This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

IFRS 17 and Solvency II
Issues Paper

Introduction and objective

1 The objective of this paper is to address, as part of the preparation of the Draft Endorsement Advice for IFRS 17, the questions of the European Commission and the European Parliament in respect of the interaction between IFRS 17 and Solvency II.

2 The Commission asked EFRAG to assess the potential ability for the companies to benefit from the work undertaken in reporting under Solvency II regime. This assessment should follow the comparison of the estimated impact on the financial statements with the information provided under Solvency II to understand the size of the differences between IFRS 17 and Solvency II.

3 The Parliament stressed the need to fully understand the interaction between IFRS 17, which employs a principles-based approach, and other regulatory requirements for insurance entities in the EU, in particular Solvency II, especially in relation to the cost of implementing IFRS 17.

Structure of this paper

4 This paper first puts the issue in perspective, by analysing the number of EU insurers subject to the Solvency II requirements and comparing the results with the number of EU insurers reporting under IFRS.

5 Next, the paper presents the similarities and differences between IFRS 17 and Solvency II, by comparing the text of these two regimes and assessing the impact of any differences.

6 Subsequently, the paper presents the findings of EFRAG outreach activities to assess whether and to what extent insurers are able to use Solvency II calculations and systems when implementing IFRS 17. Hereby, EFRAG took into consideration the results of EIOPA's assessment of IFRS 17, covering the effects on competition, product availability and financial stability and EIOPAs views on using Solvency II inputs, approaches and processes for an efficient implementation of IFRS 17.[1]

7 Finally, the paper presents some observations on the estimated impact on the financial statements and proposes the text to be included in the Draft Endorsement Advice.

8 Appendix 1 presents, per Member State, an overview of the data relevant for this issues paper.

Putting the issue in perspective

[1] EIOPA's analysis of IFRS 17 Insurance Contracts, EIOPA-18-717 dated 18 October 2018.

9 According to a recent paper issued by EIOPA,[2] there were, at the end of 2018, 3,438 insurance and reinsurance undertakings (in this issues paper, together referred to as 'insurers') active in the EU, of which 573 were excluded from Solvency II because they were below the Article 4 threshold of the Solvency II Directive 2009-138/EC, and 181 for other reasons. Based on these statistics, **2,684 insurers are subject to the Solvency II requirements**.

10 Article 4 lists different quantitative thresholds, the most important ones relating to the size of the business in terms of premiums and technical provisions – annual gross written premium income lower than 5 million Euros or gross technical provisions lower than 25 million Euros.[3]

11 The EIOPA paper describes the prudential regime applied to insurers excluded from Solvency II and notes that in 9 Member States there are no insurers excluded from the scope of Solvency II, and 6 Member States apply a regime similar to Solvency II but with some exemptions. However, the number of excluded insurers in these 6 Member States is so small that this has no impact on the analysis presented below.

12 If all 2,684 insurers subject to Solvency II also apply IFRS in their financial statements, there is, in theory, a large potential for the EU insurance market to capitalise (at least, partially) on its investments in Solvency II when implementing IFRS 17. Whether this will the case in practice, is discussed in the next sections.

Application of IFRS in the EU insurance market

13 Appendix 1 shows that, at the end of 2018, the application of IFRS in the individual financial statements of non-listed insurers is prohibited in Austria, Belgium, Denmark, France, Italy, Romania, Spain and Sweden. The total number of insurers subject to Solvency II in these Member States is 1,045.[4]

14 The appendix also shows that IFRS is required in individual financial statements in Croatia, Cyprus, Estonia, Greece, Latvia, Lithuania, Malta, Portugal, Slovak Republic, and Slovenia. This concerns 244 insurers.

15 The other Member States permit the use of IFRS in the individual financial statements of the remaining 1,395 insurers. However, in some Member States, this permission is conditional. One prime example is Germany (with 338 insurers under Solvency II), where the application of IFRS is only allowed if these financial statements are also prepared and filed under German GAAP. The EFRAG Secretariat has been informed that, because of this condition, no German insurer applies IFRS unless required.

[2] EIOPA, Consultation Paper on the Opinion on the 2020 review of Solvency II, BoS-19/465 dated 15 October 2019.

[3] In its Consultation Paper, EIOPA discusses several options to increase the threshold. Depending on the option chosen, this would increase the number of exempted companies by about 250 to 300. Since the consultation is open for comments and any final decisions are not expected to be made before the planned submission of the final endorsement advice on IFRS 17, these options are ignored in the remainder of this issues paper.

[4] If these companies are listed and also prepare consolidated financial statements, they are, however, still subject to both IFRS and Solvency II. For a full understanding of the statistics and its nuances, see the footnotes in appendix 1.

16 **According to Insurance Europe 537 EU insurers actually applied, at the end of 2018, IFRS in their individual or consolidated financial statements.**[5] Since all these insurers are also subject to Solvency II, all these companies would benefit from potential cost synergies when implementing IFRS 17. **On the other hand, at the end of 2018, 2,147 EU insurers were subject to Solvency II, but not required to apply IFRS (including IFRS 17) in their individual financial statements.**

17 The EFRAG Secretariat notes that the statistics above focus on insurers applying IFRS in their own consolidated or individual financial statements. In the case of insurance groups applying IFRS, their subsidiaries need to report IFRS figures and other information for consolidation purposes and are therefore also subject to IFRS 17 and Solvency II. Since there are no public data available on the number of such subsidiaries, it is not possible to provide any quantitative data. Given the level of consolidation in the EU insurance market,[6] the EFRAG Secretariat expects the number to be significant. However, it should also be mentioned that such subsidiaries will be able to benefit from IFRS 17 implementation activities (including the development of dedicated systems) within the group, thereby limiting the costs they would otherwise incur. The EFRAG Secretariat notes that this advantage is not the case when these subsidiaries are not part of an insurance group, but of a group carrying out other activities such as banking.

Questions for EFRAG TEG
18 Do EFRAG TEG members have any comments or questions on paragraphs 9 to 17?

