INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

SURVEY REPORT

IMPACT UPON SUPERVISORS OF IMPLEMENTATION OF IFRS

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Impact upon Supervisors of Implementation by Insurers of International Financial Reporting Standards (IFRS)

Report on Responses to Survey

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Executive Summary

In light of the introduction of the International Financial Reporting Standards (IFRS), in a number of jurisdictions, including IFRS 4 "Insurance Contracts", the IAIS Accounting Subcommittee has carried out a survey on their implementation. The primary purpose of the survey is to collect and analyse information on the status of the application of IFRS in IAIS member jurisdictions, including their impact and the reaction by insurance supervisors, and to provide this as basic information to members.

Thirty jurisdictions responded to the survey. The following are the main findings from the survey responses.

1. Status of Application of IFRS

(1) Overall situation

Twenty two jurisdictions out of 30 responded that IFRS is applied to the financial statements of insurance companies, regardless of whether application is required or permitted. Twelve of those 22 jurisdictions are EU member states. In general, there is no significant difference in application status between life and non-life insurance.

(2) Timing of application

Almost all responding jurisdictions in which IFRS is applied responded that the application of IFRS began on 1 January 2005.

(3) Plan for future application of IFRS

Among eight jurisdictions in which IFRS is not applied at this time, six responded that the application of IFRS is scheduled within the next few years (mostly in 2007-2008).

2. Supervisory reaction

(1) Change in definition of insurance contract

On the basis of the survey responses received, more than half of the jurisdictions in which IFRS is applied responded that certain products do not meet the IFRS 4 definition of an insurance contract, and most of these have taken or plan to take supervisory measures in response to the change in definition. The common nature of such measures is to broaden the definition for supervisory reporting purposes, with the intention of neutralising the impact of the change in definition.

(2) “Mismatch” between assets and liabilities

On the basis of the survey responses received, more than half of the jurisdictions expressed concern over “mismatch” between assets and liabilities, which may be brought about by a difference in valuation bases between assets and liabilities. Most jurisdictions which expressed concern have taken supervisory measures as well as to apply certain options within IFRS for general purpose accounting. Measures include shadow accounting, the mandatory application to financial assets of fair value through profit and loss, and the elimination of the impact of unrealised capital gains.

(3) Catastrophe and equalisation provisions

Catastrophe and equalisation provisions were recognised before the introduction of IFRS in most responding jurisdictions in which IFRS is applied. Upon the introduction of IFRS, the such provisions were reclassified from liability to capital in some jurisdictions, abolished from general purpose financial statements in some jurisdictions, or were abolished from consolidated financial statements but retained in solo financial statements in one jurisdiction Some of these jurisdictions have taken supervisory measures in response to the change in accounting by formulating supervisory rules such as requirements for equalisation provisions for certain types of insurers for supervisory reporting, and deduction from equity for capital adequacy measurement.

(4) Discretionary participation features

Some of the responding jurisdictions in which IFRS is applied stated that discretionary participation features were classified as an intermediate category that was neither liability nor capital before the introduction of IFRS. The proportion of contracts which fall into such a category looks significant in each relevant market. Some of those jurisdictions responded that the accounting classification had changed, i.e. moving from the intermediate category to liabilities.

(5) Impact of application of IAS 39

More than half of the responding jurisdictions in which IFRS is applied stated that the accounting practice for financial instruments had changed upon the introduction of IAS 39, including change in valuation basis from book value (or lower of book or market value) to fair value, and change in valuation basis from net market value to fair value. More than half of those jurisdictions have taken supervisory measures in response to the change in accounting practice, e.g. designation of financial instruments as a category for "fair value through profit and loss" for supervisory reporting, or continuation of the existing asset valuation regulation for supervisory accounting. Also, more than half of those jurisdictions stated that “prudential capital filters” are applied or are going to be applied, e.g. reversal or deduction of gains and losses arising from a change in the firm’s own creditworthiness, deduction of unrealised capital gains, and reversal of gains and losses from cash flow hedges.

3. Impact of application of other IFRSs

Quite a number of other standards are specified as having a significant impact on the financial statements of insurance companies. Most of these are considered to have an impact on equity as the final results of their application. In particular, IFRS 1 *First-time Adoption of International Financial Reporting Standards*, IAS 12 *Income Taxes*, IAS 16 *Property, Plant and Equipment*, IAS 18 *Revenue*, IAS 19 *Employee benefits*, IAS 27 *Consolidated and Separate Financial Statements*, IAS 32 *Financial Instruments: Presentation*, IAS 38 *Intangible Assets* and IAS 40 *Investment Property* were specified by a number of jurisdictions.

Introduction[1]

In light of the introduction of the International Financial Reporting Standards (IFRS) in a number of jurisdictions, including IFRS 4 "Insurance Contracts", the IAIS Accounting Subcommittee has carried out a survey on their implementation. The primary purpose of the survey is to collect and analyse information on the status of the application of IFRS in IAIS Member jurisdictions,[2] including their impact and the reaction by insurance supervisors, and to provide this as basic information to members. Thirty jurisdictions responded to the survey. The key observations are given below.

This report provides basic factual information, most of which is qualitative, on the status of application of IFRS. Once experience on the application of IFRS has been accumulated and the financial statements based on IFRS become available in a significant number of jurisdictions, a further study on the quantitative impact and the assessment of the impact may be beneficial.

I. General Status of Application of IFRS

1. Number of jurisdictions by classification of the status of application of IFRS for general purpose financial reporting

1 See also Annex *"Explanatory Note"*

2 The survey was conducted on members of the IAIS Technical Committee and Accounting Subcommittee together with other members who volunteered responses.

