"

• Health insurers are most confident, life insurers least confident.</td><td>"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.</td></tr>
<tr><td>"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".
• There are concerns about the untested nature of vendor solutions – only prototypes so far.</td><td>"Big decisions loom about the CSM engine"

• Nearly four in 10 insurers are undecided whether to position the CSM calculator in their actuarial systems or in the finance sub-ledger system.
• "Wherever it is positioned, it will be important to bring actuarial and accounting teams closer together to combine their perspectives and expertise – and exercise appropriate governance and control."</td></tr>
</table>

[25] Deloitte, "2021 Countdown Underway I Insurers Prepare for IFRS 17 Implementation."
[26] KPMG International, "In It to Win It."

Table 1	
Deloitte's Report "2021 countdown underway Insurers prepare for IFRS 17 Implementation"[25]	**KPMG's Report "In it to win it Feedback from insurers on the journey to IFRS 17 and IFRS 9 implementation one year in"[26]**
"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 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% haven't decided which approach. • Method to calculate the risk adjustment – 54% haven't decided which method. • Expected approach to retrospective application – 31% don't know yet. • Assessing the granularity of data requirements for disclosures – 60% not yet addressed.
"When asked if the stakeholders in their organization were clear on what needed to be	***".. the majority of insurers so far have delivered training only for members of the***

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Deloitte's Report "2021 countdown underway Insurers prepare for IFRS 17 Implementation"[25]	**KPMG's Report "In it to win it Feedback from insurers on the journey to IFRS 17 and IFRS 9 implementation one year in"[26]**
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.	***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:
  ◦ financial statements that better reflect the results of business performance;
  ◦ easier access to capital markets for mergers and acquisition and fundraising activities; and
  ◦ improved information to support product design."
• IFRS 17 will have an impact:
  ◦ On product design – 82% agree
  ◦ On KPIs – 80% agree
  ◦ 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:
	  ◦ Product design and pricing (71%)
	  ◦ Investment policy (49%)
	  ◦ Risk management (45%)
	  ◦ 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 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 early September 2018, based on the evidence from its outreach with the European insurance industry and case study (see Appendix 2: Links to Documents from EFRAG's Consultation), the EFRAG Board communicated its view to the IFRS Foundation that six technical issues merit further consideration by the IASB[27].

On October 3, 2018, Insurance Europe issued a release stating "IFRS 17 must be reopened and the 11 issues that were identified during EFRAG's testing must be addressed. Implementation of the standard needs to be delayed by two years to allow time to make the necessary improvement and to allow time for the wide range of companies that are affected to implement the standard."[28]

In Canada, the Canadian Life and Health Insurance Association has also requested a two-year delay.[29]

In its March 2018 communication[30] regarding the European Commission's public consultation on the "Fitness Check on Supervisory Reporting", EIOPA underscored its commitment to contribute to a thorough assessment of the consistency between different reporting frameworks such as Solvency II and IFRS 17 and the cost/benefit of reporting obligations. In its July 2018 communication[31] to the European Commission on the EU Framework for Public Reporting, EIOPA acknowledged the benefit of sound internationally-accepted accounting standards and stated that it would be actively assessing IFRS 17.

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 on August 15, 2018 of an Accounting Standards Update[32] 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.

[27] European Financial Reporting Advisory Group, "04/09/2018 - LETTER TO IASB ON IFRS 17."
[28] Insurance Europe, "Position on IFRS 17 | Insurance Europe."
[29] Canadian Life and Health Insurance Association, "CLHIA - IFRS 17 - Canadian Request for Two-Year Implementation Date Deferral."
[30] EIOPA, "Letter to European Commission on 'Fitness Check on Supervisory Reporting.'"
[31] EIOPA, "Letter to European Commission on the EU Framework for Public Reporting by Companies."
[32] US Financial Accounting Standards Board, "ASU 2018-12—FINANCIAL SERVICES—INSURANCE (TOPIC 944): TARGETED IMPROVEMENTS TO THE ACCOUNTING FOR LONG-DURATION CONTRACTS."

Takeaways 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 this means for the management of insurance businesses is unprecedented. Already, the IASB has agreed certain clarifications[33] and there may be further interpretations and clarifications to come. Educational materials and guidance are still under development by various parties (see Appendix 3: Links to Websites Supporting Implementation). In many jurisdictions, uncertainty is amplified because the critical question of how regulators and the tax authorities will respond is as yet unanswered.