Similarities and differences between IFRS 17 and Solvency II – technical comparison

19 Comparing IFRS 17 and Solvency II on a high level, the respective primary objectives and the scope of the two regimes differ. IFRS 17 deals with reporting the rights and obligations from insurance contracts in the context of general purpose financial reporting, i.e. reporting of information to the financial markets. Solvency II is part of a risk-based prudential regime and focuses on the total spectrum of prudential supervision on insurers for the protection of the interests of policyholders and beneficiaries. To serve their respective objectives, both IFRS 17 and Solvency II adopt a current-value measurement basis, however with the methodological differences that are described below.

20 Solvency II applies a balance sheet approach and focuses on measurement of the insurance liabilities at a point in time. IFRS 17 includes requirements for the measurement of insurance contracts as well as the accounting treatment of changes in the resulting assets and liabilities, whether within the balance sheet (in the form of changes in the risk adjustment or the contractual services margin CSM), in profit or loss, or in OCI.

21 In other words, IFRS 17 deals with both measurement and performance reporting, while Solvency II focuses on measurement. That being said, it should also be noted that both regimes are based on current measurement of the (uncertain) future cash flows of insurance contracts, although starting from a different

[5] This includes the financial statements of 133 insurers in Sweden, where, at the moment, the national Financial Services Authority requires IFRS in the consolidated financial statements of unlisted insurance companies. On 19 December 2019, the Authority communicated that it will propose removing this requirement. A decision will be made in Autumn 2020, effective 1 January 2021.

[6] Reference is made to statistics published by Insurance Europe on its website: Insurance Data, European insurance industry database, Total insurance.

perspective (fulfilment under IFRS 17 and transfer to a third party under Solvency II). As both approaches use market inputs to the maximum extent, the starting point for a number of inputs is similar in principles under both reporting regimes.

22 When analysing the details of both sets of requirements, the EFRAG Secretariat observes many similarities. The detailed requirements of the two frameworks are, however, not identical and therefore a number of potential differences can be identified. The most relevant ones are described below, following the structure of IFRS 17.

(a) **Definition/contracts affected**: all contracts legally regulated as insurance activities fall under the scope of Solvency II. Under IFRS 17, contracts that do not include significant insurance risk (in particular investment contracts without Discretionary Participation Features (DPF) and some service contracts) are excluded while investment contracts with DPF (which also do not include significant insurance risk) are within the scope of this standard. Contracts with significant insurance risk that are legally regulated as insurance activities represent the common scope of application of the two regimes. These two different formal scoping approaches capture a large common area and will translate in practice in differences only for those contracts legally regulated as insurance activities that do not have significant insurance risk.

(b) **Scope of consolidation**: there can be, depending on the international composition of the reporting group, significant differences in the consolidation scope between the two reporting regimes.[7] Groups with significant subsidiaries outside the EU but in countries that, under Solvency II, qualify as 'equivalent'[8] do not have to implement Solvency II definitions and measurement to these activities, but do have to apply IFRS 17 to all subsidiaries in the group. Depending on the detailed regulations of the 'equivalent' regimes, this may or may not create other differences than those identified when comparing IFRS 17 with Solvency II.

(c) **Business combinations**: as IFRS 17 requires the creation of a CSM when acquiring a portfolio of insurance contracts, and Solvency II does not (the concept of the CSM does not exist under Solvency II), business combinations will lead to a difference in measurement at acquisition date and subsequently.

(d) **Separating components (unbundling)**: the separation requirements of IFRS 17 differ from the Solvency II requirements, since the latter focuses on insurance risks only and IFRS 17 also focuses on financial and service components. The most important of these components will be embedded derivatives and, possibly, distinct investment components. On the other hand, Solvency II requires unbundling of insurance components within one contract between different lines of business, while IFRS 17 keeps all insurance components within one contract together.

(e) **Granularity/grouping of contracts**: the level of granularity differs between IFRS 17 and Solvency II. At the highest level: under IFRS 17, the definition of a portfolio focuses on both similar risks and managing contracts together,

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[7] This difference is not the result of IFRS 17, but of IFRS 10, 11 and 12.

[8] 'Equivalence' is defined in Articles 379 and 380 of the Commission Delegated Regulation 2015/35. One of the criteria is whether the assessment of the financial position of an insurer relies on sound economic principles and whether solvency requirements are based on the economic valuation of all assets and liabilities. At the end of November 2019, EIOPA has assessed as fully equivalent the supervisory systems of Switzerland and Bermuda, and as provisionally equivalent the systems of Australia, Brazil, Canada, Japan, Mexico and the USA.

while Solvency II only focuses on homogeneous risk groups. Although in many cases the portfolios will likely be identical, differences could occur. Next, within these portfolios IFRS 17 requires the identification of three groups (including a group of contracts that are onerous at initial recognition) and annual cohorts; such requirements do not exist in Solvency II. This will not only have an impact on determining the CSMs, but possibly also on determining the future cash flows for measurement purposes: potentially there will be an impact on the contract boundaries and on the level of mutualisation/cross-subsidisation between contracts in one portfolio and/or group (see below).

(f) **General measurement approach**: both IFRS 17 and Solvency II are based on a current-value approach that leverages on market-based data. IFRS 17 focuses on an 'entry-type' approach (the fulfilment cash flows), while Solvency II focuses on an exit value. However, as is stated above, also Solvency II uses much entity-specific information (because of the lack of an active market in which insurance contracts can be transferred to another company), and, secondly, IFRS 17 requires a consistent check with market data. In practice, there could be a number of inputs that are similar under both reporting regimes.

(g) **Future cash flows (including expenses)**: assuming no differences in the contract boundaries (see hereafter), the approaches IFRS 17 and Solvency II are quite similar but not identical. One difference concerns expenses: under Solvency II, all overhead expenses incurred in servicing insurance obligations shall be taken into account. Under IFRS 17, overhead expenses are allocated to groups of contracts if they are directly attributable to fulfilling insurance contracts; this can mean that, under IFRS 17, in principle there may be overhead expenses that cannot be allocated to the insurance liabilities (not directly attributable).