					Required	Permitted	Not applied
Listed company	Life			Consolidated	20	1	9
				Solo	9	6	15
	Non-Life			Consolidated	20	1	9
				Solo	8	6	16
Unlisted company	Stock company	Life		Consolidated	9	12	9
				Solo	7	7	16
		Non-Life		Consolidated	9	12	9
				Solo	7	7	16
	Other than stock company	Life		Consolidated	3	10	17
				Solo	1	5	24
		Non-Life		Consolidated	4	10	16
				Solo	2	5	23
		Mutual company	Life	Consolidated	4	12	14
				Solo	2	7	21
			Non-Life	Consolidated	4	12	14
				Solo	2	8	20

(1) Overall situation

IFRS is applied to insurance companies in 22 jurisdictions, regardless of whether application is required or permitted. Twelve of those 22 jurisdictions are EU member states. There is no significant difference in application status between life and non-life.

(2) Listed insurance companies

IFRS is required in 20 jurisdictions, and permitted in one jurisdiction. The application of IFRS only to consolidated financial statements is required in six jurisdictions and the application of IFRS to both consolidated and solo financial statements is required in nine jurisdictions, while the application of IFRS is required to consolidated financial statements and permitted to solo financial statements in five jurisdictions. In one jurisdiction, IFRS is permitted for both consolidated and solo financial statements. There is no difference between life and non-life insurance.

(3) Unlisted insurance companies

In addition to the 21 jurisdictions in which listed companies are required or permitted to apply IFRS,[3] they are also permitted to be applied in one further jurisdiction. The application of IFRS is required to both consolidated and solo financial statements of stock companies in seven jurisdictions. The application of IFRS is required to both consolidated and solo financial statements other than of stock companies in three jurisdictions[4] out of those seven. The application of IFRS is permitted to both

3 Among those 21 jurisdictions, IFRS are not applied to unlisted companies in one jurisdiction.

4 Only mutual companies exist actually as other than stock company in 1 jurisdiction, and no mutual company exists actually in one jurisdiction.

consolidated and solo financial statements of mutual companies in one jurisdiction out of those seven. While the application of IFRS is required only to consolidated financial statements of all types of company, IFRS is not applied to solo financial statements in two jurisdictions. Beside these seven jurisdictions, the application of IFRS to consolidated financial statements is permitted in 12 jurisdictions of which the application of IFRS to solo financial statements is also permitted in seven.

(4) Plan for future application of IFRS

Among eight jurisdictions in which IFRS is not applied at this time, six responded that the application of IFRS is scheduled within the next few years. One jurisdiction in which IFRS is not applied to insurance companies yet[5] stated that IFRS will be required for subsidiaries of listed companies from 2007. One jurisdiction responded that there is a plan to align the accounting standards with IFRS in around five years. One jurisdiction responded that use of IFRS will be permitted within two years. One responded that IFRS will be applied from 1 January 2007. One jurisdiction responded that IFRS 4 is planned to be applied in 2007 or 2008. One jurisdiction responded that IFRS will be applied from 2007.

5 Although all listed companies in this jurisdiction are required to apply IFRS, this jurisdiction currently has no listed insurance company.

2. Number of jurisdictions by classification of relationship of general purpose accounting standards (“GP”)[6] to supervisory purpose accounting standards (“SP”)[7]

					(1) SP is same as GP, same approach as IFRS	(2) SP is different from GP, same approach as IFRS	(3)SP is different from GP, different approach as IFRS	(4) SP is same as GP, different approach as IFRS	(5) N/A
Listed company			Life	Consolidated	11	2	6	3	8
				Solo	8	1	7	8	6
			Non-Life	Consolidated	10	3	6	3	8
				Solo	7	2	7	8	6
Unlisted company	Stock company		Life	Consolidated	12	2	6	3	7
				Solo	9	1	7	9	4
			Non-Life	Consolidated	11	3	6	4	6
				Solo	8	2	7	9	4
	Other than stock company		Life	Consolidated	5	1	6	3	15
				Solo	3	-	6	8	13
			Non-Life	Consolidated	6	1	6	4	13
				Solo	4	-	6	8	12
		Mutual company	Life	Consolidated	8	1	6	3	12
				Solo	5	-	6	8	11
			Non-Life	Consolidated	7	2	6	4	11
				Solo	5	1	6	8	10

(1) Listed insurance companies

Regarding life insurance, SP is the same as GP and the same approach as IFRS for consolidated financial statements in 11 jurisdictions, and for solo financial statements in eight. For non-life insurance, all jurisdictions but one are in the same category as for life insurance. For non-life insurance in that one jurisdiction SP is different from GP but the same approach as IFRS.

SP is different from GP but the same approach as IFRS for consolidated financial statements in two jurisdictions, and for solo financial statements in one.

6 It should be noted that, whilst IFRS is required or permitted for certain general purpose financial reports, it has not necessarily replaced local GAAP. Where this is the case IFRS and general purpose accounting standards (GP) may differ and this should be taken into account within the context of this section of the paper.

7 This section focuses on the general relationships between supervisory standards, general purpose standards and IFRS. For example, when the general purpose standards, which are different from IFRS, are used also for supervisory standards, the response should be classified as “(4) SP is same as GP, different approach to IFRS”.

SP is different from GP and a different approach to IFRS for consolidated financial statements in six jurisdictions, and for solo financial statements in seven jurisdictions.

SP is the same as GP but a different approach to IFRS for consolidated financial statements in three jurisdictions[8], and for solo financial statements in eight.

