Assistance to EFRAG for impact analysis of IFRS 17 Insurance Contracts
Updated Report

Presentation to EFRAG Board

16 July 2020

LE Europe

VVA CONSULTING

The updated report

- As in previous report of 2018, 4 key topics are addressed

1. **Competition** from non-EU insurers faced by EU insurers in product and capital markets
2. Development of the EU insurance markets since 2005 – **product mix and prices**
3. Developments in the **asset allocation** of European insurers
4. **Investors' perception of the clarity of the financial reports** of EU insurance undertakings

- Presentation sets out key findings of study

The updated report

- The **updated report** takes account of:

1. the fact the **IASB Board** tentatively adopted in December 2019, and January, February and March 2020 a **number of amendments** for final approval by IASB members

2. an **additional round of stakeholder consultations**

3. **material gathered / prepared by EFRAG**

4. **up-to-date quantitative data**

The updated report

- **Qualitative information sources**
  - Extensive desk research and literature review for the original 2018 study which was updated with targeted research for the 2020 update
  - An online survey of insurance undertakings and external analysts/investors (165 replies overall in 2018);
  - A first round of 47 stakeholder interviews for the 2018 iteration of this study; and
  - A second round of an additional 21 stakeholder interviews, for this updated report (2020)

- **Quantitative information sources**
  - EIOPA
  - Eurostat
  - Refinitiv (formerly Thomson Reuters)

Chapter 3 Competition from non-EU insurers faced by EU insurers

- **In general, insurance undertakings from the EU face little competition from non-EU undertakings** in EU insurance markets

- However, for some, business is focused on **more niche insurance products** -> the market is a **world-wide market** and in such markets EU insurance enterprises compete with undertakings from major insurance centres outside the EU

- Insurance undertakings from the EU face **little competition** from non-EEA undertakings **in EU capital markets. But they do** when **raising funds internationally**

Chapter 3 Competition from non-EU insurers faced by EU insurers

- Industry stakeholders mentioned **two factors which may impact on their competitive position in capital markets** following the implementation of IFRS 17

1. The **financial bottom line of some insurers**, especially life insurance undertakings may become **more volatile**
   - The limited empirical literature on the issue of P&L volatility and cost of funds suggest that the cost of capital of undertakings showing greater P&L volatility may face higher debt costs in international debt markets in the short run

2. IFRS 17 may make it **more difficult to compare the financial statements with those of insurance undertakings from countries not adopting IFRS 17** - although it is not clear whether the situation would be worse than now

   - At present time(under IFRS 4) external analysts find it challenging to compare the financial and economic performance of different insurance undertakings as current accounting practices vary across jurisdictions and the quality of information provided is inconsistent across countries, impeding full comparability

Chapter 3 Competition from non-EU insurers faced by EU insurers

- Majority of supervisory authorities and some insurance undertakings indicated that, in the **long run**, the new accounting standards will bring **increased transparency** to financial reporting practises of European insurance companies -> **improving their ability to raise funds in capital markets**

- Finally, the information provided by the insurance undertakings to EFRAG (based on EFRAG's case studies in 2018) suggests that with regard to expenses of insurance undertakings subject to IFRS17:
  - **on-going IFRS17 costs** are **unlikely** to have a very marked impact
  - **one-off costs may have a more substantial impact** in the period(s) during which such costs are incurred

Chapter 4 Development of the EU insurance markets since 2005 – product mix and prices

- **Key fact: decline of the market share of life-insurance** in the total insurance market (measure by gross premiums) from **2005 to 2008 (**and the concomitant increase in the market share of non-life) and broadly stable shares thereafter

- Life insurance, however, remains still by far the largest insurance segment

- The **overall price of insurance grew faster than the general consumer price index over the period 2005 to 2019**
  - annual rate of growth of **price of insurance** connected with **health** was **markedly higher than overall inflation**
  - **price of transport insurance** increased **only marginally faster** than the overall consumer price index

Chapter 4 Development of the EU insurance markets since 2005 – product mix and prices

According to stakeholders:

- in general, **financial reporting does not play a big role in product mix and pricing**
- **IFRS 17 is not expected to have significant impacts on short-term insurance contracts.** The main changes for short-term insurance contracts will depend upon companies' existing insurance accounting practices
- **however, long-duration contracts** (such as life insurance) or product features which expose the P&L to market fluctuations (such as participating contracts evaluated using the general model) **may be affected** by the adoption of the new standard
  - due a general aversion against volatility, insurance undertakings may decide to focus more on products/lines of business with lower volatility impact on bottomline

Chapter 4 Development of the EU insurance markets since 2005 – product mix and prices

- **Most stakeholders** (industry players and supervisory authorities) **welcomed the improvements introduced by the IFRS 17 amendments**, in particular regarding reinsurance
- However, there are **still some concerns** about **implementation of the annual cohort requirement, especially for the "Life" segment "**

Chapter 5 Developments in the asset allocation of European insurers

- Key fact to note: although there is considerable discussion about insurers moving away from debt securities towards new asset classes and /or equity, the **aggregate data from EIOPA on the investments of EU insurers do not show a significant movement out of the debt securities at the EU wide level**

- **The majority of stakeholders** (i.e. supervisory authorities, insurers and external investors) note **that IFRS 17 alone will not impact the asset allocation of insurance undertakings** -> this activity is more driven by risk management and/or asset/liability management
  - Accounting is one of the factors but never the first when it comes to the investment decisions.

Chapter 5 Developments in the asset allocation of European insurers

- **Some insurance undertakings** reported that **investments in equity and structured funds may become less attractive** following the **adoption of IFRS 9**, as IFRS 9 may prevent the proper performance reporting of equity instruments

- **Views are mixed on whether an alternative to IFRS 9 is needed** to portray long-term investments by insurers.

- **To date there is insufficient evidence**, as the large majority of insurers do not apply IFRS 9 due to the IFRS 4 amendments to defer the application of IFRS 9

Chapter 6 Investors' perception of the clarity of the financial reports of EU insurance undertakings

- In **Germany, France, and the UK, the global financial crisis increased the cost of capital in the insurance sector more** than in any other of the comparator industries (banks, basic resources, financial services other than banks, industrial goods & services, media, technology, telecommunications, travel and leisure)
  - The difference was **particularly sizeable in the several months following the collapse of Lehman Brothers in September 2008**, when the effect can be observed even in Italy
- Moreover, in Germany, France, and the UK, the **comparatively higher capital costs in many cases did not fully reverse until 2018**

Chapter 6 Investors’ perception of the clarity of the financial reports of EU insurance undertakings

- **Among stakeholders**, there was a **general agreement** that **analysts face great difficulties when evaluating the financial report of an insurance company**

- However, there are differing views on the potential impact of IFRS 17 on the cost of capital for EU insurance undertakings:
  - some industry players believe that IFRS 17 will translate into confusion in the market especially in the short term
  - a majority of supervisory authorities and some insurance undertakings note that, in the long run, the new accounting standard will bring increased transparency in the financial reporting of European insurance companies -> this should improve their ability to raise capital on the market

- Furthermore, it was noted that **IFRS 17 could make the insurance industry more attractive to a generalist investor**, which would **reduce the cost of equity in the long run**

Chapter 6 Investors' perception of the clarity of the financial reports of EU insurance undertakings

- The **education of external investors and analysts is a major concern for industry stakeholders** (both life and non-life) -> challenge will be to **explain the balance sheets and underlying financial assumptions to the external investors during the transition time**

- It is possible that **IFRS 17 could lead to a perceived weakening of the financial strength of companies** and, at **least temporarily, increase the cost of capital** for European insurers while investors familiarise themselves with the new standard

- **Supervisory authorities and auditors** commented that the **insurance industry is still in the process of developing an understanding of the implications of the standard and forming common accounting practices**. Many concerns are interpretational and will only be solved in practice following the adoption of the standard

Chapter 6 Investors’ perception of the clarity of the financial reports of EU insurance undertakings

- In terms of rating, **two major rating agencies** (FITCH and S&P) commented that **IFRS 17 is unlikely to directly affect insurers' ratings** because the economic substance of their balance sheets will not change.

Q&As

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