Ensuring 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[34]. 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
- 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[35]. 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

[33] IFRS Foundation, "IFRS - IASB and Joint IASB—FASB Update June 2018."

[34] As an example, in Canada, the Office of the Superintendent of Financial Institutions has requested semi-annual reporting on the status of IFRS 17 implementation activities. http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/adv-prv/Pages/ifrs17.aspx

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

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, 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 impact in these areas well before 2021.

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.

Regulatory and Supervisory Use of General Purpose Accounting Standards

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

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 recognises 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 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:

- Product pricing, portfolio profitability and growth and product mix strategies based 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
- Viability and riskiness of investment strategies assessed using accounting numbers

- Adequacy of capital (and the appropriateness of shareholder dividend policy) based on regulatory targets and not on sophisticated economic capital assessments
- Non-GAAP actuarial analyses, such as sources of earnings or embedded value added, not being routinely used 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 quite 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 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.

EXTRACTS FROM INSURANCE CORE PRINCIPLES ICP 17 Capital Adequacy The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention.	
ICP 17.1	The supervisor requires that a total balance sheet approach is used in the assessment of solvency to recognise the interdependence between assets, liabilities, regulatory capital requirements and capital resources and to require that risks are appropriately recognised.
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 standardised 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 standardised 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-based 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[36] 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 or 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[37] 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.Two examples of such standards are:

1. The EU Solvency II Directive[38] articulates the supervisory risk tolerance equivalent to an insolvency probability of 0.5% as follows:

   "In order to promote good risk management and align regulatory capital requirements with industry practices, the Solvency Capital Requirement should be determined as the economic capital to be held by insurance and reinsurance undertakings in order to ensure that ruin occurs no more often than once in every 200 cases or, alternatively, that those undertakings will still be in a position, with a probability of at least 99,5 %, to meet their obligations to policy holders and beneficiaries over the following 12 months. That economic capital should be calculated on the basis of the true risk profile of those undertakings, taking account of the impact of possible risk-mitigation techniques, as well as diversification effects."

2. To define the going concern level of assets that a life insurer is expected to maintain, the policy paper[39] which informed the design of the Canadian Life Insurance Capital Adequacy Test used a confidence level of 99% Conditional Tail Expectation (CTE) over 1 year with adequate funds remaining after one year to allow the insurer to fulfil its policyholder obligations or pass the risks on to a succeeding insurer.

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

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[36] Insurer Solvency Working Party of the International Actuarial Association, "A Global Framework for Insurer Solvency Assessment A Global Framework for Insurer Solvency Assessment A Global Framework for Insurer Solvency Assessment A Report by the Insurer Solvency Assessment Working Party of the International Actuarial Association."

[37]Lessons from the banking sector - 1998 speech by Mr. Greenspan, "The role of capital in optimal banking supervision and regulation" https://www.bis.org/review/r980309b.pdf

[38] EC, "Directive 2009/138/{EC} of the {European} {Parliament} and of the {Council} of 25 {November} 2009 on the Taking-up and Pursuit of the Business of {Insurance} and {Reinsurance} ({Solvency} {II})."

[39] MCCSR Advisory Committee, "Canadian Vision for Life Insurer Solvency Assessment."

Box 1 - TECHNICAL CONSIDERATIONS

Margins for risk
The IFRS 17 Basis for Conclusions (BC209) states that the IFRS 17 risk adjustment "should not represent:… (b) 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[40]. 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.

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 rather 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.

[40] The IFRS 17 risk adjustment for non-financial risk will 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.

Supervisors deciding to adopt IFRS 17 for risk-based solvency and capital adequacy assessments should initiate policy reform projects in consultation with industry, audit professionals, actuaries and other key stakeholders.

Steps would include:
1. Initial design (or adaptation of existing framework) of the capital framework (including capital requirements, the definition of available capital and solvency control levels) determined in keeping with economic principles, the total balance sheet approach (ICP17.1) and desired risk tolerance and target criteria (ICP 17.8 and ICP 17.3.7).
2. Redesign of regulatory returns (financial statements and capital adequacy returns) and development of consistent and clear sets of instructions and definitions (ICP 9.4.8). Under IASB accounting rules insurers are given some latitude to determine the format for financial statements. This freedom to choose a format, even though it has no direct impact on recognition and measurement issues, will create difficulties in the processing, analysing, comparison and trend analysis of IAS/IFRS accounting data, hence the need for standardization for regulatory purposes.
3. Field testing of the impact of the proposed capital adequacy regime.
4. Determination of any transitional adjustments based on the results of the field testing.
5. Determination of any changes to consolidated supervision frameworks.
6. Assessment of the pros and cons of issuing new regulation versus rules versus guidance. Drafting of the requirements, consultation, approval and issuance.