(2) Unlisted insurance companies

SP is the same as GP and the same approach as IFRS for consolidated financial statements of stock companies in the life sector in 11 jurisdictions, and for solo financial statements of stock companies in the life sector in eight. All jurisdictions but one are in the same category for non-life insurance as for life insurance; in that one jurisdiction SP is different from GP but the same approach as IFRS. Regarding mutual companies, SP is the same as GP and the same approach as IFRS for consolidated financial statements for life insurance in eight and for solo financial statements for life insurance in five jurisdictions. All jurisdictions but one are in the same category for non-life insurance as life insurance; in that one jurisdiction SP is different from GP but the same approach as IFRS. In one jurisdiction IFRS is acceptable for both SP and GP for both consolidated and solo financial statements of unlisted stock companies.

SP is different from GP and the same approach as IFRS for consolidated financial statements in one jurisdiction and for both consolidated and solo financial statements in one jurisdiction, in addition to the one, noted above.

SP is different from GP and a different approach to IFRS for both consolidated and solo financial statements in four jurisdictions, and for consolidated financial statements in one and for solo financial statements in two.

SP is the same as GP and a different approach to IFRS for both consolidated and solo financial statements in four jurisdictions[9], and for solo financial statements in five.

(3) As described above, little difference was observed between life and non-life insurance.

II. Status of Application of IFRS 4 and Supervisory Reaction

Twenty jurisdictions out of 30 responded that IFRS is applied to the financial statements of insurance companies.

8 In one of these three jurisdictions, national GAAP is used for supervisory purpose financial statements, while IFRS is used for general purpose consolidated financial statements of listed companies.

9 Only for non-life insurance companies in one jurisdiction.

1. Definition of Insurance Contract

(IFRS 4, Appendix A)

A. Description

IFRS 4 defines an insurance contract as a "contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder." This section addresses the impact of the application of this definition.

B. Members' Responses

(1) Products excluded from the definition of an insurance contract under IFRS 4
Twelve jurisdictions responded that certain types of products have been excluded from the definition of an insurance contract under IFRS 4. Such products include: investment contracts such as investment-linked and fixed term annuity products in one jurisdiction; some unit-linked products in four jurisdictions; some endowment policies in one jurisdiction; some long term savings products in one; investment-linked products in three jurisdictions; supplementary contracts without life contingencies and deposit type contracts in one jurisdiction; short-term endowment contracts in one jurisdiction.

(2) Restructuring of insurance products
No jurisdiction responded that significant restructuring of insurance products had occurred in reaction to the change in definition of an insurance contract.

(3) Significance of the products excluded from the definition
Three jurisdictions provided specific data on the significance in the market of the products excluded from the definition. Investment contracts represent in excess of 75% of the life insurance market as measured by insurance liability in one jurisdiction. Individual investment-linked products amount to 25.5% of the life insurance market in terms of premium in one jurisdiction. Index and unit linked products represent 38% of the life market (25% of the total) in terms of premium in one jurisdiction.

(4) Supervisory reaction
Eight jurisdictions responded that supervisory measures have been taken or are planned to be taken to adjust the impact of the change in definition. Such measures include: adjusting the calculation of the solvency margin by neutralising the impact of IFRS in one jurisdiction; retaining the existing definition of an insurance contract for supervisory purposes in two jurisdictions; accounting for any contract that has an insurance element as an insurance contract for supervisory reporting in one jurisdiction; considering a contract an insurance contract if the risk held by the insurer is above 1%

in one jurisdiction; applying specific rules to technical provisions which do not depend on the accounting in one jurisdiction. One jurisdiction responded that it is considering introducing prudential filters when calculating the solvency of insurance groups. One jurisdiction responded that it will take prudential measures if there is significant change in the available solvency margin due to lower technical provisions.

(5) Reference information
For reference, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) recommends as a prudential filter 'to reverse the accounting definition of insurance contracts and to keep on the current entity-based approach, for supervisory purposes.'[10]

2. "Mismatch" between Assets and Liabilities

(IFRS 4, IN 3, Para 3)

A. Description

IFRS 4 applies to all insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds, except for specified contracts covered by other IFRSs. It does not apply to other assets and liabilities within the scope of IAS 39 *Financial Instruments: Recognition and Measurement*. This section addresses concern over a possible issue regarding the matching of assets and liabilities.

B. Members' Responses

(1) Concern on "mismatch"
Twelve jurisdictions responded that "mismatch" between assets and liabilities has been observed or that there is a concern that this would arise from the use of different measurement bases for assets and liabilities.

(2) Measures taken within general purpose standards
Twelve jurisdictions responded that measures are being taken within general purpose standards to resolve "mismatch" issues. Such measures include: measuring all financial assets backing insurance liabilities at fair value through profit or loss where the option exists, and measuring investment contract liabilities at fair value through profit or loss in one jurisdiction; shadow accounting in three jurisdictions; relevant methods permitted by IFRS 4 in three jurisdictions; reclassification as "fair value through profit and loss" opted for as a different measurement attribute by insurers on their own initiative in three jurisdictions; measuring assets backing insurance liabilities and investment properties at fair value through profit and loss in one jurisdiction.

10 CEIOPS, Recommendations regarding the Implications of the IAS/IFRS Introduction for the Prudential Supervision of Insurance Undertakings, September 2005

(3) Supervisory reaction

Six jurisdictions responded that supervisory measures have been taken in response to the “mismatch” issue. Such measures include: a requirement to measure all assets in statutory funds at fair value through profit and loss in one jurisdiction; the mandatory application to financial assets of "fair value through profit and loss" in two jurisdictions for supervisory reporting only; the elimination of the impact of unrealised capital gains in one jurisdiction; the use of prudential filters in the calculation of regulatory capital in one jurisdiction; and the reversal of gains and losses arising from a change in the firm’s own credit standing in one jurisdiction.