(h) **Contract boundaries**: the requirements of both regimes are quite similar. Determining the contract boundary of an insurance contract is challenging under both reporting regimes, as both reporting regimes require a significant amount of judgement, in particular whether or not a price or levels of benefits can be set that fully reflect the risks.

(i) **Discount rates**: IFRS 17 has a principle-based approach and Solvency II a prescriptive approach, where the rate is determined by EIOPA. Both regimes aim at determining the risk-free interest rate term structure, consistent with market information and the characteristics of the insurance contracts. Under IFRS 17, an entity can apply a so-called bottom-up approach (starting from a liquid risk-free yield curve) or a top-down approach (starting from a yield curve that reflects the current market rates of return implicit in a fair value measurement of a reference portfolio of assets). Under Solvency II, the EIOPA-determined discount rate can (if certain conditions are fulfilled, to be approved by the national insurance supervisory authority) include two other factors, being the matching adjustment or the volatility adjustment that may or may not be consistent with the principle-based approach of IFRS 17.

(j) **Risk adjustment**: for Solvency II, this adjustment is determined and fixed in legislation. IFRS 17 requires judgement, both in respect of the estimation technique as well as for the parameters that serve as input. At the same time, it should be noted that the Solvency II cost-of-capital technique is an accepted technique under IFRS 17, that it could be suitable for certain portfolios.

(k) **CSM**: Solvency II does not recognise the concept of a CSM, so this will lead to a difference in IFRS 17 and Solvency II reporting.

(l) **Subsequent measurement**: in IFRS 17, this section mainly deals with how to account for changes in components of the fulfilment cash flows and the CSM; the general measurement approach described above is not changed. As under Solvency II subsequent measurement is completely aligned with initial measurement, any differences at initial recognition between IFRS 17 and Solvency II described above are applicable to subsequent measurement as well.

(m) **Options to the general measurement approach**: in respect of the general measurement approach, differences between IFRS 17 and Solvency II are created by the IFRS 17 exceptions for contracts under the premium allocation approach, reinsurance contracts held, and investment contracts with DPF; Solvency II does not include such exceptions.

(i) **Premium allocation approach**: the premium allocation approach (PAA) is a simplification of the general measurement approach under IFRS 17, and can be applied if certain conditions are met. In practice, the most important condition refers to the coverage period of each contract in a group (one year or less). Such simplification does not exist in Solvency II, and as a result there is no CSM under Solvency II where there is an implicit CSM under IFRS 17 included in the liability for remaining coverage. If the amendment proposed by the IASB in June 2019 to allow the recognition of insurance acquisition cash flows as assets would be adopted, this will result in another difference, since Solvency II does not recognise such an asset.

(ii) **Reinsurance contract held**: for reinsurance contracts held, Solvency II applies a ‘net’ approach for determining the risk margin of insurance contracts and allocates reinsurance cash-inflows to corresponding insurance contracts, whereas IFRS 17 presents ceded reinsurance as a separate reinsurance asset. As a result, the risk adjustment may differ between the reinsurance contracts held and the underlying insurance contracts. Furthermore, the contract boundaries may not be the same and the CSM is determined differently for both sets of contracts.

(iii) **Investment contracts with DPF**: the main difference between the two reporting regimes for these contracts refers to the CSM (and any subsequent changes therein).

(n) **Balance sheet**: the requirements in respect of items to be presented in the balance sheet under both reporting regimes are similar but not completely identical. IFRS 17 requires the separation of both insurance contracts issued and reinsurance contracts held into assets and liabilities. As a result, there can be four categories: insurance contracts issued that are assets, insurance contracts issued that are liabilities, reinsurance contracts held that are assets, and reinsurance contracts held that are liabilities. Solvency II separates insurance contracts issued (liabilities) and reinsurance contracts held (assets). This difference is mainly caused, in practice, by the differences in the treatment of acquisition cash flows, which, under IFRS 17, can result in assets, while Solvency II does not recognise these cash flows in the balance sheet. On the other hand, IFRS 17 combines all cash flows from insurance contracts at portfolio level in one balance sheet item (an asset or a liability), while Solvency II requires, in the Solvency and Financial Condition Report (SFCR), separation of a number of components of this asset or liability (for example, premiums receivable or claims payable). In this respect, Solvency II is more detailed in its presentation requirements.

(o) **Profit or loss**: IFRS 17 requires the presentation of a profit or loss account, Solvency II does not.

(p) **Disclosures**: ignoring the disclosure requirements related to performance reporting, the requirements of IFRS 17 and Solvency II are quite similar (with differences in the details). Both provide further insight in financial amounts as well as in (managing) risks, for example by requiring the disclosure of the bases, methods and main assumptions/significant judgements in measuring the insurance liabilities.

(q) **Transition approach**: IFRS 17 offers three different transition approaches, while Solvency II offered only one: a point-in-time approach for measuring the insurance liabilities in the balance sheet. The main difference in practice will refer to the measurement of the CSM under IFRS 17 at transition date. This difference is another reflection of the fact that Solvency II does not have a concept of CSM, as mentioned above.

(r) **Comparative amounts**: while IFRS 17 requires the presentation of comparative amounts at transition, Solvency II did not.

Questions for EFRAG TEG	
23	Do EFRAG TEG members have any comments or questions on paragraphs 19 to 22?

24 When assessing the impact of similarities and differences between IFRS 17 and Solvency II, it should be kept in mind that, at this point in time, there are significant differences between insurers on their phase of preparation for the implementation of IFRS 17. While some are already (close to) running 'dry-runs', others are still in the stage of analysing the details of IFRS 17 and preparing high level assessments of the required changes.

25 At the same time, there are large differences in the activities of EU insurers and insurance groups, in respect of the specificities of their insurance contracts, (inter-) national composition, size and systems.

