

# IFRS 17 – Insurance contracts report

EIOPA's report on the implementation &  
synergies and differences with Solvency II

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**eioipa**

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## EXECUTIVE SUMMARY

IFRS 17 is expected to bring uniformity and transparency to insurer's and reinsurer's financial statements, leading to significant changes not only in the insurance industry, but also on the regulatory side where some changes on the use of IAS Options<sup>1</sup> have been observed in the EU. Following the initial publication of IFRS 17 in 2017, EIOPA published its analysis of the benefits IFRS 17<sup>2</sup>, and now, after IFRS 17 first application, the analysis is complemented with this report on the implementation of IFRS 17 and the synergies and differences with Solvency II.

Within the first half of the report, EIOPA covers the main aspects of the implementation of IFRS 17, with special focus on its first application, which in 68% of cases was simultaneous to the first application of IFRS 9 due to the temporary exemption allowed by the IASB. While the first application of these two standards overall led to a decrease of shareholders' equity, the impact decreased along the last two years with the increase in interest rates thanks to the capacity of the combination of IFRS 9 and IFRS 17 to mitigate volatility.

Respondents reported average fulfilment cashflows 2.5% lower than Solvency II technical provisions, although adding the average contractual service margin (8.6% of fulfilment cashflows on average) this difference is reversed. The report highlights several differences among both frameworks, including the alternative valuation methods allowed by IFRS 17, the Variable Fee Approach and the Premium Allocation Approach, which were reported to be predominant for life and non-life business respectively.

Despite the existing differences, respondents highlighted very material synergies with the Solvency II framework on several aspects, including contract boundaries identification, cashflow projection, risk adjustment calculation and, in particular, the determination of discount rates. More than 75% of respondents reported to use EIOPA's risk-free rate term structure (RFR) with an additional 13% using it as an input to determine IFRS 17 risk free rate. However, the illiquidity premium allowed in IFRS 17 frequently led to significant differences between IFRS 17 and Solvency II discount rates.

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<sup>1</sup> See Article 5 of the [Regulation \(EC\) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards](#)

<sup>2</sup> [https://www.eiopa.europa.eu/eiopa-analyses-benefits-ifs-17-insurance-contracts-2018-10-19\\_en](https://www.eiopa.europa.eu/eiopa-analyses-benefits-ifs-17-insurance-contracts-2018-10-19_en)

# 1. INTRODUCTION

## 1.1. BACKGROUND

IFRS 17 – Insurance contracts entered into force on 1 January 2023<sup>3</sup>. The new standard, which took almost 20 years, aims to increase transparency and to reduce differences in the accounting for insurance contracts and it replaces IFRS 4 (interim standard), which was mainly relying on local accounting standards.

IFRS 17 and Solvency II are two of the main regulatory projects within the insurance industry of the last decades and naturally share most of their core elements<sup>4</sup>, which are expected to bring some synergies and make possible to re-use some of the Solvency II processes for IFRS 17 purposes, limiting the administrative burden of undertakings and facilitating the re-conciliation of the two frameworks (figures) by analyst and financial market participants.

While in general IFRS can be used for Solvency II purposes for the recognition and valuation of all balance sheet items other than technical provisions (in case of use of fair value under IFRS)<sup>5</sup>, the recognition and valuation of technical provisions for Solvency II purpose is based on specific prudential requirements, which are separate and different from IFRS 17. Indeed, although the recital (54) of the Solvency II Directive states: *The calculation of technical provisions should be consistent with the valuation of assets and other liabilities, market consistent and in line with international developments in accounting and supervision*; the two projects were run separately and have several differences<sup>6</sup>, some of them justified by the different purposes of the two frameworks.

In addition, according to article 296 of the Delegated Regulation 2015/35 the Solvency and Financial Condition Report shall include, separately for each material line of business, a quantitative and qualitative explanation of any material differences between the bases, methods and main

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<sup>3</sup> Insurers were provided the option to align the dates of implementation of IFRS 9 (“Financial Instruments”) and IFRS 17 at the same time (starting from 1/01/2023), to limit the operational burden to apply two major accounting changes in two different time.

<sup>4</sup> E.g. realistic/market consistent valuation, approach based on probability-weighted estimate of future cashflows, discounting of future cashflows, risk adjustments, etc.

<sup>5</sup> See to Article 9, paragraph 1 and 2, of Commission Delegated Regulation 2015/35. EIOPA Guidelines on recognition and valuation of assets and liabilities other than technical provisions provide additional guidance.

<sup>6</sup> For instance, expected future profits (called the contractual service margin in IFRS 17) are an element of the technical provisions under IFRS 17 while in Solvency II the absence of a contractual service margin means that future profits are directly included in the Own Funds. Other differences are granularity/aggregation of the contracts (i.e. “annual cohort principle” in IFRS 17), more principle-based approach for discounting and risk adjustments in IFRS 17, reporting/disclosure, etc.

assumptions used by that undertaking for the valuation for solvency purposes and those used for their valuation in financial statements.

In 2018 EIOPA published an analysis on IFRS 17 insurance contracts<sup>7</sup>, which included a comparison of IFRS 17 and Solvency II frameworks with the aim of identifying commonalities, differences and potential synergies. However, it should be noted that the document was developed in 2018 and the IASB amended IFRS 17 in June 2020<sup>8</sup>, including some relevant amendments, and the Commission introduced an exemption for the so-called annual cohort requirement in its Regulation (EU) 2021/2036. In addition, during these 5 years of preparation both, supervisors and standard users, have gained significant experience and achieved a deeper knowledge on IFRS 17 framework. It is also worth mentioning that the analysis was purely qualitative as there was no data available, so there is no quantitative data allowing for a proper understanding of the real impact of the differences between both frameworks.

For these reasons, EIOPA decided to prepare a high-level data request addressed to IFRS 17 users (via the National Competent Authorities) to gather a high-level overview of:

- i) the first implementation of IFRS 17 and
- ii) the main synergies and differences with Solvency II.

This data request also served to create one harmonised data request across Europe instead of having several different data requests issued by different NCAs, which would have increased the burden for the industry and limited the scope of the analysis.

## 1.2. DESCRIPTION OF THE DATA

Article 4 of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards requires publicly traded companies to prepare their consolidated accounts in conformity with the international accounting standards adopted by the Commission. For this reason, the survey was addressed to listed groups with the aim to cover

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<sup>7</sup> [https://www.eiopa.europa.eu/eiopa-analyses-benefits-ifs-17-insurance-contracts-2018-10-19\\_en](https://www.eiopa.europa.eu/eiopa-analyses-benefits-ifs-17-insurance-contracts-2018-10-19_en)

<sup>8</sup> [IFRS - Amendments to IFRS 17 Insurance Contracts](#)

at least 50% of listed groups<sup>9</sup>, leading to a sample composed of 53 groups from 17 Member States<sup>10</sup> (out of a total of 121 groups using IFRS<sup>11</sup>).

The reference date for the data request was the 30<sup>th</sup> of June 2023, i.e., the semi-annual financial statements.

**Caveat:** Considering the relatively limited size of the sample, the use of semi-annual financial statements (i.e., non-audited data), that 2023 has been the first year of application of IFRS 17 and that some data points have been asked on best effort basis (i.e., including estimates, judgement and assumptions) as providing the data required in a few cases additional calculations, the results provided in this report should be interpreted as providing an overview of the order of magnitude of implementation choices and differences with Solvency II rather than accurate measurements.

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<sup>9</sup> In some Member States (in accordance with the options provided by the mentioned IAS Regulation), non-listed groups and/or individual undertakings are allowed or required to use international accounting standards. For efficiency reasons, Member States were allowed to address the data request to other IFRS 17 users beyond listed groups for their own use. However, this data is not included in this consolidated report.

<sup>10</sup> Austria, Belgium, Croatia, Denmark, Finland, France, Germany, Iceland, Ireland, Italy, Lithuania, Netherlands, Norway, Poland, Slovenia, Spain and Sweden

<sup>11</sup> 2022 annual data from S.01.02.

## 2. IMPLEMENTATION OF IFRS 17

In this first section, the report provides an overview of the implementation of IFRS 17 organised within two subsections: the one dedicated to the first application and the second one focused on the implementation of the main elements of the framework, i.e., the groups of contracts, the choice of the valuation method, the discount rates, the risk adjustment and the contractual service margin.

### 2.1. FIRST APPLICATION

#### 2.1.1. OVERVIEW

The first application of IFRS 17 led to significant changes on the value of insurance liabilities indirectly impacting shareholders' equity. As part of implementation process, IFRS 17 users assessed the impact of moving from IFRS 4 and IAS 39 to IFRS 17 and IFRS 9<sup>12</sup>.