(4) Reference information

For reference, CEIOPS recommends that in Member States using historical cost-based accounting prudential filters may be needed 'to maintain the current national rules for the measurement of insurance liabilities' and comments that 'some jurisdictions may want to allow the use of certain elements of the accounting methods envisaged by IFRS 4 (e.g. shadow accounting and change of discount rate)', in which case it could be necessary to impose limits upon the use of IFRS 4 options for prudential purposes. For Member States using a market value-based approach, CEIOPS recommends limiting the use of IFRS 4 options, or providing guidance, to change the measurement of insurance liabilities.[11] Caution is also advised in both cases to ensure that options are exercised, and the insurance liabilities measured, in conformity with the Prudential Directives. CEIOPS has also noted that, for held-to-maturity-financial assets, ‘there can be a need for countermeasures for market jurisdictions[12] because of the mismatch risk in covering the technical provisions.’[13]

3. Financial Guarantee Contracts

(IFRS 4, Para 4(d) revised by amendments issued in August 2005)

A. Description

11 CEIOPS, ibid.

12 Although the “market jurisdiction” is not necessarily defined specifically, the CEIOPS recommendations describe the current accounting regimes in Member States as follows:

“Based on the different national application of the options in the Accounting Directives ,i.e. historical cost values, current values and fair values for certain balance sheet items] the accounting systems in Member States can be divided, for the sake of clarity of this analysis, in two groups:

- historical cost-based

- market value-based”

Within this context, for example, the introduction of “held-to-maturity” criteria to assets may cause a mismatch in a 'market jurisdiction' which has applied market value-based measurement to assets and liabilities.

13 CEIOPS, ibid, Annex 3.

IFRS 4 provides that an entity shall not apply this IFRS to financial guarantee contracts unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, in which case the issuer may elect to apply either IAS 39 and IAS 32 or this Standard to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable. This section addresses the situation and impact of the application of IFRS to financial guarantee contracts.

B. Members' Responses

(1) Present accounting practices
Eleven jurisdictions responded that the accounting practices for financial guarantee contracts are the same as under revised IFRS 4[14]. Non-life insurance companies reported financial guarantees as insurance contracts in one jurisdiction. Financial guarantee contracts are accounted for as insurance products in two jurisdictions.[15] Two jurisdictions responded that there are no financial guarantee contracts issued by insurance companies in their jurisdiction. One jurisdiction responded that there are no specific rules regarding financial guarantee contracts.

(2) Change foreseen upon introduction of IFRS
Regarding changes in accounting practices foreseen upon the introduction of IFRS, one responded that some insurers are expected to apply IAS 39 to financial guarantee contracts.

(3) Supervisory reaction
Regarding the difference between general purpose accounting and supervisory accounting, one jurisdiction responded that the liability relating to financial guarantee contracts reported under IAS 39 is treated as a technical provision for the regulatory capital calculation. One jurisdiction responded that the accounting method for financial guarantees is different between general purpose accounting and supervisory accounting, which requires measurement on a market consistent basis.

4. Catastrophe and Equalisation Provisions

(IFRS 4, IN 4(a), Para 14(a))

A. Description

IFRS 4 prohibits provisions for possible claims under contracts that are not in existence at the reporting date (such as catastrophe and equalisation provisions) from being

14 Previously, financial guarantees were accounted for as financial liabilities in one jurisdictions.

15 In one jurisdiction, some insures treat financial guarantee contracts in the same way as other general insurance contracts, while some do not.

reported as liabilities. This section addresses the impact of the prohibition of catastrophe and equalisation provisions.

B. Members' Responses

(1) Accounting practices before introduction of IFRS

Seventeen jurisdictions responded that the practice of carrying catastrophe and equalisation provisions was carried out prior to the introduction of IFRS, of which the practice was required in 11 jurisdictions and permitted in six.

(2) Change in accounting practices

Eleven jurisdictions responded that such accounting practices had changed or been abolished. Seven jurisdictions responded that the classification of the provisions had moved from liabilities to capital[16]. One jurisdiction responded that the practice of carrying catastrophe and equalisation provisions had mostly been abolished only for general purpose accounts. One jurisdiction responded the requirement for equalisation provisions had been partly abolished, while the requirement to build such provisions in solo financial statements still exists. Two jurisdictions responded that the practice had been abolished. Six jurisdictions responded that the practice had not changed.

(3) Quantification of such provisions

Eight jurisdictions specified the size of such provisions as a percentage of total assets. The figures were: 0.03%, below 0.5%, 0.74%, 0.8%, 1.51%, 1.7%, 2.39%, and 5.58%.

(4) Supervisory reaction

Five jurisdictions responded that supervisory measures had been taken in response to the change of accounting practice by the formulation or retention of supervisory rules such as the requirement for an equalisation provision for certain types of insurers for supervisory reporting only. One jurisdiction responded that for the calculation of group solvency, the amount which equals the sum of the individual equalisation provisions in the solo financial statements of the companies included in the consolidated accounts has to be deducted from equity. One jurisdiction responded that catastrophe provisions have to be set up for prudential purposes and the amount of catastrophe provisions is deducted from equity for capital adequacy measurement.

(5) Reference information

For reference, CEIOPS recommends that a prudential filter may be needed 'to deduct from equity elements an amount of reserves equal to the current equalisation provisions as well as to add it to technical provisions to be covered by appropriate assets.'[17]

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16 The change is planned in one jurisdiction.

17 CEIOPS, ibid.

5. Liability Adequacy Test and Impairment Test

(IFRS 4, IN 4(b), Para 14(b), 15-20)

A. Description

IFRS 4 requires a test for the adequacy of recognised insurance liabilities and an impairment test for reinsurance assets. This section addresses the application of such tests.

B. Members' Responses

(1) Situation before introduction of IFRS
Eleven jurisdictions responded that a test equivalent to the requirements of IFRS 4 was carried out prior to the introduction of IFRS.

(2) Whether permitted or required
All of those 11 jurisdictions responded that such a test was required.