26 Therefore, the EFRAG Secretariat is of the opinion that it is not be achievable, at this point in time, to provide a full and comprehensive EU-wide overview of the nature and significance of all identified or possible differences between Solvency II and IFRS 17. The latter is still subject to potential amendments (although the fundamentals will not change), implementation activities are still ongoing (at least for the next few years), and there are significant differences between companies.

Similarities and differences between IFRS 17 and Solvency II – impact assessment

27 Based on publicly available information and outreach, it is possible to describe, on a rather high level, the nature of (potential) differences.

28 For this exercise, the EFRAG Secretariat has used two sources of information:

(a) A publication issued by EIOPA in October 2018 (see paragraph 29); and

(b) Questionnaires to and interviews with members of the IAWG and representatives of five large audit/consultancy firms, in November/December 2019 (see paragraphs 30 to 35).

29 As part of an analysis to conclude on potential efficiency gains of applying Solvency II inputs and approaches for the implementation of IFRS 17 by European insurers, EIOPA has presented, in October 2018 and based on its experience to date, the following analysis of the (potential) impact of similarities and differences:[9]

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[9] EIOPA's analysis of IFRS 17 Insurance Contracts, EIOPA-18-717 dated 18 October 2018. EIOPA mentions that its analysis had to be kept at a reasonable level to remain relevant to

(a) On initial recognition of obligations:

(i) The point in time as which insurance obligations are recognised under both frameworks is conceptually similar. However, IFRS 17 introduces a simplification, which may lead to differences in some cases. The practical impact of such differences is not expected to be significant.

(ii) Expected profits at inception are recognised in the reconciliation reserve (equity) of that period under Solvency II and are allocated over the lifetime of the contract according to the service provided under IFRS 17. This is reflective of the different objectives of regulatory and accounting frameworks. The accounting framework needs to present the entity's performance, including the allocation of gains and losses to specific reporting periods.

(b) On the definition of cash flows:

(i) Cash flows and expenses included in the valuation of Solvency II technical provisions are expected to be consistent with IFRS 17 in most cases.

(c) On grouping and aggregation of contracts and contract boundaries:

(i) In principle, the Solvency II approach to determine the relevant level of aggregation for expected cash flows and other inputs is anticipated to be consistent with IFRS 17. However, further disaggregation by 'annual cohorts' to grouping according to profitability is needed for IFRS 17.

(ii) The Solvency II requirement to identify homogeneous groups can be considered as a basis for IFRS 17's requirement of grouping contracts.

(iii) The contract boundaries have been found to be similar in principle, differences for certain contracts cannot be ruled out.

(d) On the determination of the appropriate discount rate:

(i) IFRS 17 allows for both a top-down and a bottom-up approach, adjusting for illiquidity whilst taking into account all market inputs. Solvency II sets out a bottom-up approach without an explicit measure of illiquidity. It converges to an ultimate forward rate (UFR) after the last liquid point.

(ii) Solvency II's techniques and approaches for the volatility adjustment (VA) and matching adjustment (MA) may be used, taking into consideration IFRS 17-specific assumptions. The Solvency II extrapolation method may need to be adjusted for IFRS 17, if relevant market inputs were found to make a significant difference.

(e) On the risk adjustment:

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deliver the set objective. That means that not all commonalities or differences could be assessed in detail and the analysis may not capture potential issues stemming from national implementation and specificities in the design and treatment of certain contracts (for example, the analysis does not cover in detail: the balance sheet presentation of premiums due, obligations without commercial substance, investment components embedded within insurance contracts). Other issues, like differences in scope: Solvency II applies to insurance and reinsurance undertakings, IFRS 17 applies to insurance contracts, have been found less relevant (by EIOPA) when assessing the areas of potential efficiency gains to be reaped.

(i) The approach to determining the risk margin in Solvency II is conceptually different from the risk adjustment in IFRS 17 (transfer vs entity-specific).

(ii) Nevertheless, for the practical implementation of IFRS 17, Solvency II's risk margin's underlying principles, inputs and processes may be considered for IFRS 17, subject to potential adaptation.

(f) On reinsurance:

(i) There are different approaches as to considering effects from reinsurance held: Solvency II takes a 'net approach' for determining the risk margin of insurance contracts and allocates reinsurance cash-inflows to corresponding insurance contracts, whereas IFRS 17 presents ceded reinsurance as a separate reinsurance asset.

(ii) The concept of reinsurance contracts; contract boundaries are different and the application of the different concepts may lead to differences in the valuation of reinsurance held between the two frameworks.

30 In its Executive Summary, EIOPA's analysis concluded that, for the actual implementation of IFRS 17, crucial inputs and processes developed for Solvency II can be used, but may need adaptation to varying degrees. Notwithstanding potential need for adaptation, it is expected that significant efficiency gains can be reaped. These efficiency gains are most prevalent in the building blocks of IFRS 17: cash flows, discount rate and risk adjustment.

31 After the publication of this EIOPA paper, the IASB has suggested several amendments that, if adopted, may have an impact on the above analysis. Furthermore, since the paper was published, the IFRS 17 implementation activities have progressed significantly and more detailed work has been done, that could provide additional and new information on the similarities and differences between Solvency II and IFRS 17.[10]

32 Therefore, in November and December 2019, the EFRAG Secretariat performed outreach to members of the IAWG and to representatives of five large audit/consultancy firms, to be informed on the most recent experience regarding these similarities and differences.

33 Overall, respondents reported, based on their experience to date, a number of actual or expected differences. In the view of the EFRAG Secretariat, this can be explained by:

(a) The differences in starting point of insurers and ways in which Solvency II has been implemented;

(b) The ongoing level of understanding the details of IFRS 17;

(c) The need to interpret important areas of the more principled-based approach of IFRS 17 in areas such as the designation of contracts to the different measurement approaches, the discount rate, the risk adjustment, and the cash flows from participation and mutualisation/cross-subsidisation;

[10] EIOPA has updated its assessment in its Consultation Paper on Solvency II, concluding that alignment of the technical provisions calculated under Solvency II with the calculations under IFRS 17 is not possible, referring to: the different objectives of the two frameworks; the valuation concepts (transfer value versus fulfilment value); the granularity of the calculations and unbundling; and the fact that IFRS 17 is currently under review. EIOPA had also considered the possibility to introduce a simplification on the Solvency II framework in line with the IFRS premium allocation approach, but abandoned this proposal because of the possible introduction of significant complexities with limited benefits.