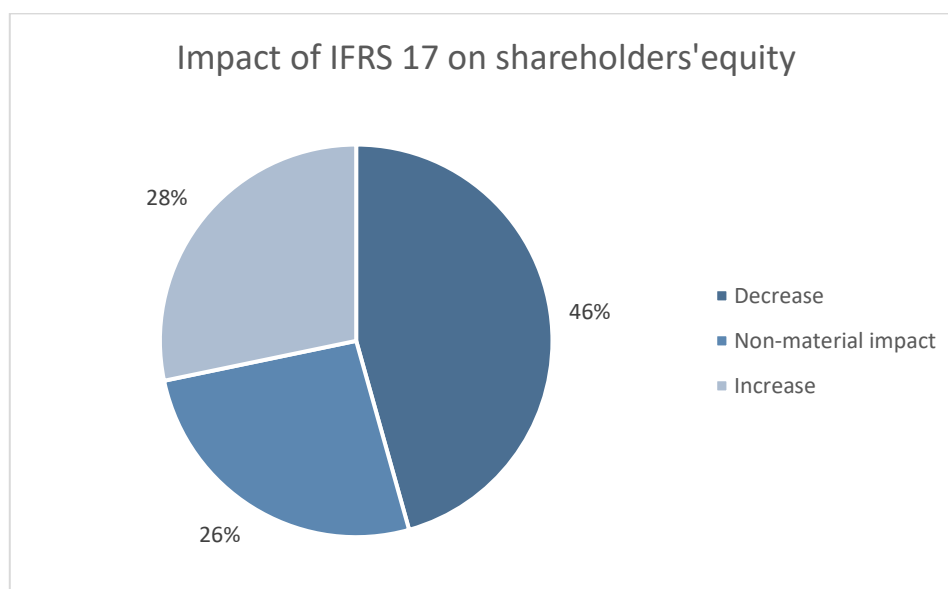
The data showed an overall negative impact, measured strictly as the impact on shareholder's equity due to the change from IFRS 4 / IAS 39 to IFRS 17 / IFRS 9, as 46% of respondents reported a reduction of shareholders' equity, 26% a minimal overall impact and 28% reported an increase<sup>13</sup>. Both standards are significantly different so there are several reasons behind this impact, although some of the most important ones are the use of different interest rates, the differences between the prudence margins embedded in IFRS 4 technical provisions and IFRS 17 risk adjustment, and the new contractual service margin in IFRS 17.

However, the impact was significantly case-dependent, among others, due to the nature of the business, as IFRS 17 Premium Allocation Approach (PAA), mainly used in non-life business, is quite similar to IFRS 4 unearned premium method, while IFRS 17 general model (GM) and Variable Fee Approach (VFA), mainly used in life business, are significantly different from IFRS 4 recognition and valuation method. In addition, IFRS 17 also allows for several modelling choices (e.g., to determine discount rates used or to measure the risk adjustment), therefore contributing to a higher variability. In addition, IFRS 17 allows three alternative approaches for the transition from IFRS 4 to IFRS 7: the full retrospective approach, the modified retrospective approach and the fair value approach; as well as the option of the overlay approach for the first application of IFRS 9.

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<sup>12</sup> Some respondents applied IFRS 9 for the first time also in 2023 and only had data of the joint impact for both IFRSs.

<sup>13</sup> Due to data availability, some respondents answered based on 01/01/2022 data.



Finally, it is also worth mentioning the interaction with the economic environment, as some respondents reported that the impact of the change from IFRS 4 / IAS 39 to IFRS 17 / IFRS 9 proved to be significantly dependent on the interest rates. Increasing interest rates during 2022 and 2023 have mitigated the impact of the change, probably because under IFRS 4 / IAS 39 the increase on interest rate might have a larger impact on debt instruments than on technical provisions, while under IFRS 17 / IFRS 9 this mismatch is significantly lower.

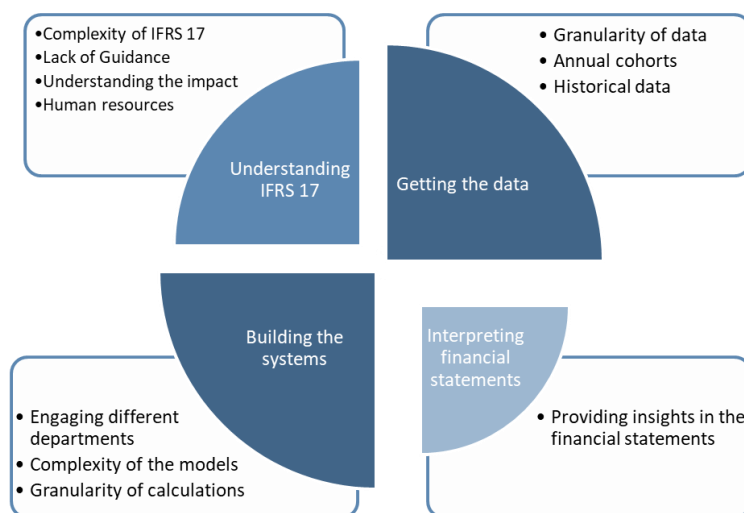
### 2.1.2. MAIN CHALLENGES

The main challenges identified by insurance groups can be classified into four categories based on the stage of process to produce financial statements with IFRS 17: understanding IFRS 17, getting the data, building the systems and interpreting the financial statements.

Getting the data and building the systems were reported to have been the most important challenges, with special focus on the granularity of the data/calculations and the annual cohort requirement<sup>14</sup>. Understanding IFRS 17, in particular due to the lack of detailed guidance and experts, was frequently mentioned as major challenge. Finally, respondents also considered that interpreting the data to build the consolidated financial statements was a significantly demanding task.

<sup>14</sup> Under IFRS 17, undertakings are required to group insurance contracts from each portfolio of insurance contracts into three main categories, i.e., onerous contracts, contracts that do not have a significant possibility of becoming onerous and other contracts. In addition, this groups should be further divided so groups do not include contracts issued more than one year part. This groups with contracts issued within the same year are also known as annual cohorts.

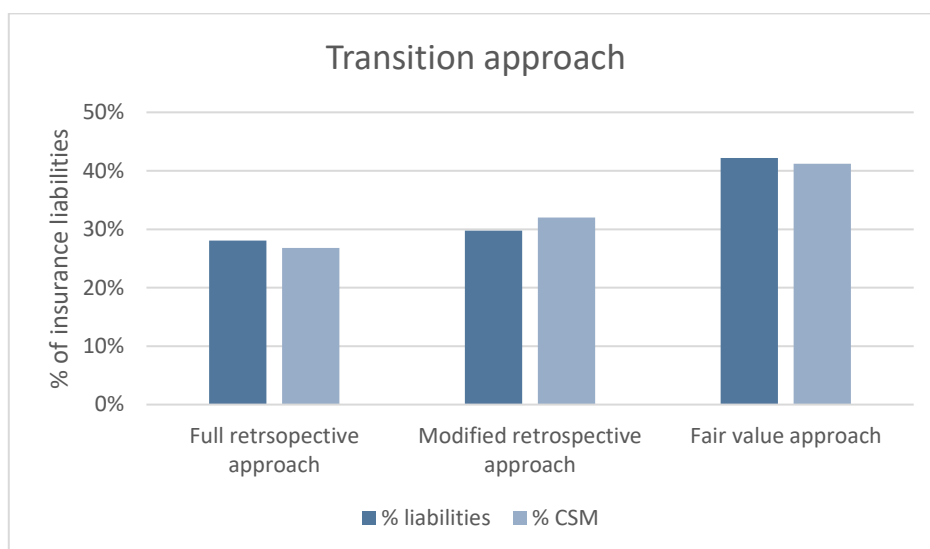




### 2.1.3. TRANSITION APPROACH

IFRS 17 envisages three alternative approaches for the transition from IFRS 4 to IFRS 17: the full retrospective approach, the modified retrospective approach and the fair value approach. By the default, IFRS 17 required applying the standard requirements to all existing contracts retrospectively (full retrospective approach). However, this might be impracticable for long-term contracts, in particular in life business, so IFRS 17 also allows for other two approaches. The modified retrospective approach still requires a retrospective application of IFRS 17 requirements but allowing some modifications to ease data limitations. Finally, the fair value approach relies on the difference between the fulfilment cashflows and the fair value of the contract to determine the contractual service margin.

All three IFRS 17 transition approaches have been used to a similar extent, although the fair value approach has been the most frequent option (41.9% of insurance liabilities) followed by the modified retrospective approach (29.6%) and the full retrospective approach (27.9%). On average all three approaches led to proportional amounts of contractual service margin (CSM), although individually significant differences exist, which might indicate that the amount of the CSM depends more on the product than on the transition approach.



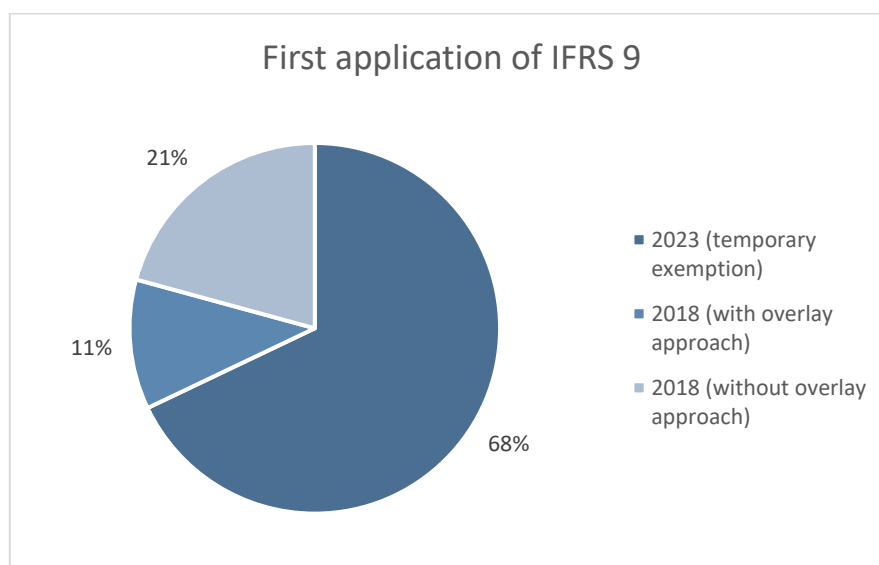
#### 2.1.4. INTERACTION WITH IFRS 9: FIRST APPLICATION OF IFRS 9

IFRS 9 “Financial Instruments” was issued in July 2014 with a mandatory effective date of the 1<sup>st</sup> of January 2018. Having different effective dates for IFRS 9 and IFRS 17 (respectively 01/01/2018 for IFRS 9 and 01/01/2023 for IFRS 17) concerns arose from insurance industry, regarding temporary accounting mismatches, volatility, additional administrative costs and complexity to implement two major accounting principle in a not synchronised way.