(3) Change in implementation of tests
One jurisdiction responded that a revised test for non-life insurance contracts was introduced in line with IFRS 4. Five jurisdictions responded that they have introduced a test which would meet the requirements of IFRS 4, although this test was not carried out before the introduction of IFRS.

6. Change of Accounting Policies for Insurance Contracts

(IFRS 4, IN 5, Para 22, 25)

A. Description

IFRS 4 permits an insurer to change its accounting policies for insurance contracts only if, as a result, its financial statements present information that is more relevant and no less reliable, or more reliable and no less relevant. In particular, an insurer cannot introduce any of the following practices, although it may continue using accounting policies that involve them:

(a) measuring insurance liabilities on an undiscounted basis.

(b) measuring contractual rights to future investment management fees as an amount that exceeds their fair value as implied by a comparison with current fees charged by other market participants for similar services.

(c) using non-uniform accounting policies for the insurance liabilities of subsidiaries.

This section addresses the requirements for additional conditions in addition to those of IFRS 4.

B. Members' Responses

No jurisdiction responded that any additional conditions are required for changes in accounting policies for insurance contracts beside the conditions provided in IFRS 4.

7. Change of Accounting Policy on Future Investment Margins

(IFRS 4, IN 8, Para 27, 28)

A. Description

IFRS 4 provides that there is a rebuttable presumption that an insurer's financial statements will become less relevant and reliable if it introduces an accounting policy that reflects future investment margins in the measurement of insurance contracts. This section addresses the impact of the application of such a provision.

B. Members' Responses

(1) Situation before introduction of IFRS
Eight jurisdictions responded that investment margins were reflected in the measurement of insurance contracts prior to the introduction of IFRS 4[18].

(2) Whether permitted or required
Three jurisdictions responded that the method referred to in (1) was permitted, while five jurisdictions responded that it was required.

(3) Change upon introduction of IFRS
One jurisdiction responded that the method referred to in (1) has been changed to use a risk free discount rate. One jurisdiction responded that a revised method will be applied from January 2007. One jurisdiction responded that the method referred to in (1) represented a modification upon the introduction of IFRS 4 and the new valuation rules allow future investment margins to be considered when valuing participating life insurance products.[19]

(4) Supervisory reaction

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18 Only for life insurance in three jurisdictions, only for life and health insurance in one jurisdiction, only for investment-linked insurance products issued by life insurers in one jurisdiction.

19 However, insurers with a large amount of assets yet to be allocated as bonus to policyholders will not be able to claim credit for such future investment margins. All insurers regulated by the authority currently fall under this category.

One jurisdiction responded that supervisory rules do not allow insurers to use assumptions based upon future investment margins to estimate the technical provisions.

8. Embedded Derivatives

(IFRS 4, IN 10(a), Para 7)

A. Description

IFRS 4 clarifies that an insurer need not account for an embedded derivative separately at fair value if the embedded derivative meets the definition of an insurance contract. This section addresses the impact of the application of IFRS 4 on accounting for embedded derivatives.

B. Members' Responses

(1) Present situation
Three jurisdictions responded that there are products for which embedded derivatives are accounted separately.

(2) Significance of embedded derivatives
No jurisdiction responded that the products for which embedded derivatives are accounted separately are significant in the market.

(3) Supervisory reaction
One jurisdiction responded that embedded derivatives are also governed by the relevant liability valuation regulation for prudential purposes. One jurisdiction responded that embedded derivatives will need to be measured separately at fair value in the liability adequacy test from January 2007. One jurisdiction responded that, for the purpose of supervisory reporting, the embedded derivative will be accounted for as part of the insurance contract, as the contract has an insurance element and is issued by a licensed insurer.

9. Unbundling of Deposit Components

(IFRS 4, IN 10(b), Para 10(a))

A. Description

IFRS 4 requires an insurer to unbundle (i.e. account separately for) deposit components of some insurance contracts, to avoid the omission of assets and liabilities from its balance sheet. Unbundling is required if both the following conditions are met:

(i) the insurer can measure the deposit component (including any embedded surrender options) separately (i.e. without considering the insurance component).

(ii) the insurer's accounting policies do not otherwise require it to recognise all obligations and rights arising from the deposit component.

This section addresses the impact of the application of such requirements.

B. Members' Responses

(1) Present situation

Six jurisdictions responded that the deposit components are unbundled. One jurisdiction responded that accounting policies already recognised all obligations and rights from the deposit component of life insurance since before the introduction of IFRS 4. One jurisdiction responded that certain investment-linked products with deposit components may need to be unbundled. One jurisdiction responded that for index-linked life insurance products policyholders' assets are required to be shown separately and unbundled from the insurance contract. One jurisdiction responded that insurance contracts with an explicit savings objective are unbundled. One jurisdiction responded that unbundling is relevant in the case of reinsurance contracts such as non-proportional contracts where the deposit premium is linked to a claims ratio.

(2) Significance of unbundled products

Two jurisdictions responded that such products are very significant in the market. One jurisdiction responded that the proportion of such products in the market is still low but growing. One jurisdiction responded that such products are reasonably significant. One jurisdiction responded that such products are not significant.

(3) Supervisory reaction

Two jurisdictions responded that prudential rules for supervisory reporting differ from general purpose accounting standards. One of them also responded that the relevant prudential rule may require unbundling even in the case that general purpose accounting standards do not require but permit unbundling. One jurisdiction responded that the relevant liability valuation regulation still applies to supervisory accounting.

10. Expanded Presentation

(IFRS 4, IN 10(d), Para 31-33)

A. Description

IFRS 4 permits an expanded presentation for insurance contracts acquired in a business combination or portfolio transfer. An insurer is permitted, but not required, to

use an expanded presentation that splits the fair value of acquired insurance contracts into two components:

(a) a liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues; and

(b) an intangible asset, representing the difference between (i) the fair value of the contractual insurance rights acquired and insurance obligations assumed and (ii) the amount described in (a). The subsequent measurement of this asset shall be consistent with the measurement of the related insurance liability.