Improving Supervisory Review and Reporting

EXTRACT FROM INSURANCE CORE PRINCIPLES ICP 9 Supervisory Review and Reporting
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 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.

Insurers may continue to disclose certain non-GAAP measures (e.g., 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 (e.g., CSM rather than embedded value).

Supervisors will need to update metrics[41] and incorporate the new information from IFRS statements when evaluating an insurer.

EXTRACT FROM INSURANCE CORE PRINCIPLES ICP 14 Valuation The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention.	
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.

For jurisdictions that <u>do not</u> intend to move to IFRS 17 as its regulatory accounting standard:

- ***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 may need to be redesigned (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) may need to be redesigned (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 not only be used to compute the actuarial liabilities but the output from these models (requiring multiple runs and seamless interface with CSM and other financial systems) will also 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[42].

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.

[41] International Accounting Standards Board, "The Essentials-Busting Insurance Jargon."
[42] Howes, "Actuarial Models in an IFRS 17 World Reprinted from Society of Actuaries - Modeling Section - Issue 7."

Use of Insurers' Stress and Scenario Testing in Making Supervisory Judgments

EXTRACTS FROM INSURANCE CORE PRINCIPLES ICP 16 Enterprise Risk Management for Solvency Purposes The supervisor establishes enterprise risk management requirements for solvency purposes that require insurers to address all relevant and material risks.	
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 which 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 analyse 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* 16.16 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 form a high-level assessment of whether the insurer is adequately capitalised to withstand a range of standardised 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-based 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 (ICP 16.16.8), 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 would 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
- That 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

EXTRACT FROM INSURANCE CORE PRINCIPLES ICP 14 Valuation The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention.	
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 subjecting valuations to independent review. The supervisor should require a valuation methodology which 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. In the words of the IASB, "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."[43].

The submissions for consideration by the IASB's Transition Resource Group of aspects requiring interpretation and clarification have been extensive and voluminous. EFRAG's Case study highlighted areas of accounting mismatch and implementation cost considerations. 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.

Already, on June 21, 2018 the IASB agreed to make clarifying amendments to IFRS 17[44] as part of its annual improvements cycle. The IASB's staff notes[45] articulate the basis for the decision as being "to ensure that the words in the standard reflect the decisions made by the Board during its deliberations." "The Board agreed to clarify that, for contracts subject to the variable fee approach, the determination of coverage period and quantity of benefits should include investment-related services in addition to insurance coverage. The Board also agreed to clarify that the consequential amendment in IFRS 3, 'Business Combinations', on the classification of insurance contracts applies prospectively; and, separately, that business combinations under common control are excluded from the scope of the requirements for business combinations in IFRS 17."

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 the

[43] IASB's Conceptual Framework for Financial Reporting.
[44] IFRS Foundation, "IFRS - IASB and Joint IASB—FASB Update June 2018."
[45] IASB Staff, "IASB June 2018 Board Meeting Staff Paper."

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 (e.g., illiquid capital markets, definition of risk-free, lack of data).

Ensuring that Audit Standards Are Fit for Purpose

EXTRACT FROM INSURANCE CORE PRINCIPLES **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 in October 2018[46]. 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[47] 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.
- 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 work with audit entities and standard setting bodies in the jurisdiction to address any shortcomings.

Supervisors should evaluate how audit firms are building their capacity to audit financial statements prepared in accordance with this complex standard.

[46] http://www.ifac.org/publications-resources/isa-540-revised-auditing-accounting-estimates-and-related-disclosures
[47] https://www.iaisweb.org/page/supervisory-material/comment-letters/file/67940/iais-comments-on-iaasb-ed-isa-540-accounting-estimates-july-2017

Ensuring Adequate Professional Standards and Guidance

EXTRACT FROM INSURANCE CORE PRINCIPLES **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 is developing a model actuarial standard of practice, ISAP 4[48], dealing with IFRS 17. ISAP 4 is intended to "Provide useful and high-quality guidance to actuaries providing actuarial services in relation to IFRS X, to facilitate widely accepted convergence of principle-based actuarial standards within and across jurisdictions"[49]. Many interested parties have provided comments on the exposure draft[50]. Once promulgated, this standard will not be binding on actuaries unless 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[51].