To address these concerns, the IASB issued amendments to IFRS 4 in 2017 in order to give users the option to align the dates of the first application of both standards, with two operational solutions applicable until the 1<sup>st</sup> of January 2021, later extended up to the 1<sup>st</sup> of January 2023 in the amendment to IFRS 17 issued in June 2020: a temporary exemption from IFRS 9 and the overlay approach<sup>15</sup>.

The data received shows that the European insurance industry has made good use of these two options, as 68% of respondents opted for the temporary exemption and 11% used the overlay approach, while the remaining 21% decided not to postpone the full application of IFRS 9.

<sup>15</sup> For designated financial assets, a company is permitted to reclassify, between P&L and OCI, the difference between the amounts recognised in P&L under IFRS 9 and those that would have been reported under IAS 39.



## 2.2. IMPLEMENTATION

### 2.2.1. GROUPS OF CONTRACTS

IFRS 17 applies some specific principles to onerous contracts, i.e., those contracts expected to bear losses for the undertaking. For this reason, IFRS 17 users are required to allocate insurance contracts of each portfolio to three different groups based on their expected profitability into onerous contracts, contracts that at initial recognition have no significant possibility of becoming onerous subsequently and other contracts.

#### Onerous contracts

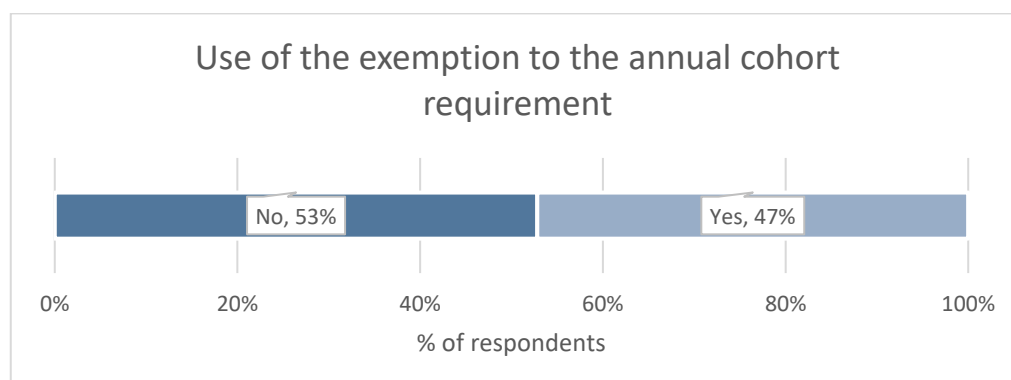
Onerous contracts were reported by most respondents (85%), although the materiality is quite limited, in particular for life business (2.39% of total life liabilities, with a loss component equal to 0.15% of total life liabilities on average). For non-life business the onerous liabilities represented 2.90% of total non-life liabilities, but the weight of the loss component increased up to 0.48%, probably due to non-life insurance liabilities being usually lower than life insurance liabilities. Health insurance liabilities accounted for 2.14% of total liabilities with a loss component equal to 0.28% of total health liabilities on average.



### Annual cohorts

In addition to the three groups based on expected profitability, IFRS 17 requires that each group does not include contracts issued more than one year apart, i.e., undertakings should create groups with annual cohorts of contracts. This requirement is particularly demanding as not always reflect how the insurance business is managed (e.g., when the risk is shared among policyholders from different annual cohorts).

When adopting IFRS 17, the Commission allowed for an exemption to the annual cohort requirement for intergenerationally mutualised contracts, which includes contracts with specific profit participation features, as well as contracts that are managed across generations and apply Solvency II matching adjustment. Within the data request, almost half of the respondents (47%) reported to be using the exemption. It should be noted that the sample of respondents included groups not issuing contracts eligible for the exemption, so the real use of the exemption for eligible cases might be significantly higher.

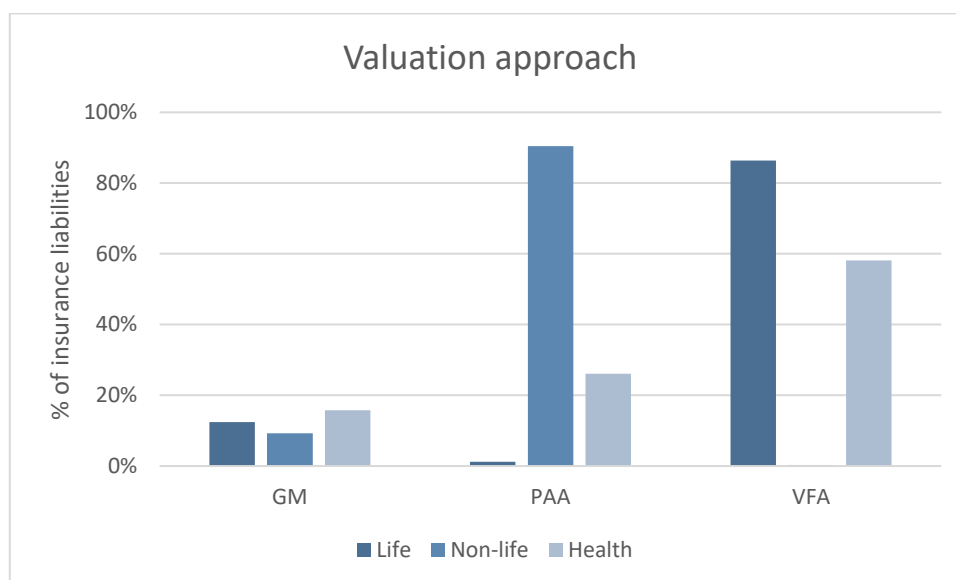


Although not explicitly covered within the data request, several respondents commented that the exemption was mainly used within the VFA. Some respondents reported applying only the annual cohorts to post-transition business (i.e., business underwritten after 01/01/2023), while other two reported to go beyond the annual cohort requirement and define quarterly cohorts within non-life business.

### 2.2.2. VALUATION METHODS

IFRS 17 allows for three different valuation methods. The General Model (GM) or building-blocks approach, which is based on three main building blocks: the present value of expected future cashflows, the risk adjustment and the contractual service margin. The Premium Allocation Approach (PAA), mainly allowed for short-term contracts, allows to simplify the calculation of the liability for remaining coverage based on an unearned premium approach, significantly closer to the valuation principles of IFRS 4. Finally, the Variable Fee Approach (VFA) is a modification of the GM for contracts with direct participation features that allows to estimate the present value of future cashflows based on the market value of the underlying assets and a variable fee charged by the undertaking.

The valuation methods chosen clearly depends on the type of business, with life insurance clearly leaning towards the VFA (86.4%) and non-life insurance towards the PAA (90.4%). For health business the choice of methods is more evenly split, probably depending on whether the underlying nature of the business is closer to life or non-life.

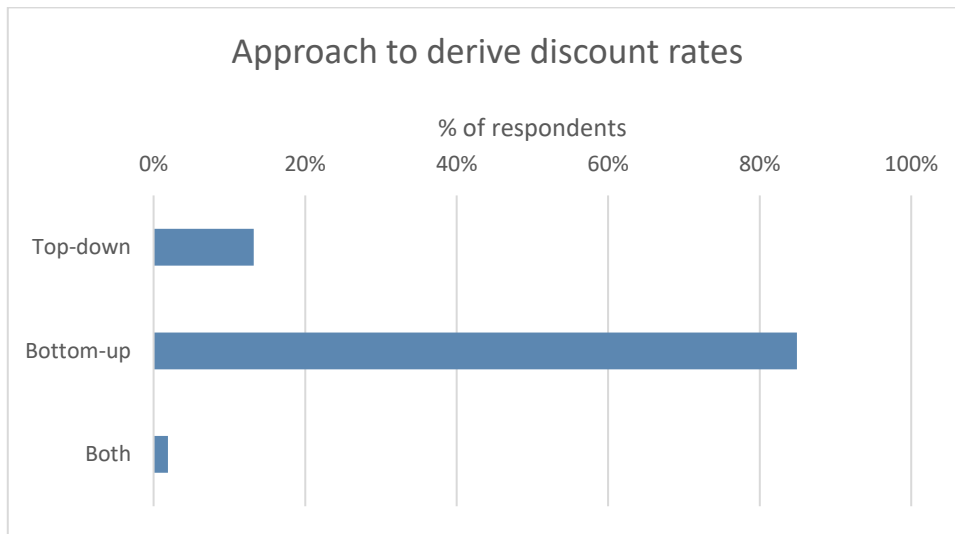


### 2.2.3. DISCOUNT RATES

#### Approach to derive discount rates

IFRS 17 describes two alternative approaches to derive the relevant discount rate: the bottom-up approach and the top-down approach, both of them aiming to identify the relevant discount rate that reflects the characteristics of the insurance obligations. The bottom-up approach starts from the risk-free rate and adds the necessary adjustments to reflect the nature of the insurance obligations (e.g., an illiquidity premium). The top-down approach follows the opposite approach, i.e., starts from the market rate of some reference assets (e.g., a bond) and deducts the spread component for all relevant risks (e.g., credit risk).