This section addresses the application of such practice.

B. Members' Responses

(1) Situation before introduction of IFRS
Seven jurisdictions responded that the expanded presentation of acquired insurance contracts was made prior to the introduction of IFRS[20]. A further jurisdiction commented that the equivalent function was often achieved through particular approaches to accounting for acquired goodwill, although the expanded presentation was not directly implemented.

(2) Whether permitted or required
Five jurisdictions responded that the presentation referred to in (1) was required, and two that it was permitted.

(3) Change in practices
Eight jurisdictions responded that the expanded presentation was not made prior to the introduction of IFRS, but that it had now been introduced. One jurisdiction responded that it had not yet decided whether this would be required for supervisory purposes.

11. Discretionary Participation Features

(IFRS 4, IN 10(e), Para 34-35)

A. Description

IFRS 4 addresses limited aspects of discretionary participation features contained in insurance contracts or financial instruments. Some insurance contracts contain a discretionary participation features as well as a guaranteed element. The issuer of such a contract:

(a) may, but need not, recognise the guaranteed element separately from the discretionary participation feature. If the issuer does not recognise them

20 One jurisdiction responded that it was carried out partially.

separately, it shall classify the whole contract as a liability. If the issuer classifies them separately, it shall classify the guaranteed element as a liability.

(b) shall, if it recognises the discretionary participation feature separately from the guaranteed element, classify that feature as either a liability or a separate component of equity. This IFRS does not specify how the issuer determines whether that feature is a liability or equity. The issuer may split that feature into liability and equity components and shall use a consistent accounting policy for that split. The issuer shall not classify that feature as an intermediate category that is neither liability nor equity.

This section addresses the impact of the classification option under IFRS 4.

B. Members' Responses

(1) Situation before introduction of IFRS
Three jurisdictions responded that discretionary participation features were classified as an intermediate category that was neither liability nor capital prior to the introduction of IFRS.

(2) Products classified as an intermediate category
Those three jurisdictions responded that all contracts with discretionary participation features (or with-profits business) fell under the intermediate category.

(3) Significance of such products
Those three jurisdictions responded that the proportion of such contracts account for 40%, 60%, and 60 - 80% in the market.

(4) Change upon introduction of IFRS
One jurisdiction responded that the classification of discretionary participation features has not changed because discretionary participation features only apply to individual financial statements which are not adjusted to IFRS. One jurisdiction responded that the accounting classification of discretionary participation features has changed and they are now classified as liabilities. One jurisdiction responded that discretionary participation features are now classified as liabilities or capital for general purpose reporting based on the choice of each company.

(5) Supervisory reaction
No jurisdiction responded that any supervisory measures had been taken in response to a classification change.

(6) Reference information
For reference, CEIOPS recommends as a prudential filter that 'supervisors may want to maintain the current national regime, by reallocating amounts from equity to liabilities, to

the extent [to] which they are assessed to be allocated to policyholders as bonuses in the future'.[21]

12. Timing of Application

(IFRS 4, IN 12, Para 41)

A. Description

IFRS 4 provides that entities should apply IFRS 4 for annual periods beginning on or after 1 January 2005, but earlier application is encouraged. This section addresses the timing of the application of IFRS.

B. Members' Responses

(1) Introduction of IFRS 4
Eighteen jurisdictions reported that the application of IFRS 4 began on 1 January 2005. One jurisdiction responded that the application of IFRS 4 began on 1 January 2006.

(2) Accounting year of insurance companies
Sixteen jurisdictions responded that the accounting year of insurance companies begins in January. One jurisdiction responded that the accounting year of most insurance companies begins in July. One jurisdiction responded that the beginning of the accounting year of insurance companies varies but January or April is more common. One jurisdiction responded that the accounting year of insurance companies begins in December for 20%, March for 50%, June for 20%, and otherwise for 10%.

13. Impact of Application of IAS 39

A. Description

This section addresses the impact on prudential supervision of insurance companies arising from the application of IAS 39 *Financial Instruments: Recognition and Measurement*.

B. Members' Responses

(1) Change in accounting practices
Eleven jurisdictions responded that accounting practices for financial instruments had changed upon the introduction of IAS 39. Such changes include: change in basis of valuing assets from 'net market value' to fair value in two jurisdictions; change in

21 CEIOPS, ibid.

valuation basis from book value (i.e. typically ‘cost’) or “lower of book or market” to fair value in seven jurisdictions.

(2) Significance of change in practice
Seven jurisdictions responded that such change is or is expected to be significant. Among those seven jurisdictions: two responded that such change is expected to be significant, but the significance has not been assessed; one responded that such change is significant on the asset side; one responded that the increase in asset value is 17% according to figures from one large insurer. One jurisdiction responded that the impact varies for different insurers.

(3) Supervisory reaction
Six jurisdictions responded that supervisory measures have been taken[22]. They include the following: financial instruments must be designated as “fair value through profit and loss” for the purpose of supervisory reporting in three jurisdictions; continuation of the existing asset valuation regulation for supervisory accounting instead of IAS 39 in one jurisdiction; lowering the available solvency margin if the value of assets, previously accounted for at fair value but now accounted for at purchase cost, increases in one jurisdiction; a requirement to value assets which are intended to cover technical provisions in accordance with the valuation of the related liabilities in one jurisdiction.