(d) The need to build systems to enable calculations (including the CSM) on a more granular level; and

(e) The need to build systems to identify and report, in the appropriate section of the financial statements, any changes in the cash flows.

34 The results of these outreach activities have been classified under the following categories:

(a) On initial recognition of obligations:

(i) There are considerable differences in the activities of insurers, impacting the significance of the implications of the differences identified between the two reporting regimes in respect of their scope. For instance, in the UK investment contracts without DPF form an important part of the insurers' activities, while this business is much smaller or immaterial in other Member States. Differences and operational complexity relating to contracts that are under the scope of the insurance regulation (and therefore under Solvency II) but without significant insurance risk (thus excluded from IFRS 17) are not in the scope of this paper, since its focus is to identify synergies for contracts that are subject to both reporting regimes.

(ii) There was general agreement that there are differences on initial recognition, but that, in most cases, the practical impact is not expected to be significant.

(iii) There will be differences for unbundling, where IFRS 17 sets a high bar for unbundling insurance components of a contracts, while Solvency II requires unbundling into homogeneous risk groups.

(iv) Differences are also expected for the initial recognition and subsequent measurement of liabilities in business combinations, in particular regarding the CSM.

(b) On the definition of cash flows:

(i) Ignoring the impact of contract boundaries (see next point), respondents identified differences in the expense cash flows between the two reporting regimes (allocation of overhead expenses and investment management expenses if there are no investment-related or investment-return services provided, and the importance (if any, see above) of investment contracts that are scoped out of IFRS 17). Depending on the activities of the insurer, the differences can be significant.

(ii) Differences are also expected in the cash flows of participating contracts, related to differences in the discount rate (see below) and the projected earned rates.

(c) On grouping and aggregation of contracts and contract boundaries:

(i) The differences in aggregation levels, in particular the IFRS 17 requirements to identify three groups within a portfolio (which may differ from a Solvency II line of business) and, secondly, annual cohorts within these groups (including one group for onerous contracts, that has to be monitored going forward), have been identified as a main differentiator between Solvency II and IFRS 17.

(ii) The IFRS 17 pronouncements in respect of mutualisation/cross-subsidisation will require a complex reallocation between groups and annual cohorts, with particular impact on the CSM. Furthermore, the

IFRS 17 concept of recognising a liability for allocating unappropriated surpluses to future contracts does not exist in Solvency II.

(iii) IFRS 17 has exemptions to the general measurement model, while Solvency II has not. The application of the PAA is expected to be closer to present IFRS 4 practice than to Solvency II.

(iv) The recognition of insurance acquisition cash flows creates an intangible asset under IFRS 17 (if this amendment is adopted), that is not recognised under Solvency II.

(v) Additionally, there are differences in the contract boundaries that, depending on the nature of the contracts, can be significant. Some of these differences relate to the unbundling requirements (see above). At the same time, for a large number of contracts, the outcome is identical.

(d) On the determination of the appropriate discount rate:

(i) This is a challenging area of judgment, that, in many cases, will result in a difference between Solvency II and IFRS 17. The discussions between involved parties are ongoing and the outcome is still unclear. A key element in the discussions is the determination of the appropriate market reference rate(s), in particular for countries where there is no market for very long-term financial instruments. Furthermore, the top-down and bottom-up calculations under IFRS 17 do not always result in the same outcome.

(e) On the risk adjustment:

(i) There are portfolios where the risk adjustments will be similar, but there are also portfolios where there will be differences because IFRS 17 requires the risk adjustment to be determined from an entry-point of view, while Solvency II requires an exit-point of view.

(ii) While there may be portfolios where the risk adjustment under IFRS 17 can be determined using the Solvency II approach, the mandatory disclosure of the confidence level under IFRS 17 requires additional activities.

(f) On reinsurance:

(i) In general, EIOPA's observations are supported by the implementation activities.

35 Overall, next to the CSM, respondents expect, because of the necessary adaptations, the main differences in particular for life insurance contracts, are the levels of aggregation, the allocation of expenses to insurance liabilities, the discount rate and the risk adjustment. The amount of additional implementation activities and costs resulting from these adaptations will vary with the activities of the insurer and by company.. At the same time, it was stressed that the interpretation activities of IFRS 17 have not yet been completed. As a result, the overview presented above is still subject to change.

Questions for EFRAG TEG
36 Do EFRAG TEG members have any comments or questions on paragraphs 25 to 35?

Use of Solvency II calculations and systems

37 The EFRAG Secretariat notes that insurers have shown different approaches to IFRS and Solvency II implementation projects, partly related to the size and composition of insurance groups, and partly related to the strength (both

quantitative and qualitative) of the reporting departments. According to the respondents of EFRAG's outreach activities, this has resulted in considerable differences between insurers in respect of the level and technical robustness of the integration of Solvency II systems and financial reporting systems.

38 Combined with the fact that IFRS 4, with a few exceptions, grandfathered the previous accounting principles to measure insurance liabilities, there are, at the moment, considerable differences in the starting position of insurers to determine such liabilities under IFRS.

39 At one side of the spectrum, there are insurers that have made significant investments in building databases including elementary cash flow data on a contract-by-contract basis and integrating actuarial and financial reporting systems. These databases form the basis for Solvency II calculations and can – despite the differences presented above – also, to a large extent, be used for IFRS 17 purposes.

40 At the other side, there are (still) insurers that, in particular in their reporting activities, apply work-around solutions using spreadsheet applications and performing manual activities to determine and present their Solvency II liabilities. For these insurers, the potential for synergies with previous investments is much less.