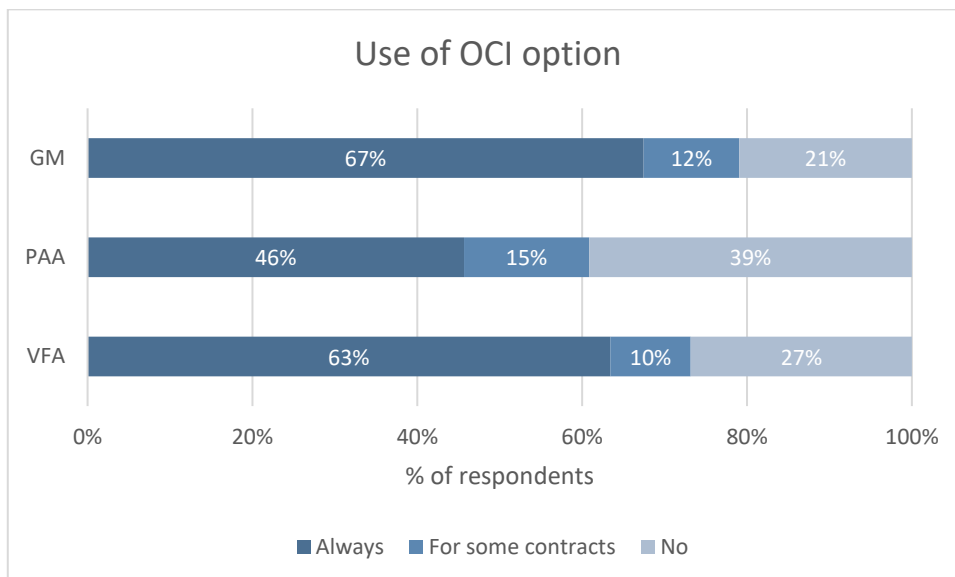
Although most respondents reported to use different discount rates for different products, all except for one used always the same approach, either bottom-up (85% of respondents) or top-down (13%). Therefore, it can be concluded that the choice of the approach to derive the relevant discount rate is an accounting policy usually made at group level.



**Use of OCI option to address the volatility of the income statement**

P&L statements of long-term business models, as insurance business, may reflect short-term volatility from changes in market prices, which is not relevant for the long-term horizon of the typical insurance business model. One of the measures to reduce the short-term volatility of the Profit and Loss (P&L) account is the IFRS 17 option to account for the impact of changes in financial assumptions through other comprehensive income (OCI) instead of through P&L.

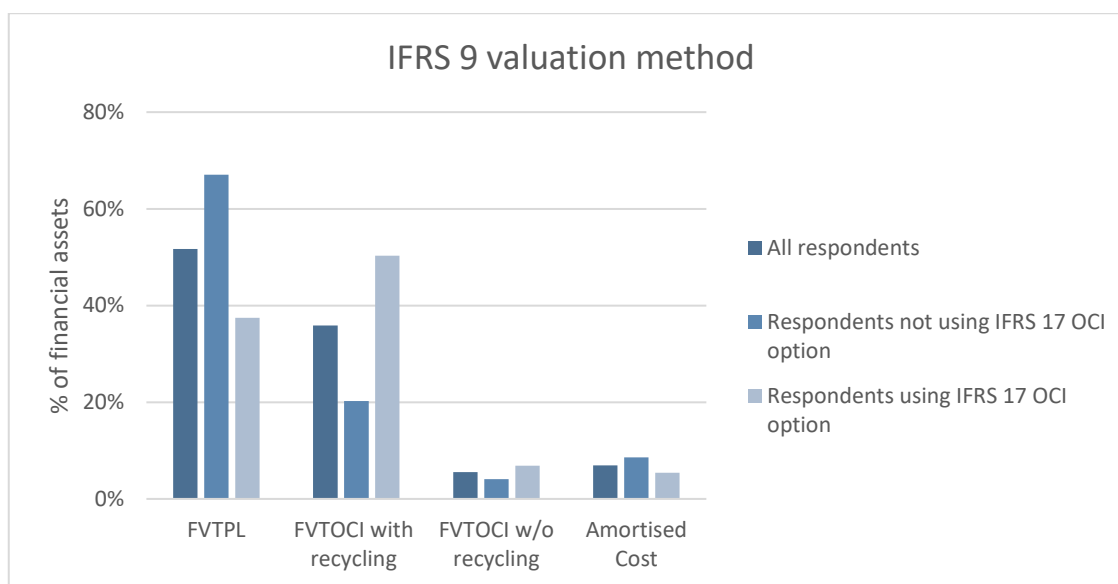
The data shows that this option is frequently used, especially in the GM (79% of the respondents) and the VFA (73%). For the PAA, where the discounting is not always required, the use of the OCI option is slightly lower (61%)



The use of IFRS 17 OCI option is a good example of the synergies with IFRS 9, which also includes options to recognise gains and losses in OCI. In the past insurance undertakings have already made good use of valuation methods that allowed for further P&L stability in accordance with IAS 39 and in IFRS 9 this trend continues. However, it should be noted that under IFRS 9, valuation at fair value through OCI (FVTOCI) is different for equity and debt instruments. While for debt instruments amounts previously recognised in OCI are eventually “recycled” to P&L, for equity instruments all gains and losses directly recognised in OCI will never be recognised to P&L.

It is particularly interesting to see the interaction between both standards, as respondents using IFRS 17 OCI option clearly used less IFRS 9 fair value through profit and loss FVTPL valuation (37% vs 67% for respondents not using IFRS 17 OCI option). Some respondents highlighted that not recycling gains and losses on realisation of equity instruments valued at FVTOCI creates some issues, including potential mismatches with IFRS 17 valuation for products with profit participation as well as less useful presentation of financial performance.

In any case, FVTPL is the most used IFRS 9 valuation method in general, which shows the natural matching with the market-consistent valuation of IFRS 17 liabilities.



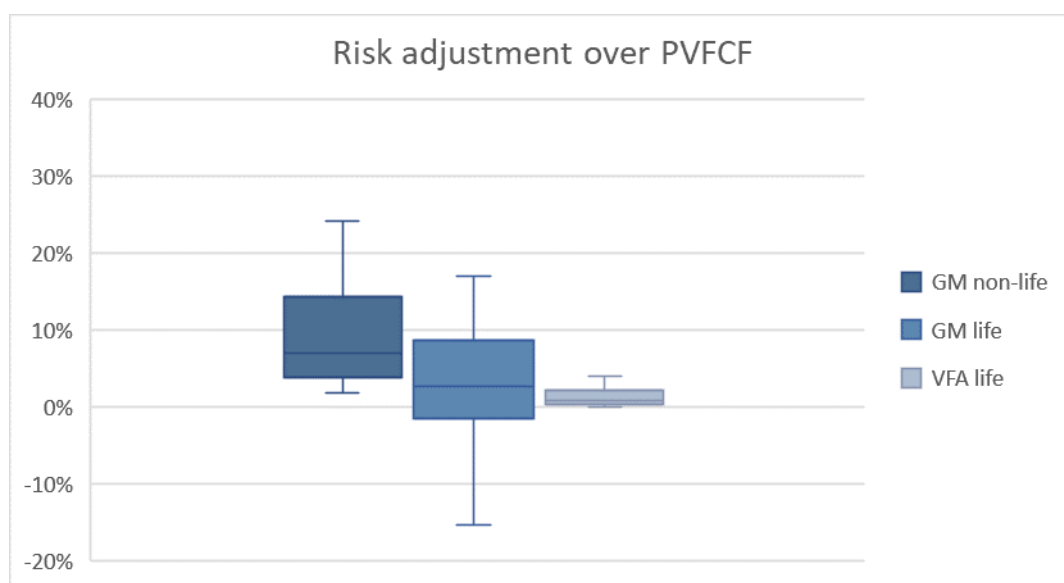
## 2.2.4. RISK ADJUSTMENT

### Overview

To ensure consistency with the approach followed in IFRS 13 to determine a similar risk adjustment for non-financial risk, IFRS 17 allows for a wide range of options for the calculation of the risk-adjustment, in particular the method used, the confidence level and the diversification effects



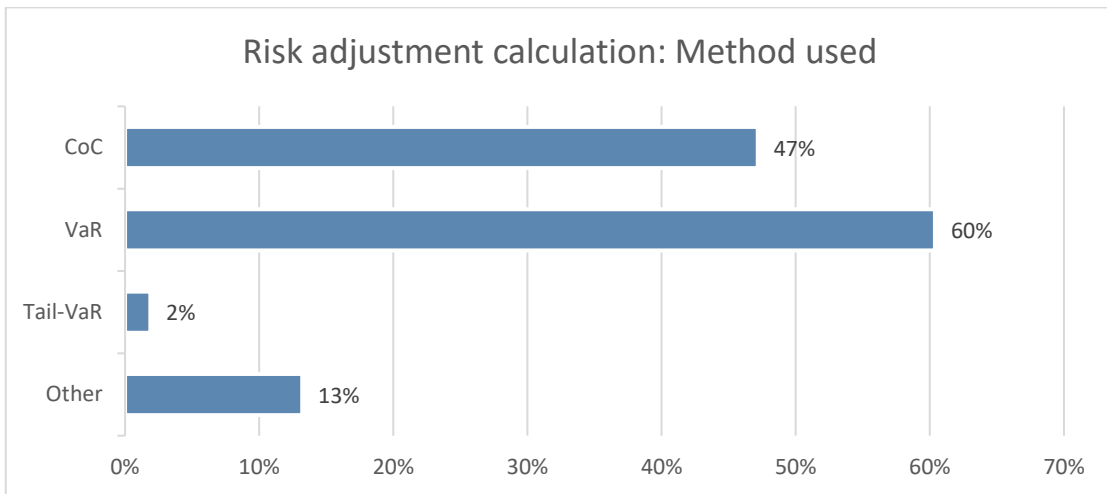
considered. This leads to significant variability in risk adjustment amounts among IFRS 17 users, with higher risk adjustments in non-life business (6.5% over the present value of the future cashflows (PVFCF) in the general model) compared to life business, where the risk adjustment reported was particularly low within the VFA (0.8% vs. 3.4% for the general model). As the average confidence level is very similar for life and non-life business (approximately 80%, see “Confidence level” subsection below), this difference is explained by the differences in the moments<sup>16</sup> of the distribution of the PVFCF.