(4) Prudential capital filters
Nine jurisdictions[23] responded that “prudential capital filters” are applied or are going to be applied to the calculation of capital adequacy for regulatory purposes. As prudential capital filters:
- one jurisdiction responded that regulatory reporting requirements already require that if the net market value is likely to diminish or evaporate, then the amount of that potential reduction is regarded as inadmissible for solvency purposes;
- three jurisdictions responded that gains and losses arising from a change in the firm’s own creditworthiness are reversed or deducted from equity. In addition, unrealised capital gains are deducted from equity in Italy, and gains and losses from cash flow hedges are reversed for the regulatory capital calculation in one jurisdiction;
- four jurisdictions responded that prudential capital filters are going to be applied.

(5) Additional guidance or restricted use of fair value
No jurisdiction responded that additional guidance on the use of fair value had been provided.

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22 Only for life insurance in one jurisdiction, only for non-life insurance in one jurisdiction..

23 In addition to those nine jurisdictions, one jurisdiction is deliberating on “prudential capital filters” as part of the development of new capital requirements under the RBC framework which will be implemented in 2008. In this jurisdiction, most IFRSs including IAS 39 are applied, although IFRS 4 has not yet been applied, as mentioned in the footnote 9.

(6) Reference information

For reference, CEIOPS notes that, for Member States using an historical cost approach, fair value measurement implies the recognition of unrealised capital gains, which cannot be entirely accounted for under the current solvency regime. It recommends as a prudential filter that 'specific treatment for unrealised capital gains and losses related to financial instrument as well as property valuation' is required.[24] Regarding the Fair Value Option, CEIOPS suggests as a prudential filter that 'the valuation can be adjusted to neutralise the impact of IAS 39. The use for the Fair Value Option can be also restricted for prudential reporting. In order to accept fair valuation for solvency purposes, specific requirements may be retained or established by supervisors (rules, regularity, definition of fair value)'.[25] CEIOPS notes that 'the potential inclusion of gains and losses related to changes in own creditworthiness would not be in line with the current EU solvency regime' and recommends as a prudential filter that 'gains and losses arising in the valuation of financial liabilities on a fair value basis in relation to own creditworthiness are deducted from the Available Solvency Margin.'[26]

14. Impact of Application of IFRS other than IFRS 4 and IAS 39

A. Description

This section addresses the impact on prudential supervision of insurance companies arising from the application of IFRS other than IFRS 4 and IAS 39.

B. Members' Responses

Fifteen jurisdictions specified IFRSs which are considered to have significant impact upon the financial statements of insurance companies. The following is a list of the IFRSs identified.

IFRS 1 *First-time Adoption of International Financial Reporting Standards* (specified by three jurisdictions)

One jurisdiction indicated that the impact of paragraph 20 is significant since it requires that all cumulative actuarial gains and losses of employee benefits liabilities may be recognised at the date of transition to IFRS. One jurisdiction indicated that paragraph 15 has an impact on the value of real estate since it permits an entity to elect to measure an item of property, plant and equipment at the date of transition to IFRS at its fair value and use that fair value as its deemed cost at that date.

24 CEIOPS, ibid.

25 CEIOPS, ibid, Annex 3.

26 CEIOPS, ibid.

IFRS 2 *Share-based Payment* (specified by one jurisdiction)

One jurisdiction indicated that paragraph 8 has an impact on equity in the first IFRS balance sheet since it requires that, when the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, goods or services shall be recognised as expenses.

IFRS 3 *Business Combinations* (specified by one jurisdiction)

One jurisdiction indicated that paragraphs 54 and 55 have an impact on equity and profit and loss since they require that goodwill acquired in a business combination shall be measured at cost less any accumulated impairment losses, while goodwill was previously amortised under local GAAP.

IAS 12 *Income Taxes* (specified by three jurisdictions)

This standard deals with how to account for the current and future tax consequences of:

- *Transactions and events of the current period recognised in the financial statements.*
- *Future recovery of the carrying amount of assets in the balance sheet*
- *Future settlement of the carrying amount of liabilities in the balance sheet.*

One jurisdiction noted that the discounting of deferred tax reserves is not permitted by IAS 12, while they were previously discounted. One jurisdiction indicated that the calculation method for deferred tax had changed from an income statement approach to a balance sheet approach, which would result in potentially more deferred tax assets being recognised. This jurisdiction also noted that the change considerably increases the level of disclosure on deferred tax.

IAS 16 *Property, Plant and Equipment* (specified by three jurisdictions)

Property, plant and equipment are recorded initially at cost. After acquisition, an entity may choose to measure them either at cost less accumulated depreciation and impairment losses, or at fair value.

One jurisdiction noted that the effects of variation in the fair value are deducted from equity concerning capital adequacy measurement. One jurisdiction noted that changes in fair value are recognised in equity while they were previously recognised in profit and loss. One jurisdiction indicated that IAS 16 has an impact due to the option to use fair value for real estate assets.

IAS 18 *Revenue* (specified by two jurisdictions)

Revenue is recognised when it is probable that benefits will flow to the entity and these benefits can be measured reliably. For services, revenue is recognised as work is performed.

Two jurisdictions noted that IAS 18 requires deferring the recognition of a certain type of revenue which was previously recognised at inception (e.g. up front fees for the management services component of investment contracts).

IAS 19 *Employee Benefits* (specified by five jurisdictions)

Paragraph 78: The rate to discount post-employment benefit shall be determined by reference to market yields on high quality corporate bonds (or government bonds).
Paragraph 92: Certain unrecognised actuarial gains and losses of post-employment benefit liability should be recognised as income or expense.

Two jurisdictions noted that IAS 19 requires the recognition of defined benefit surpluses and deficits which were previously not recognised. One of them has reacted to this by requiring that superannuation fund deficits are recognised but surpluses are inadmissible for capital measurement. One jurisdiction indicated that the requirement of paragraph 92 has an impact on equity in the first IFRS balance sheet. One jurisdiction noted paragraph 78. One jurisdiction indicated that IAS 19 potentially creates larger pension deficits and surpluses. This jurisdiction has reacted to this impact by requiring that all pension surpluses are derecognised for prudential reporting purposes and a transitional option has been introduced for the treatment of pension deficits.