41 Respondents to the extensive case study, performed by EFRAG in early 2018, anticipated cost savings, however limited in size, in the implementation of IFRS 17 as a result of the investments made in Solvency II. EFRAG could not obtain any quantitative evidence for these assertions. Respondents mentioned the following cost drivers arising from the differences between Solvency II and IFRS 17:

(a) Granularity: while the aggregation at portfolio level is broadly similar in the two regimes, current actuarial tools have to be upgraded to support IFRS 17 increased granularity compared to Solvency II;

(b) Calculation of the CSM and risk adjustment under IFRS 17, in particular for life insurance contracts;

(c) Differences between the cash flows, e.g. expenses, interest rates, and policyholders' participation;

(d) Reporting: IFRS 17 requires the definition of an accounting model aimed at preparing a full balance sheet and P&L while Solvency II focusses on the statement of financial position and capital.

42 More than half of the respondents to the simplified case study, performed by EFRAG in 2018 as well, expected that the implementation of Solvency II would reduce the costs of applying IFRS 17 to some extent.

43 Outreach performed by the EFRAG Secretariat in November/December 2019 to members of the IAWG and to representatives of five large audit/consultancy firms revealed that the possibility to capitalise on Solvency II investments varies between insurers, depending on their starting position.

44 Respondents provided the following observations:

(a) As is described above, in a number of companies Solvency II has resulted in the development (or improvement) of actuarial systems able to perform cash flow calculations needed to determine the Solvency II liabilities. Without these investments and the steep learning curve that occurred for Solvency II, the implementation of IFRS 17 would be an even greater challenge than it already is today and would have reasonably resulted in higher costs to achieve the same implementation quality. Although the level of granularity of these calculations is different under IFRS 17 (requiring the storage of more data and adaptations of the systems) and, as is described in earlier paragraphs, there are other differences between the two reporting systems, the availability of these actuarial systems provides a basis for re-using these systems and capitalising (at least, in part) on the Solvency II investments.

(b) At the same time, the existing actuarial systems used for Solvency II calculations are not yet sufficiently integrated with the financial reporting systems (for example, not producing the required journal entries), and respondents observed that the control environment surrounding these systems would require improvements to meet the auditability requirements under IFRS 17 in time for approval of the financial reporting. This is particularly relevant because of the differences in reporting timelines: generally, reporting the required (audited) IFRS information occurs much earlier than the Solvency II information.

(c) The respondents to the outreach noted that, since there are adaptations in the parameters and assumptions to be used in calculating the liabilities for participating insurance contracts, re-using the actuarial cash flow models would mean, in practice, re-performing the calculations with these different parameters and assumptions, and under different scenarios. This was considered to be an important operational challenge. Yet synergies are possible in terms of elementary contract and cash flow data.

(d) Solvency II focuses on measurement of the balance sheet at a point in time, while IFRS 17 is based on a ‘roll-forward’ approach, specifying where changes in the cash flows should be reported in the financial statements: as adjustments to the CSM or the risk adjustment, in profit or loss, or in OCI. Even when the balance sheet measurement would be similar or the same, the IFRS 17 focus on performance reporting requires adaptations of the actuarial systems and very different financial reporting systems. In particular, as the CSM is a unique and vital part of IFRS 17, this requires the development of completely new systems.

(e) Regarding the determination of the risk adjustment under IFRS 17, reference was made to the existence of ‘internal models’ under Solvency II, which could provide a solid basis since these models are, by nature, geared to the identification and management of the risks of an insurer.

(f) The existence of three different transition approaches under IFRS 17 limits, to a certain extent, the use of Solvency II systems, since IFRS 17 requires, under the (modified) retrospective approaches, a (partial) reconstruction of the past while Solvency II applies a prospective (ie future-focused) measurement approach similar to the IFRS 17 fair value approach

(g) Differences between the two reporting systems may result in increased costs for both preparers and users because of the need to prepare and respectively understand the two different outcomes.

45 Another aspect of using Solvency II calculations and systems for IFRS 17 concerns the audit of information.

46 At the moment, several Member States have introduced full or partial audit requirements with regard to Solvency II ‘figures’.[11] EIOPA publically consulted on whether there should be an auditing requirement in the future, reviewed Solvency II Directive for the group and for the single Solvency and Financial Condition Report (SFCR).

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[11] EIOPA, Consultation Paper on the Opinion on the 2020 review of Solvency II, BoS-19/465 dated 15 October 2019. AccountancyEurope, Survey of audit of Solvency II reporting by insurance undertakings, December 2016 (reconfirmed with small changes by AccountancyEurope to the Secretariat, November 2019).

47 Audit requirements contribute to the reliability of financial information. In those areas where these two reporting regimes are aligned and can use the same systems, having audited Solvency II information supports the reliability of IFRS 17 information.

Questions for EFRAG TEG
48 Do EFRAG TEG members have any comments or questions on paragraphs 37 to 47?

Estimated impact on the financial statements

49 When carrying out the extensive and simplified case studies in 2018, the EFRAG Secretariat asked respondents to provide quantitative information on the estimated impact of applying IFRS 17 to the selected portfolios. Only limited information was received, the results differed significantly between the portfolios and no overall pattern could be identified.

50 Outreach performed by the EFRAG Secretariat in November/December 2019 to members of the IAWG and to representatives of five large audit/consultancy firms revealed that it is not expected that, in the short term, insurers will be sufficiently advanced in their IFRS 17 implementation activities to present quantitative information in respect of the estimated impact on their financial statements. Furthermore, the IASB is, at the moment, discussing several (potential) amendments of IFRS 17, that may have an impact on such estimates.

51 Therefore, the EFRAG Secretariat has focused on comparing IFRS 17 and Solvency II in qualitative terms, combined with, where possible, providing quantitative information on the estimated costs of implementing IFRS 17.[12]

Questions for EFRAG TEG
52 Do EFRAG TEG members have any comments or questions on paragraphs 49 to 51?