### Method used

Although IFRS 17 does not prescribe any method to calculate the risk adjustment, initially three methods were envisaged: Cost of Capital (CoC), i.e. the approach followed by the Solvency II framework, Value at Risk (VaR) and Tail Value at Risk (Tail-VaR). Out of these three methods, the former two are the most frequently used: 47% and 60% of respondents respectively, while the Tail-VaR is barely used (2%). It should be noted that the percentages do not add up to 100% as some respondents used more than one method, although most of them (81%) used only one, showing again that the choice of method is usually a group decision rather than a product decision.

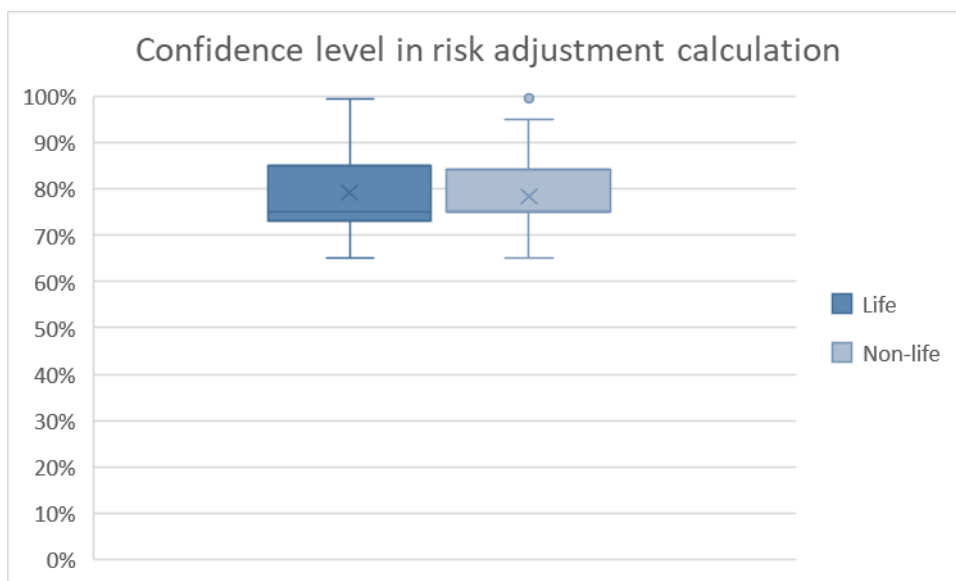
<sup>16</sup> Mean, variance, skewness, kurtosis.



Regarding the methods accounted under “Other”, each case was different, although most of them were based on different scenario calculations.

**Confidence level**

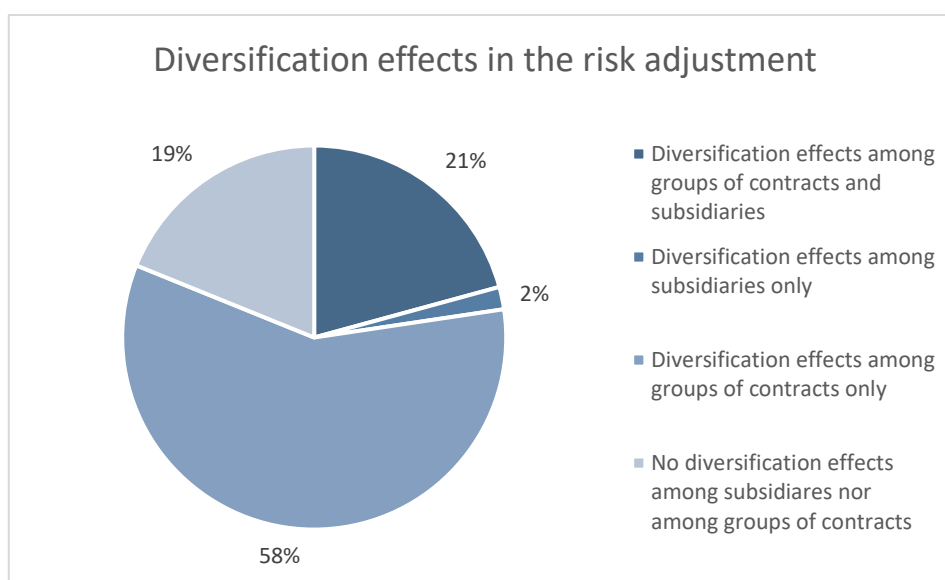
Another relevant source of variability within the risk adjustment is the freedom to choose the confidence level used to calibrate the calculation. Contrary to the overview of the average risk adjustment, the confidence level does not show material differences between life and non-life businesses with a 79% and 78% average confidence levels respectively. The chart below representing the average risk adjustment used by each respondent illustrates that variability in both cases, life and non-life, is also similar:



The choice of the confidence level was reported to be the same within the group for all life products in 69% of the cases and in 65% of the cases for non-life products, showing another example of decision frequently taken at group level.

### Diversification effects considered

Finally, the third main source of variability within the risk adjustment calculation is the consideration of diversification benefits, which might be considered not only at product or undertaking level, but also at group (consolidated) level. However, despite allowing for it, only 23% of groups included diversification effects among subsidiaries, while 58% considered diversification effects among groups of contracts and 19% only among contracts within the same group.



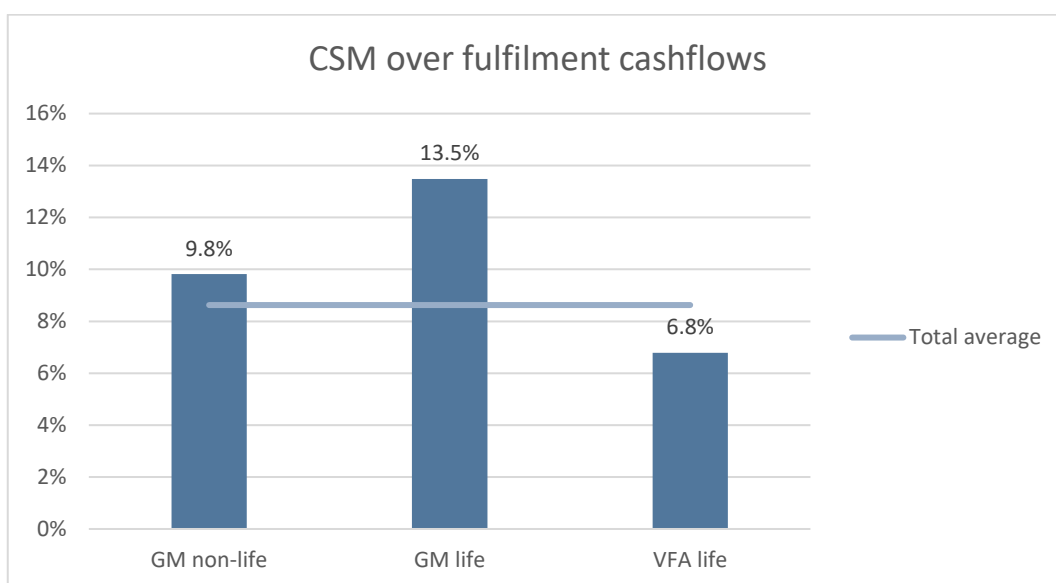
### 2.2.5. CONTRACTUAL SERVICE MARGIN

IFRS 17 requires insurance and reinsurance undertakings to allocate the profit from a contract throughout its whole life. For that purpose, expected profit at initial recognition is recognised as the contractual service margin increasing insurance liabilities. Along the life of the contract, the contractual service margin is released as the insurance service is provided and the profit is recognised in the P&L account.

The contractual service margin represented on average 8.6% of the fulfilment cashflows<sup>17</sup>, being higher for contracts under the GM (9.8% for non-life and 13.5% for life) than for life contracts under

<sup>17</sup> Including non-life business under the GM and life business under the GM and VFA.

the VFA (6.8%). One of the main reasons behind this difference probably is that products using the VFA are savings products, which usually have larger fulfilment cashflows, while contracts under the GM include also other types of products. Except in case of the VFA, the ratio showed large variability because of low or even negative fulfilment cashflows (i.e. 'liability' with a positive value) due to the projection of future profits, which also supports the hypothesis that differences are mainly due to the differences among fulfilment cashflows.



