EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY

EIOPA's analysis of IFRS 17 Insurance Contracts

EFRAG TEG meeting
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Overview

- Introduction: EIOPA’s mandate
- Expected impact on financial stability and the European public good
- Potential effects on attractiveness, competitiveness and availability of insurance products
- Using Solvency II inputs and processes
- Conclusions

Introduction: EIOPA’s mandate

- Publication of IFRS 17: May 2017
- Importance to European insurers:
  - Predecessor IFRS 4 Insurance Contract
  - Exemption from using IFRS 9 Financial Instruments
- EIOPA’s mandate
  - To actively promote high-quality international accounting standards
  - Involvement in endorsement process: ARC, EFRAG
  - To act in view of a common supervisory culture and consistent supervisory approaches

Expected impact on financial stability and the European public good

- Objective of the analysis
  - o Accounting standards shape financial information that determine actions by decision-makers on capital markets
  - o Relevance to provide useful information for the capital markets:
    - Financial situation
    - Performance
  - o Assess potential impacts on financial stability

- Criteria used
  - o ECB (2006): Assessment of accounting standards from a financial stability perspective

Expected impact on financial stability: assessment against the chosen criteria

- Reliance on principle-based accounting standards
- Use of reliable and relevant values
  - Infrequent market transactions and low liquidity
- Recognition of the allocation and magnitude of risks
  - Explicit, entity-specific measurement of insurance risk held and transferred
- Provision of comparable financial statements
  - Sensitivity of equity to interest rates

Expected impact on financial stability: assessment against the chosen criteria (continued)

- Provision of clear and understandable financial statements
  - o Risk adjustment for non-financial risk
- Portrayal of the financial situation (liquidity, profitability, solvency)
  - o Recognition of profits from reinsurance contracts held
- Alignment of accounting rules with sound risk management practices
- Promotion of forward-looking recognition of risks
- Avoidance of negative and promotion of positive externalities
- Enhancement of market confidence and corporate governance

Expected impact on financial stability: main findings

- IFRS 17 expected to enhanced transparency:
  - Risk-sensitive and current valuation
  - Valuation and profitability
  - Business model
- IFRS 17 can be described as complex:
  - Communication efforts needed
  - Information is enriched and more relevant, yet potentially less comparable
- IFRS 17 expected to reflect volatility:
  - Assets and liabilities subject to interest rate and other financial risk
  - Positive impact on financial stability, as fair reflection of economic reality

Potential effects on attractiveness, competitiveness and availability of insurance products

- Observable trends and developments in insurance products:
  - Following commercial strategies: shift to non- or less-guaranteed life insurance products
  - Capital guarantee
  - Deferred valuation of annuities
  - Unit-linked products (growth rate of 8% since 2010)

- Recent economic developments have led to significant changes in product design and availability

Potential effects on attractiveness, competitiveness and availability of insurance products (continued)

- Analysis of potential effects of regulatory change:
  - o Impact on insurers' investments
  - o Investment behaviour from 2011 to 2016 shows trends associated with 'search for yield'

- Clear conclusions not identifiable
- No observable trends or behaviour linked to introduction of Solvency II

Potential effects on attractiveness, competitiveness and availability of insurance products (continued)

- Main findings:
  - o Economic reality determines business strategies, supply and features of contracts, pricing and consumers’ demand
  - o Introduction of SII has not provided evidence for changes in insurers’ investment allocation or product availability – linked to SII.

Using Solvency II inputs and processes

- Objective of the analysis
  - Assess potential efficiency gains of applying elements of SII for the implementation of IFRS 17

- Comparison of key areas and building blocks of SII, which may be particularly useful:
  - Initial recognition
  - Definition and allocation of expected cash flows
  - Grouping and level of aggregation
  - Contract boundaries
  - Risk margin
  - Reinsurance

Using Solvency II inputs and processes: main findings

- Key inputs and processes developed for SII can be used, yet may require adaptation to varying degrees
- Efficiency gains expected to be most prevalent in IFRS 17’s building blocks:
  - Cash flows
  - Discount rate
  - Risk adjustment

Conclusions

- Expected increased transparency and comparability through IFRS 17
  - provide better insights into insurers' business models, exposures and performance
  - better reflect economic reality
  - support efficient risk management
  - have the potential to strengthen financial stability in the European Economic Area (EEA)
  - can be regarded as beneficial for the European public good
- Reservations:
  - Determination of discount rate and risk adjustment
  - Complexity: cohorts, reinsurance held

Thank you

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