Proposed text for the Draft Endorsement Advice

53 The EFRAG Secretariat proposes to include the following text in Appendix 3 of the Draft Endorsement Advice.

In the section 'Interaction IFRS 17 and Solvency II':

54 Comparing IFRS 17 and Solvency II on a high level, both frameworks adopt a current-value measurement approach. The differences that exist in the detailed requirements of the two frameworks reflect the objectives and scope of the two respective regimes. IFRS 17 deals with reporting the rights and obligations from insurance contracts in the context of general purpose financial reporting, i.e. reporting of information to the financial markets. Solvency II focuses on the valuation of insurance obligations within a risk-based framework with the protection of policyholders and beneficiaries at its heart.

55 Both Solvency II and IFRS 17 include requirements on measurement of insurance contracts on the balance sheet; in addition, IFRS 17 includes requirements for performance reporting. Solvency II applies a balance sheet approach and focuses on measurement of the insurance liabilities at a point in time. IFRS 17 includes requirements for the measurement of insurance contracts as well as the accounting treatment of changes in the resulting assets and liabilities, whether within the balance sheet (in the form of changes to the risk adjustment or the contractual services margin CSM), in profit or loss, or in OCI.

[12] These cost estimates will be included in another section of the DEA and are, therefore, not part of this issues paper.

56 In other words, IFRS 17 deals with both measurement and performance reporting, while Solvency II focuses on measurement. That being said, it should also be noted that both regimes are based on current measurement of the (uncertain) future cash flows of insurance contracts, although starting from a different perspective (fulfilment under IFRS 17 and transfer to a third party under Solvency II). As both approaches use market inputs to the maximum extent, the starting point for a number of inputs is similar in principles under both reporting regimes.

57 When analysing the details of both sets of requirements, it can be observed that there are many similarities in the texts, but that they are not identical: a number of potential differences can be identified. As a result, key inputs and processes of Solvency II may be used but they may require adaptations to varying degrees. The nature and significance of the differences depends on the characteristics of the insurance contracts issued by insurers and on the technological approach taken in the implementation of both regimes, and can vary between companies.

58 To assess the (potential) extent of such differences, EFRAG has used two sources of information:

(a) A publication issued by EIOPA in October 2018, covering the effects on competition, product availability and financial stability and EIOPAs views on using Solvency II inputs, approaches and processes for an efficient implementation of IFRS 17;[13] and

(b) Outreach to industry experts (preparers and accounting advisors) in November/December 2019.

59 Overall, next to the CSM, respondents expect, because of the necessary adaptations, the main differences in particular for life insurance contracts, are the levels of aggregation, the allocation of expenses to insurance liabilities, the discount rate and the risk adjustment. The amount of additional implementation activities and costs resulting from these adaptations will vary with the activities of the insurer and by company.

In the section 'Costs and benefits of applying IFRS 17':

60 IFRS 17 and Solvency II are both based on current measurement of (uncertain) future cash flows of insurance contracts. Also for both, the measurement is based on a probability-weighted estimate of future cash flows, time value of money and an allowance for risk.

61 Respondents to the extensive case study, performed by EFRAG in early 2018, anticipated cost savings, however limited in size, in the implementation of IFRS 17 as a result of the investments made in Solvency II. EFRAG could not obtain any quantitative evidence for these assertions. Respondents mentioned the following cost drivers arising from the differences between Solvency II and IFRS 17:

(a) Granularity: while the aggregation at portfolio level is broadly similar in the two regimes, current actuarial tools have to be upgraded to support IFRS 17 increased granularity compared to Solvency II;

(b) Calculation of the CSM and risk adjustment under IFRS 17, in particular for life insurance contracts;

(c) Differences between the cash flows, e.g. expenses, interest rates, and policyholders' participation; and

(d) Reporting: IFRS 17 requires the definition of an accounting model aimed at preparing a full balance sheet and P&L while Solvency II focusses on the statement of financial position and capital.

[13] EIOPA's analysis of IFRS 17 Insurance Contracts, EIOPA-18-717 dated 18 October 2018.

62 In its study of October 2018, EIOPA remarked that for the actual implementation of IFRS 17 crucial inputs and processes developed for Solvency II can be used, but may need adaptation to varying degrees. Notwithstanding potential need for adaptation, it was expected that significant efficiency gains can be reaped. These efficiency gains are most prevalent in the building blocks of IFRS 17: cash flows, discount rate and risk adjustment.

63 EFRAG observes that in a number of companies Solvency II has resulted in the development or improvement of the existing actuarial systems, able to perform cash flow calculations needed to determine the Solvency II liabilities. Without these investments and the steep learning curve that occurred for Solvency II, the implementation of IFRS 17 would be an even greater challenge than it already is today and would have reasonably resulted in higher costs to achieve the same implementation quality.

64 Outreach performed by EFRAG in November/December 2019 revealed that, although stakeholders seem to expect that the level of granularity of these calculations is different under IFRS 17 (requiring the storage of more data and adaptations to the systems) and there are other differences between the two reporting systems (reflecting their respective objectives and detailed methodologies), the availability of these actuarial systems provides a basis for re-using these systems and capitalising (at least, in part) on the Solvency II investments.

65 At the same time, respondents noted that the existing actuarial systems used for Solvency II calculations are not yet sufficiently integrated with the financial reporting systems (for example, not producing the required journal entries), and respondents observed that the control environment surrounding these systems would require improvements to meet the auditability requirements under IFRS 17 in time for approval of the financial reporting. This is particularly relevant because of the differences in reporting timelines: generally, reporting the required (audited) IFRS information occurs much earlier than the Solvency II information.

66 The respondents also noted that, since there are adaptations in the parameters and assumptions to be used in calculating the liabilities for participating insurance contracts, re-using the actuarial cash flow models would mean, in practice, re-performing the calculations with these different parameters and assumptions, and under different scenarios. This was considered to be an important operational challenge. Yet synergies are possible in terms of elementary contract and cash flow data.