## 3. DIFFERENCES BETWEEN IFRS 17 AND SOLVENCY II

### 3.1. OVERVIEW

Solvency II and IFRS 17 have different purposes: the former focuses on policyholder protection, while the latter aims to provide meaningful and reliable information to financial statement users. However, they have important similarities, above all in their overarching principles, and synergies, such as:

- Realistic or market consistent valuation to remove excessive prudence or profits margins;
- General approach based on probability-weighted estimate of future cashflows<sup>18</sup>;
- Discounting of future cashflows (time value of money), also for non-life contracts, using risk-free rates (and not expected returns from assets);
- Risk adjustments

Notwithstanding the above-mentioned similarities and as respondents clearly highlighted, the implementation of IFRS 17 required a huge effort from the industry as frequently small differences required major changes into existing process. In addition, respondents also mentioned several divergences, some of which were structural, being the main ones:

- the different valuation methods, in particular the PAA, which however would be similar to the simplification for the premium provision included in the revised Guidelines on the Valuation of Technical Provisions<sup>19</sup>;
- the treatment of surplus funds<sup>20</sup>, which belong to insurance liabilities in IFRS 17 but are considered Own Funds in Solvency II; and
- the Contractual Service Margin, which does not exist in Solvency II, where expected profits at initial recognition, including expected profits in future premiums (EPIFP), directly reduce technical provisions. This difference clearly reflects the differences in the objectives between both frameworks: while IFRS 17 aims to explain the business and performance of insurance undertakings, which is based on fulfilment value and requires allocating profits to the relevant period, Solvency II is a prudential regulation aiming to ensure the solvency

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<sup>18</sup> Both frameworks include more or less relevant exemptions to this principle, as the PAA or the VFA in IFRS 17 or simplified calculations allowed for non-life technical provisions and technical provisions calculated as a whole in Solvency II.

<sup>19</sup> See Technical Annex III: [Guidelines on Valuation of Technical Provisions - Consolidated Version with Explanatory Text \(europa.eu\)](#)

<sup>20</sup> Surplus funds are part of the insurance liabilities for past and current profits to be shared with policyholders that, in some Member States, undertakings can use to absorb losses under certain conditions. Due to this loss-absorbing capacity, surplus funds are considered own funds in Solvency II despite being liabilities in the financial statements.

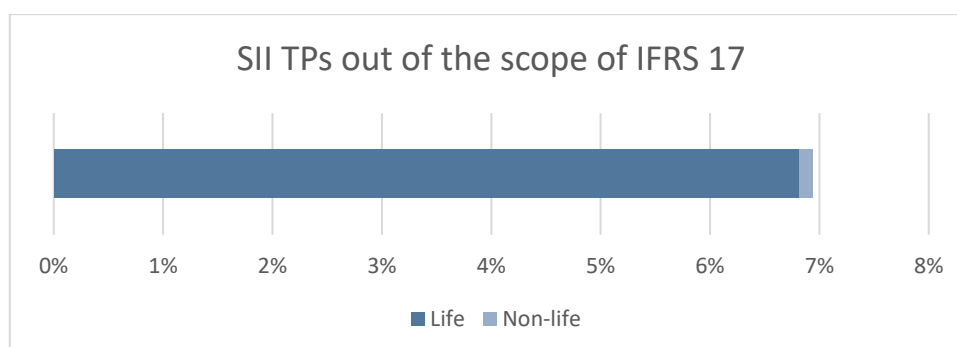
of the undertaking rather than assessing profitability, which requires identifying the transfer value of assets and liabilities, but not producing a profit and loss statement.

Apart from these three structural differences, respondents also highlighted the risk adjustment/margin, the discount rates, the contract boundaries and the allocation of expenses as the four main differences between both frameworks. Finally, some other usually less relevant differences were mentioned, including the granularity of the calculations and assumptions as well as the scope or the treatment of payables and receivables.

Within this section, we will further dig into these differences highlighted in the data request.

### 3.2. SCOPE

Solvency II includes within its scope all contracts legally regulated as insurance activities, while IFRS 17 scope is based on the definition of insurance contract and significant insurance risk. This leads to some differences, as for example distinct investment components and contracts without discretionary participation features that do not include significant insurance risk, both excluded from IFRS 17, but included within the scope of Solvency II. Nevertheless, the scope is mostly consistent, as only 6.9% of Solvency II technical provisions fall out of the scope of IFRS 17, mainly related to life business, potentially due to unit-linked contracts that do not include significant insurance risk (8.4% of life technical provisions vs 0.9% of non-life technical provisions<sup>21</sup>).



Although not directly covered in this survey, the other major difference in terms of scope between both frameworks is the perimeter of the group as well as Solvency II allowance to use local solvency

<sup>21</sup> 8.4% of Solvency II life technical provisions are out of the scope of IFRS 17, which represents 6.8% of total Solvency II technical provisions. 0.9% of Solvency II non-life technical provisions are out of the scope of IFRS 17, which represent 0.1% of total Solvency II technical provisions.

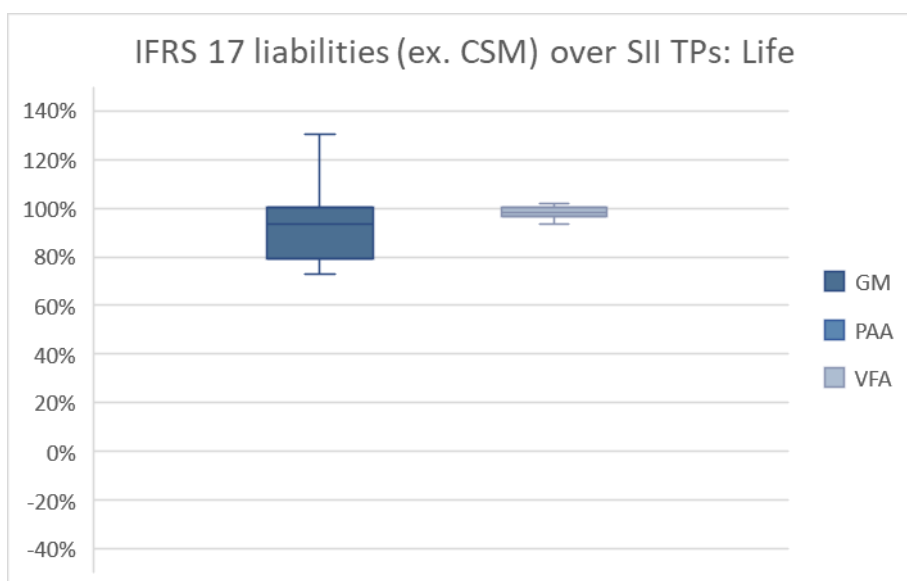
rules for subsidiaries from equivalent<sup>22</sup> third countries, while IFRS 17 requires all subsidiaries to directly follow IFRS 17 principles.

### 3.3. VALUATION

#### 3.3.1. OVERVIEW

When comparing the same life insurance contracts, Solvency II technical provisions were on average 2.5% higher than IFRS 17 life fulfilment cashflows (i.e., insurance liabilities excluding the contractual service margin). Breaking down the analysis by IFRS 17 valuation method, life insurance contracts valued under the PAA and the GM the differences increased up to 12.8% and 7.5% respectively, while for the VFA, the main valuation method for life participating contracts, the difference was only 1.7%.

Despite IFRS 17 fulfilment cashflows being lower on average for all three valuation methods, there was some individual variability, especially for the GM, so in some cases Solvency II technical provisions were lower. The chart below shows the distribution of the differences for the GM and the VFA<sup>23</sup>

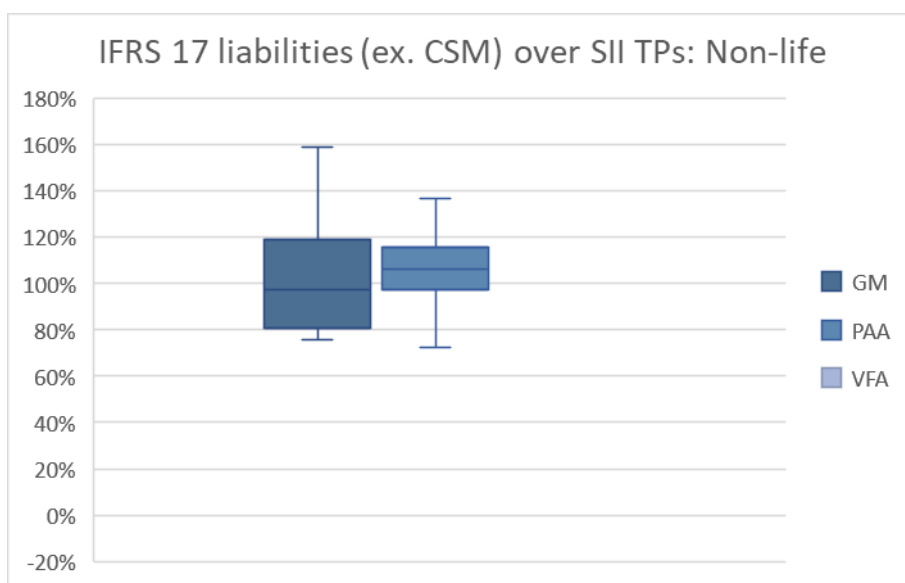


<sup>22</sup> For more information on equivalence, please visit: [International relations and equivalence - European Union \(europa.eu\)](https://european-council.europa.eu/media/en/press-communications/infographic/infographic-equivalence-2017-01-11-01.pdf)

<sup>23</sup> Data for PAA is not shown as the use of PAA is not material and the data in the sample does not allow a meaningful analysis.