IAS 21 *The Effects of Changes in Foreign Exchange Rates* (specified by one jurisdiction)

Paragraph 47: Goodwill from the acquisition of a foreign operation shall be measured in the functional currency of the foreign operation and shall be translated at the closing rate.

One jurisdiction indicated that this requirement has an impact on equity because goodwill was mostly considered a non monetary item under local GAAP and accounted for at the historical rate.

IAS 27 *Consolidated and Separate Financial Statements* (specified by two jurisdictions)
IAS 28 *Investments in Associates* (specified by one of these two jurisdictions)
IAS 31 *Interests in Joint Ventures* (specified by one of these two jurisdictions)

One jurisdiction noted that associates, joint ventures and subsidiaries are valued at cost or fair value under these IASs respectively, while they are valued at net asset value (i.e.

equity method less goodwill) under existing prudential rules. One jurisdiction noted that subsidiaries are consolidated under IAS 27, while they were previously recognised at net market value for life insurers.

IAS 29 *Financial Reporting in Hyperinflationary Economies* (specified by one jurisdiction)

IAS 32 *Financial Instruments: Presentation* (specified by four jurisdictions)

The issuer of a non-derivative financial instrument which contains both a liability and an equity component shall classify separately as liabilities, assets or equity.

Two jurisdictions indicated that this requirement has an impact on equity. One jurisdiction noted that funding instruments which are treated as liabilities under IFRS are treated as a component of equity under existing prudential rules

IAS 38 *Intangible Assets* (specified by two jurisdictions)

An intangible asset with an indefinite useful life is not amortised, but is tested annually for impairment.

One jurisdiction indicated that there is an increase in equity due to a shorter amortisation period. One jurisdiction noted that goodwill is no longer amortised, whereas it was previously amortised.

IAS 39 *Financial Instruments: Recognition and Measurement* (specified by one jurisdiction)

Derivatives are to be measured at fair value through profit and loss.

One jurisdiction indicated that this requirement has an impact on equity and profit and loss.

IAS 40 *Investment Property* (specified by five jurisdictions)

An investment property is measured initially at cost. Subsequently, an entity must adopt either the fair value model or the cost model for all investment properties.

One jurisdiction indicated that IAS 40 has an impact because a number of insurers hold significant amounts of assets in properties to back insurance liabilities. This jurisdiction has reacted to this by requiring that all properties are to be treated as fair value through profit and loss for supervisory reporting purpose. One jurisdiction indicated that IAS 40 has an impact due to the option to use fair value for real estate assets. One jurisdiction responded that the effects of variation in the fair value are deducted from equity in respect of capital adequacy measurement. One jurisdiction

indicated that an impact could arise from uncertainty in some fair value calculation techniques. One jurisdiction indicated that, if fair valuation of investment properties is used, additional differences to local GAAP arise.

III. Main Findings

The following is a summary of the supervisory action taken in response to the accounting changes upon the introduction of IFRS.

(1) Definition change of insurance contract

On the basis of the survey responses received, more than half of the jurisdictions in which IFRS is applied responded that certain products do not meet the IFRS 4 definition of an insurance contract, and most of these have taken or plan to take supervisory measures in response to the change in definition. The common nature of such measures is to broaden the definition of an insurance contract for supervisory reporting purposes from general purpose reporting, with the intention of neutralising the impact of the change in definition.

(2) “Mismatch” between assets and liabilities

On the basis of the survey responses received, more than half of the jurisdictions expressed concern over “mismatch” between assets and liabilities, which may be brought about by a difference in valuation bases between assets and liabilities. Most jurisdictions which expressed concern have taken supervisory measures as well as to apply certain options within IFRS for general purpose accounting as a result. Measures include shadow accounting, the mandatory application to financial assets of "fair value through profit and loss", and the elimination of the impact of unrealised capital gains.

(3) Catastrophe and equalisation provisions

Catastrophe and equalisation provisions were recognised before the introduction of IFRS in most responding jurisdictions in which IFRS is applied. Upon the introduction of IFRS, such provisions were reclassified from liability to capital in some jurisdictions, abolished from general purpose financial statements in some jurisdictions, or were abolished from consolidated financial statements but retained in solo financial statements in one jurisdiction Some of these jurisdictions have taken supervisory measures in response to the change in accounting by formulating supervisory rules such as requirements for equalisation provisions for certain types of insurers for supervisory reporting, and deduction from equity for capital adequacy measurement.

(4) Discretionary participation features

Some of the responding jurisdictions in which IFRS is applied stated that discretionary participation features were classified as an intermediate category that was neither liability nor capital before the introduction of IFRS. The proportion of contracts which fall into such a category is significant in each relevant market. Some of those jurisdictions responded that accounting classification had changed, i.e. moving from the intermediate category to liabilities.

(5) Impact of application of IAS 39

More than half of the responding jurisdictions in which IFRS is applied stated that the accounting practice for financial instruments had changed upon the introduction of IAS 39, including change in valuation basis from book value (or lower of book or market value) to fair value, and change in valuation basis from net market value to fair value. More than half of those jurisdictions have taken supervisory measures in response to the change in accounting practice, e.g. designation of financial instruments as a category for "fair value through profit and loss" for supervisory reporting, or continuation of the existing asset valuation regulation for supervisory accounting. Also, more than half of those jurisdictions stated that prudential capital filters are applied or are going to be applied, e.g. reversal or deduction of gains and losses arising from a change in the firm's own creditworthiness, deduction of unrealised capital gains, and reversal of gains and losses from cash flow hedges.