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 auditor and the actuarial opinion[52]. Supervisors might also wish to issue supplementary implementation guidance to address identified gaps in international and national guidance.

As an example of the approach taken for IFRS 9, in December 2015 the Basel Committee on Banking Supervision issued supervisory guidance on sound credit risk practices associated with the implementation of IFRS 9 Financial Instruments.[53]. In May 2017, the European Banking authority issued additional guidance to its regulated entities[54] in Europe.

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 (e.g., by way of memoranda of understanding) for engagement with professional bodies and regularly engage with them to promote and ensure alignment of interests.

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[48] https://www.actuaires.org/index.cfm?lang=EN&DSP=PUBLICATIONS&ACT=STANDARDS_ISAPIFRS
[49] https://www.actuaires.org/CTTEES_ASC/ISAP%20on%20IFRS/Final_SOI_ISAP4_13Sept2014.pdf
[50] https://www.actuaires.org/index.cfm?lang=EN&DSP=PUBLICATIONS&ACT=STANDARDS_EXPOSUREDRAFT-ISAPIFRS
[51] As an example - Link to work being done by the Actuaries Institute in Australia, https://www.actuaries.asn.au/professional-development-regulation/ifrs-17-and-aasb-17.
[52] See OSFI's comment on the Statement of Intent for ISAP 4 https://www.actuaries.org/CTTEES_ASC/isaps/Exposure%20Process/ISAP4_OSFI.pdf
[53] Basel Committee on Banking Supervision, "Basel Committee on Banking Supervision Guidance on Credit Risk and Accounting for Expected Credit Losses."
[54] European Banking Authority, "Final Report Guidelines on Credit Institutions' Credit Risk Management Practices and Accounting for Expected Credit Losses."

Conclusion – Regulatory and Supervisory Action

The scope and scale of the changes required to transition to IFRS 17 is unprecedented. The eventual impact will be significant but is still unclear. However, IFRS 17 is expected to benefit the industry by improving transparency and comparability and facilitate 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 facilitate consolidated supervision of regional insurance groups and conglomerates.

This note is not intended to be a substitute for detailed study or obtaining the advice of subject matter experts. In addition to the references cited in the note, the appendices include references to various public resources on IFRS 17.

This note, by highlighting many aspects to be considered by supervisors, is intended to raise awareness of the work to be done to adapt risk-based supervisory frameworks in IFRS jurisdictions. There is not a lot of time for regulators, supervisors and insurers to plan and make the transition and implementation to IFRS 17 as smooth and successful as possible. Now is the time for action.

Appendix 1: Links to Documents Summarizing the Main Features of IFRS 17

IASB Effects Analysis
https://www.ifrs.org/-/media/project/insurance-contracts/ifrs-standard/ifrs-17-effects-analysis.pdf?la=en&hash=941E01899DF8823049940FFB511CEB6990D81D35

Deloitte summary
https://www2.deloitte.com/content/dam/Deloitte/za/Documents/financial-services/za_IFRS17_Insurance_Contracts_Technical_summaryNv.pdf

EY summary
https://www.ey.com/Publication/vwLUAssets/ey-Applying-IFRS-17-Guidelines/%24File/ey-Applying-IFRS-17-Guidelines.pdf

KPMG First Impressions
https://home.kpmg.com/content/dam/kpmg/xx/pdf/2017/07/ifrs17-first-impressions-2017.pdf

PwC summary
https://www.pwc.com/us/en/cfodirect/assets/pdf/in-depth/ifrs-17-insurance-contract-accounting.pdf

Appendix 2: Links to Documents from EFRAG's Consultation

EFERAG's IFRS17 Endorsement Consultation project: https://www.efrag.org/Activities/289/IFRS-17---Insurance-Contracts

http://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FMeeting%20Documents%2F1805291337379210%2F02-03%20IFRS%2017%20Industry%20issues%20analysis%20-%20compared%20to%20TEG%2025%20July%202018%20-%20EFRAG%20TEG%2018-08-08.pdf

Summary of US GAAP requirements for insurance (including proposed changes to the Accounting for Long-Duration Insurance Contracts) and comparison with IFRS 17
https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FMeeting%20Documents%2F1709060812462007%2F13-04%20Comparison%20IFRS%2017%20and%20US%20GAAP%20-%20Issues%20Paper%20-%20EFRAG%20TEG%2018-06-13.pdf