While the data above does not show differences due to the treatment of surplus funds<sup>24</sup>, as discussed in section 2.2.5, the contractual service margin represented on average 13.5% of the fulfilment cashflows for life contracts under the GM and 6.8% for life contracts under the VFA, a material amount compared to the average difference between IFRS 17 fulfilment cashflows and Solvency II TPs. Indeed, including the CSM, IFRS 17 life insurance liabilities are approximately 5% higher than Solvency II life technical provisions both for contracts under the GM and the VFA.

For non-life business, the situation is the opposite and IFRS 17 non-life insurance fulfilment cashflows were 9.5% higher on average, mainly due to contracts under the PAA (10.2% higher). For contracts under the GM the difference was not material (0.3% higher).



This data also confirmed the insights provided by respondents, showing that the use of the PAA is one of the highest differences between Solvency II and IFRS 17. As for life business, the total IFRS 17 non-life insurance liabilities for contracts under the GM (i.e., the fulfilment cashflows plus the CSM<sup>25</sup>) are also significantly higher than Solvency II non-life technical provisions.

Within the next subsections the report analyses individually the other main sources identified, i.e., contract boundaries, cashflows / allocation of expenses, discount rates and the risk adjustment / margin.

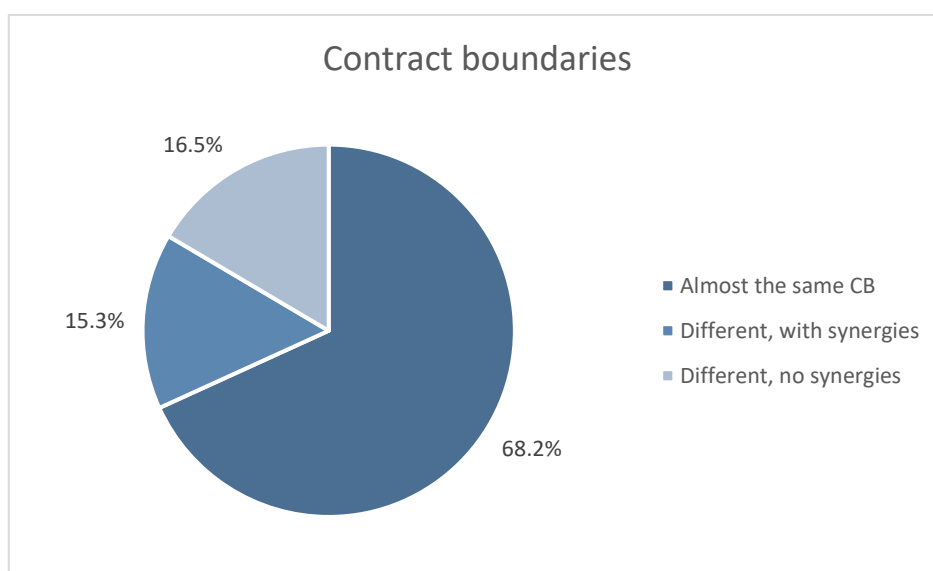
<sup>24</sup> Surplus funds are specific to a few Member States. In addition, surplus funds should still be valued and most respondents included them within technical provisions for the purposes of the comparison.

<sup>25</sup> As discussed in section 2.2.5, the CSM for non-life contracts under the GM is on average equal to 9.8% of the fulfilment cashflows.



### 3.3.2. CONTRACT BOUNDARIES AND INITIAL RECOGNITION

The principles ruling contract boundary identification in IFRS 17 are very similar to Solvency II and, in practice, respondents confirmed the synergies between both frameworks on this regard, with 68.2% of them using almost the same contract boundaries in both frameworks and an additional 15.3% acknowledging material synergies in the process despite having different contract boundaries in both frameworks. 16.5% of the respondents reported different contract boundaries without relevant synergies in the process, although this includes several cases of PAA users, which means that synergies when contract boundaries are to be identified in both frameworks are probably even higher.



The two main differences reported were unbundling and flexible/top-up premiums. While Solvency II contract boundaries are frequently identified at risk level, IFRS 17 contract boundaries are usually defined at contract level. In practice, this means that some contracts will be unbundled in Solvency II and not in IFRS 17, being particularly material the case of riders in unit-linked contracts. This will frequently lead to longer contract boundaries in IFRS 17 and therefore further future profits included in the Balance Sheet.

The second difference reported is the allowance to include within IFRS 17 insurance liabilities future flexible/top-up premiums, in particular for contracts under the VFA, while in Solvency II these premiums are usually excluded from technical provisions. As in the previous case, this difference will usually lead to further future profits being included in IFRS 17 Balance Sheet.

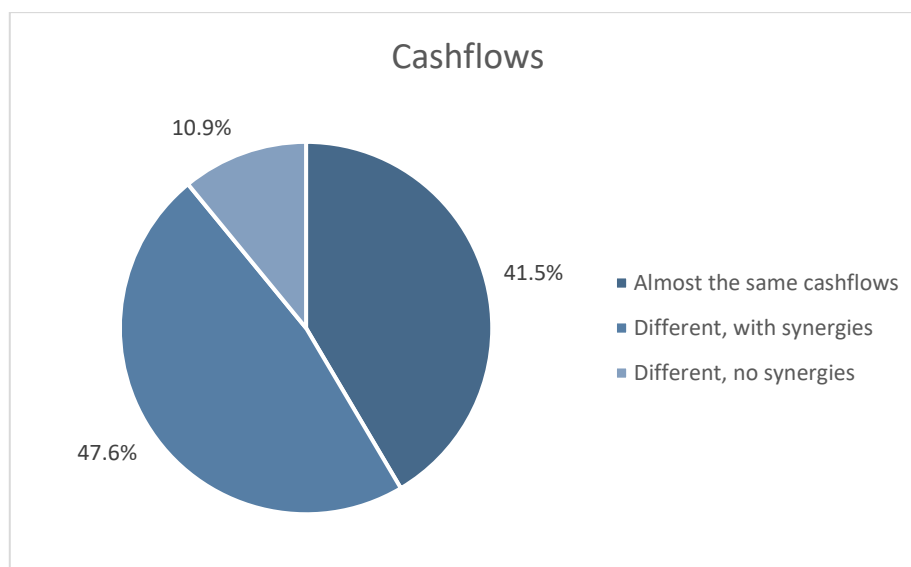
Conversely, other differences lead to further profits being included in Solvency II Balance Sheet. By design, the PAA does not include renewals, which are included within Solvency II TPs if falling within contracts boundaries.

Initial recognition was also identified as a relevant difference between both frameworks, as contracts bounded but not incepted are recognised later in IFRS 17 compared to Solvency II (except for onerous contracts).

Respondents also mentioned other minor differences, as for example the treatment of future fees, which in some cases are excluded from IFRS 17 liabilities but included in Solvency II TPs, and the interpretation of “the date when the undertaking can fully reflect the risk”, a criteria used in both frameworks which, however, in some cases is interpreted slightly differently.

### 3.3.3. CASHFLOWS

While relevant synergies were identified also regarding cashflow estimates, differences increased compared to contract boundaries as only 41.5% of respondents reported to use almost the same cashflows. However, synergies remained high as only in 10.9% of the cases no synergies were reported, highlighting also the cases justified by IFRS valuation method. Several respondents also highlighted that similarities and synergies are frequently higher for the liability for incurred claims than for the liability for remaining coverage.



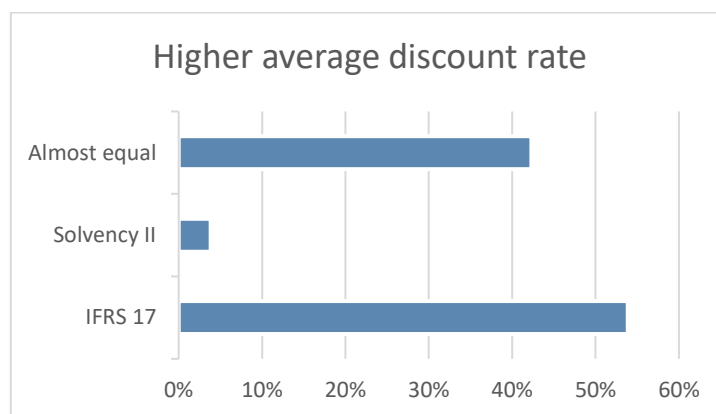
When identifying the main sources for these differences, one stood out over the rest: the allocation of expenses, as IFRS 17 only includes directly attributable expenses, while Solvency II requires to allocate indirect expenses and investment expenses to technical provisions. This difference is expected to lead to lower technical provisions in IFRS 17.

Respondents also mentioned other differences, as for example the financial assumptions used to project future cashflows (e.g., profit sharing), the treatment of funds withheld (included in IFRS 17 liabilities and considered a separate asset in Solvency II) or the granularity of assumptions (higher in IFRS 17).

### 3.3.4. DISCOUNT RATES

#### Overview

In theory, one of the main differences between IFRS 17 and Solvency II is the discount rate used. While in Solvency II it is mainly predefined as it is calculated and published by EIOPA, with the exception of the Matching Adjustment (MA), within IFRS 17 undertakings are responsible to derive the risk-free rate and any relevant adjustment (e.g., illiquidity premium). However, in practice, 42% of respondents reported to use the same or almost the same discount rate (difference below 0.1%). From the remaining 58%, in most of the cases IFRS 17 discount rate was higher than Solvency II discount rate (54% vs 4%).