67 Solvency II focuses on measurement of the balance sheet at a point in time, while IFRS 17 is based on a ‘roll-forward’ approach, specifying where changes in the cash flows should be reported in the financial statements: as adjustments to the CSM or the risk adjustment, in profit or loss, or in OCI. Even when the balance sheet measurement would be similar or the same, respondents noted that the IFRS 17 focus on performance reporting requires adaptations of the actuarial systems and very different financial reporting systems. In particular, as the CSM is a unique and vital part of IFRS 17, this requires the development of completely new systems.

68 Differences between the two reporting systems may result in increased costs for both preparers and users because of the need to prepare and respectively understand the two different outcomes.

69 Overall, EFRAG concludes that the possibility for obtaining synergies between Solvency II and IFRS reporting systems is definitely there, but varies between insurers. Synergy potential is available in areas that have a high degree of commonality under the two reporting frameworks, ie contract data, cash flow projections and actuarial systems to measure insurance liabilities. The potential

depends, to an extent, on the differences in the starting position of insurers and the investments already made in the implementation of Solvency II. And it also depends on the amount of effort to adapt existing actuarial systems, developed for the Solvency II environment, to the IFRS 17 reporting requirements. No synergies may be expected for building blocks that are peculiar to IFRS 17, such as the CSM and the components of systems focusing on reporting financial performance.

Questions for EFRAG TEG

70 Do EFRAG TEG members have any comments on the proposed text for the Draft Endorsement Advice in paragraphs 53 to 69?

Appendix 1: Overview of data underlying the quantitative analysis of the number of insurers in the issues paper

1 The analysis presented below has been derived from data provided by Insurance Europe (regarding the accounting regime for insurers and the number of insurers reporting under IFRS), and from data included in the EIOPA Consultation Paper on the Opinion on the 2020 review of Solvency II, BoS-19/465 dated 15 October 2019.

Country	IFRS in non-listed consolidated financial statements of insurers	IFRS in individual financial statements of insurers	Number of insurers at the end of 2018		Number of insurers reporting under IFRS at the end of 2018[14]	Solvency regime for non-Solvency II insurers
			Total	Subject to Solvency II		
Austria	Permitted	Prohibited	84	35	2	Other than Solvency I or Solvency II
Belgium	Required	Prohibited	69	66	20	Solvency I
Bulgaria	Permitted	Permitted[15]	37	32	37	Solvency I
Croatia	Required	Required	18	18	20	Solvency II with some differences
Cyprus	Required	Required	32	31	33	Solvency II with some differences
Czech Republic	Permitted	Permitted[16]	27	27	2	Solvency II
Denmark	Permitted	Prohibited	82	72	6	Solvency II with some differences
Estonia	Required	Required	10	10	11	Solvency II
Finland	Permitted	Permitted[17]	50	46	5	Other than Solvency I or Solvency II
France	Permitted	Prohibited	713	462	13	Solvency I
Germany	Permitted[18]	Permitted[19]	402	338	7	Other than Solvency I or Solvency II

[14] This column presents the number of insurers applying IFRS in their consolidated or individual financial statements; the split between these two statements is not available. The numbers do not include subsidiary insurers that apply IFRS only to report to their parent companies for consolidation purposes.

[15] The Insurance Code and Instructions by the Ministry of Finance require all insurers to apply IFRS. Since 2019, this requirement is included in the Accountancy Act.

[16] If the consolidated financial statements are prepared under IFRS.

[17] If audit is mandatory.

[18] Required for undertakings pending admission to trading on a regulated market.

[19] Only in addition to financial statements prepared under National GAAP.

Greece	Required	Required	38	36	42	Solvency II with some differences
Hungary	Permitted	Permitted	33	23	1	Solvency I
Ireland	Permitted	Permitted	201	187	1	Solvency I
Italy	Required	Prohibited[20]	100	96	27	Other than Solvency I or Solvency II
Latvia	Required	Required	6	6	6	Solvency II
Lithuania	Required	Required	9	9	9	Solvency II
Luxembourg	Permitted	Permitted	278	268	0	Solvency II
Malta	Required	Required	68	65	11	Solvency II
Netherlands	Permitted	Permitted	134	132	6	Solvency II with some differences
Poland	Permitted[21]	Permitted[22]	60	60	3	Solvency II with some differences
Portugal	Required	Required	41	40	41	Solvency II
Romania	Permitted	Prohibited[23]	29	27	29	Solvency I
Slovak Republic	Required	Required	14	14	12	Solvency II
Slovenia	Required	Required	15	15	15	Solvency II
Spain	Permitted[24]	Prohibited	208[25]	152	8	
Sweden	Required[26]	Prohibited	187	135	133	Other than Solvency I or Solvency II
Total EU-27			2,945	2,402	500	

[20] There were plans to require IFRS for all insurers. This decision has been postponed amid concerns with IFRS 17 (among other factors). IFRS is required for listed insurers if no IFRS consolidated financial statements are published.

[21] For subsidiaries of a group in which the parent company prepares consolidated financial statements under IFRS, and for entities having filed or intending to file for admission to public trading.

[22] Same as for consolidated financial statements.

[23] IFRS is required for all listed companies, including insurers. IFRS is permitted in the individual financial statements of insurers, but only as a secondary reporting set.

[24] Required for groups in which there is a listed undertaking; otherwise permitted.

[25] Number of insurance companies provided by ICAC.

[26] Required by the national Financial Supervisory Authority, otherwise permitted. On 19 December 2019, the Authority communicated that it will propose changes in the group accounting regulation for unlisted insurance companies, removing the requirement for these companies and occupational pension funds to apply the IAS-regulation (full IFRS) in their consolidated financial statements. A decision will be made in Autumn 2020, effective 1 January 2021.

United Kingdom	Permitted	Permitted	493	282	37	Other than Solvency I or Solvency II
Total EU-28			3,438	2,684	537	