Level of aggregation
https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FProject%20Documents%2F289%2FIFRS%2017%20Level%20of%20aggregation%20-%20Background%20briefing%20paper%20final.pdf

Release of the CSM
https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FIFRS%252017%2520Background%2520briefing%2520paper%2520CSM%2520allocation.pdf

Transition
https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FIFRS%252017%2520Background%2520briefing%2520paper%2520on%2520Transition.pdf

Appendix 3: Links to Websites Supporting Implementation

IFRS Foundation
https://www.ifrs.org/projects/2017/insurance-contracts/

https://www.ifrs.org/groups/transition-resource-group-for-insurance-contracts/

International Actuarial Association (IAA)

Links to Actuarial model Standards:
https://www.actuaries.org/iaa/IAA/Committees/Actuarial_Standards/IAA/Committees/Actuarial_Standards/Landing.aspx?hkey=2fc5a7be-42ea-4973-a4ae-850960a98efb

Links to International Actuarial Notes:
https://www.actuaries.org/iaa/IAA/Publications/IANs/IAA/Publications/international_actuarial_notes.aspx?hkey=d03a8eec-38fe-4d76-80b0-e0ed1e4e538b

IAA Risk Book:
https://www.actuaries.org/iaa/IAA/Publications/iaa_riskbook/IAA/Publications/iaa_riskbook.aspx?hkey=1bb7bce0-2c43-41df-9956-98d68ca45ce4

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Basel Committee on Banking Supervision. “Basel Committee on Banking Supervision Guidance on Credit Risk and Accounting for Expected Credit Losses,” 2015. www.bis.org.

Canadian Life and Health Insurance Association. “CLHIA - IFRS 17 - Canadian Request for Two-Year Implementation Date Deferral,” 2018. https://www.clhia.ca/web/clhia_lp4w_lnd_webstation.nsf/page/DDC288B867A66731852582DD00622EC7.

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EC. “Directive 2009/138/{EC} of the {European} {Parliament} and of the {Council} of 25 {November} 2009 on the Taking-up and Pursuit of the Business of {Insurance} and {Reinsurance} ({Solvency} {II}),” 2009. https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A32009L0138.

EIOPA. “Letter to European Commission on ‘Fitness Check on Supervisory Reporting.’” Accessed October 1, 2018. https://eiopa.europa.eu/Publications/Letters/EIOPA-18-072 Letter to Olivier Guersent on Fitness Check on Supervisory reporting.pdf.

"Letter to European Commission on the EU Framework for Public Reporting by Companies,” 2018. https://eiopa.europa.eu/Publications/Letters/EIOPA-18-491 Fitness Check on the EU Framework for Public Reporting by Companies%28GBE%29.pdf.

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Additional Readings

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Addendum

On November 14, 2018, the International Accounting Standards Board (IASB) announced[55]:

"The International Accounting Standards Board (Board) has today voted to propose a one-year deferral of the effective date for IFRS 17, the new insurance contracts Standard, to 2022.

The Board has also decided to propose extending to 2022 the temporary exemption for insurers to apply the financial instruments Standard, IFRS 9, so that both IFRS 9 and IFRS 17 can be applied at the same time."

The proposed deferral is subject to public consultation, which is expected to take place in 2019.

At its December 2018 meeting, the IASB is expected to consider whether any of the concerns and implementation challenges discussed by the Transition Resource Group and other stakeholders, including those relating to the costs and benefits of IFRS 17, warrant amendment of the Standard. The necessary (but not necessarily sufficient) criteria to be used for any potential amendments to the Standard are to be:

a. the amendments would not result in significant loss of useful information relative to that which would otherwise be provided by IFRS 17 for users of financial statements—any amendments would avoid:
    i. reducing the relevance and faithful representation of information in the financial statements of entities applying IFRS 17;
    ii. causing reduced comparability or introducing internal inconsistency in IFRS Standards, including within IFRS 17; or
    iii. increasing complexity for users of financial statements, thus reducing understandability.
b. the amendments would not unduly disrupt implementation already under way or risk undue delays in the effective date of this Standard, which is needed to address many inadequacies in the existing wide range of insurance accounting practices.

November 20, 2018

[55] *https://www.ifrs.org/news-and-events/2018/11/iasb-to-propose-one-year-deferral-of-insurance-contracts-standard/*