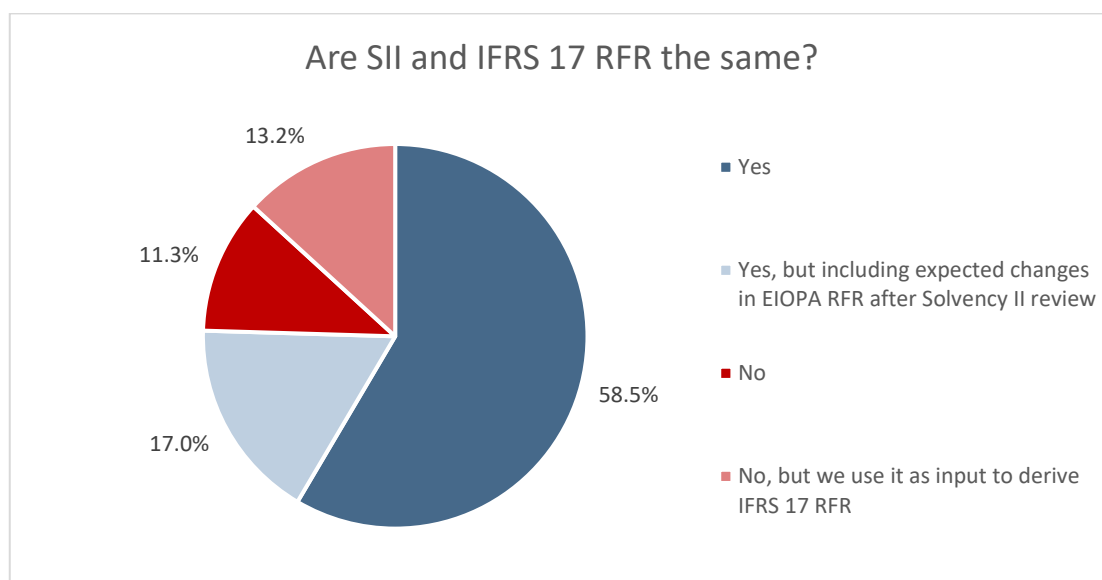


While IFRS 17 allows for two different approaches to derive the relevant discount rate (top-down and bottom-up), as discussed in section 2.2.3 the bottom-up approach is clearly dominant. This was confirmed as the most frequently highlighted difference was the use of the illiquidity premium instead of EIOPA's volatility adjustment (VA). Differences on the risk-free rate were also frequently mentioned and are analysed in the following subsection.

#### Risk-free rate

Deriving IFRS 17 risk-free rate (RFR) is one of the process that most benefited from Solvency II, as 75% of respondents reported to use Solvency II risk-free rate term structure (either the current RFR or the RFR already including changes expected after the Solvency II 2020 review<sup>26</sup>). In addition, more than half of the remaining 25% (13.2%) reported to use Solvency II RFR as input to derive IFRS 17 RFR.

<sup>26</sup> [2020 review of Solvency II - European Union \(europa.eu\)](#) See section 2.1.



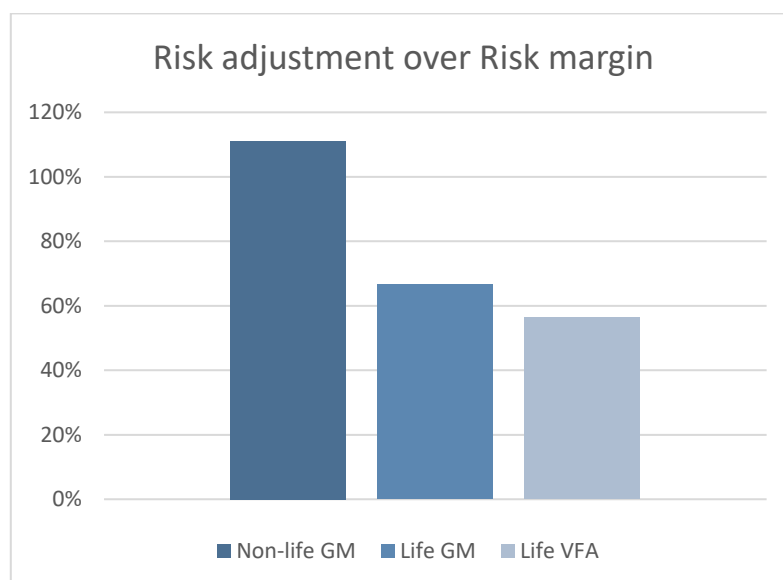
Those not directly using EIOPA's RFR highlighted a wide range of differences, but the most relevant ones were related with the main parameters involved in the process, i.e., the ultimate forward rate (more flexibly recalculated in IFRS 17), the last liquid point (sometimes longer in IFRS 17) and the credit risk adjustment (without floor (10 b.p.) and cap (35 b.p.) in IFRS 17).

Some respondents also highlighted a few additional differences including the use of different interpolation and extrapolation methods, as well as the underlying assets used to derive the RFR.

### 3.3.5. RISK ADJUSTMENT

#### Overview

The calculation of the risk adjustment is another relevant source of differences, as in Solvency II the calculation method and the confidence level are set in the regulation, while IFRS 17 users are allowed to choose according to IFRS 17 principles. Overall, this leads to material differences, with IFRS 17 risk adjustment (RA) being significantly lower than Solvency II risk margin (RM) for life business (33% for contracts under the GM and 44% for contracts under the VFA). Conversely, for non-life business IFRS 17 risk adjustment is 11% higher on average. In addition, PAA users do not calculate a separate risk adjustment for the liability for the remaining coverage.



### Confidence level

Regarding the confidence level, while Solvency II bases risk margin calculation on the SCR with a predefined cost-of-capital rate<sup>27</sup>, IFRS 17 allows standard users to use the confidence level that better reflects their business model. As discussed in section 2.2.4, this led to a wider range of confidence levels being used (usually between 75% and 85%) with an average around 80% both for life and non-life business.

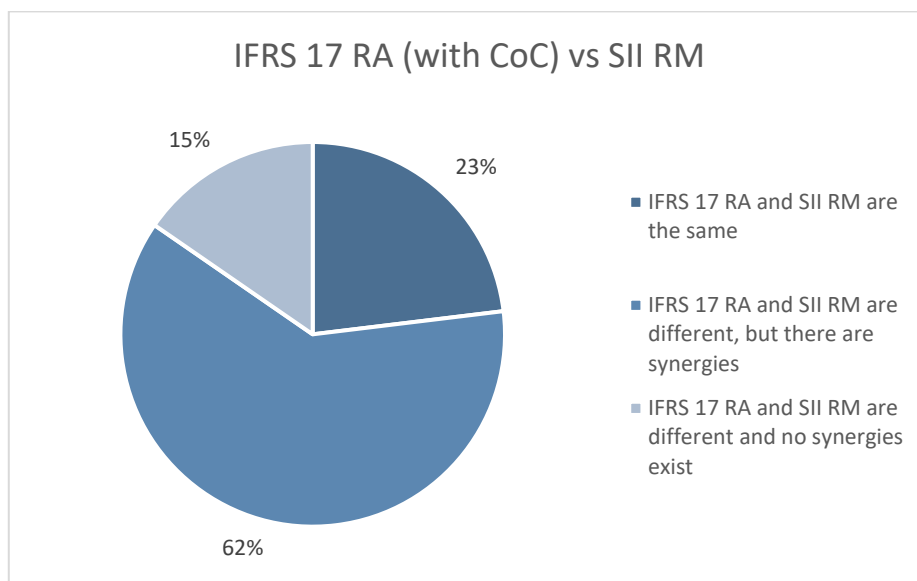
### Valuation method

While IFRS 17 allows for any valuation method, most respondents used either the CoC (47%) or the VaR (60%), with only 15% of respondents using other methods<sup>28</sup>. Out of the cases using the CoC, 23% reported the risk adjustment to be the same than the risk margin<sup>29</sup>, 62% reported some differences but recognising material synergies in the calculation process and 15% reported no synergies between IFRS 17 risk adjustment and Solvency II risk margin.

<sup>27</sup> 6% (Article 39 of the Delegated Regulation 2015/35)

<sup>28</sup> The percentages add up to more than 100% because some respondents use more than one method.

<sup>29</sup> Most respondents reporting the same risk adjustment/margin in both frameworks clarified this is considering the differences in the scope, i.e., operational risk, counterparty default risk and, when relevant, market risk.



When assessing the main sources for the differences in the risk margin and the risk adjustment calculated with the CoC, respondents mainly highlighted differences in the scope (operational risk, counterparty default risk and relevant market risk excluded from IFRS 17 risk adjustment), the allowance for diversification effects among subsidiaries within IFRS 17 (not allowed in Solvency II) and CoC rate (fixed at 6% in Solvency II and usually set according to the real business model in IFRS 17). Other differences mentioned in the data request included the differences in discount rates, the link to capital requirement (Solvency II) vs capital held (IFRS 17) and the horizon of projection.

**EIOPA**

Westhafen Tower, Westhafenplatz 1

60327 Frankfurt – Germany

Tel. + 49 69-951119-20

[info@eiopa.europa.eu](mailto:info@eiopa.europa.eu)

<https://www.eiopa.europa.eu>