

To: Solvency II WG
From: Prudential Team
Date: 20-10-2023
Reference: ECO-SLV-23-199

Subject: Summary of EIOPA's report on impacts of inflation on the (re)insurance sector

Background

Following the publication of EIOPA's report on the potential impacts that the inflation increase could have on the (re)insurance sector (available [here](#)), the secretariat reviewed the report and prepared a high-level assessment with points of interest.

In its report, EIOPA analyses the implications that a high inflationary environment, along with rising interest rates, would have on insurance and reinsurance companies. EIOPA focuses mainly on the capital, profitability and liquidity aspects of undertakings, both from a backward- and forward-looking perspective, and also assesses the impact on policyholders and their behaviour.

Members can provide their feedback, if any, in writing to prudential@insuranceeurope.eu.

Secretariat's assessment

Overall, the secretariat deems that **EIOPA's report disproportionately concentrates on the risks and impacts of inflation**, while neglecting to adequately refer to the main risk management tools that undertakings have in place to mitigate and manage their risks, including those triggered by high inflation.

While it is indeed possible that inflationary pressures can affect (re)insurance undertakings in various ways, such as increased cost of claims and higher policyholder lapses, these risks are not new to the sector and companies have already integrated them into their risk management practices. In particular, undertakings already employ rigorous inflation assumptions and controls when calculating their reserves and technical provisions. These assumptions undergo thorough scrutiny from both internal and external stakeholders (i.e. internal and external auditors, supervisors etc). Moreover, (re)insurance companies, contingent upon their risk profile, might have to evaluate their vulnerability to inflation risks as part of their Own Risk and Solvency Assessment (ORSA).

The secretariat would also like to point out below some examples where EIOPA reaches conclusions that are not adequately substantiated by the underlying analysis or are not in line with the business logic of insurance companies.

- **Page 43:** *"Therefore, given the high uncertainty on inflation, insurers need to choose a prudent approach on reserving and carefully investigate their vulnerabilities in the ORSA including sensitivities on longer lasting inflation."*
- **Secretariat's assessment:** EIOPA's suggestion for insurers to choose a prudent approach on reserving is against the best estimate principle of Solvency II.

- **Pages 45-46:** *The latest annual aggregated EEA data for gross written premiums (GWP) (Figure 4.1) shows that in 2022 GWP for life and unit-linked business have already experienced a decrease compared to 2021 while premiums for non-life have reached the highest annual change since the introduction of Solvency II (Figure 4.2). As discussed in the previous sections of the report, non-life business is more sensitive to inflation, therefore the increase in premiums observed in 2022 seems to be driven by a price*

effect amid increased cost of claims, rather than by an expansion of the business (e.g., increase in number of policies written).

- **Secretariat's assessment:** EIOPA claims that non-life premium increases are a result of increased claims costs, driven by higher inflation. However, EIOPA does not actually examine whether this is linked to a surge in written policies or other factors. For example, from an underwriting standpoint, premium rises may also stem from additional risk undertaken by insurance companies or changes in undertakings' business portfolio. Drawing the conclusion that inflationary pressures are the primary cause of premium increases requires additional analysis. Moreover, the gross written premium increase in 2019 (9.8%) is comparable to that in 2022 (9.9%), despite the considerably lower inflation rate in 2019.

- **Page 61:** *"Another way to measure liquidity risk is to assess whether liquid assets are sufficient to cover cash out-flows in case that all non-life claims would have to be paid out or in the case that all life policies would be surrendered. Figure 5.3 shows that until 2021 insurers were well positioned. In 2022, however, the ratio is higher than 100% meaning the liquid assets are no longer sufficient to cover the cash out-flows in the most extreme scenario."*
- **Secretariat's assessment:** EIOPA's proposed approach to measuring liquidity risk by assessing liquidity needs if all non-life claims are paid out at the same time or all life policies are surrendered is unrealistic. EIOPA's own liquidity stress testing as part of the 2021 exercise demonstrated that the industry has more than sufficient liquid assets to cope with extreme scenarios.

- **Page 75:** *"Solvency II reporting for the fire and other damage to property line of business shows a 4% decrease in claims ratio from 2021 to 2022, indicating a potential decrease in claims payout to consumers relative to the premium paid. In fact, while premiums may have already increased, coverage amounts may have not been adjusted. Considering that the claims rejected ratio decreased from 2021 to 2022 (6% in 2022 vs 11% in 2021), it means that the lower claims ratios cannot be attributed to higher rejection rates. In line with this trends, EIOPA's 2023 Eurobarometer shows that 11% of EU consumers felt underinsured as the potential pay-out of their insurance policies would not fully cover expenses due to inflation."*
- **Secretariat's assessment:** EIOPA claims that claim amounts have not been indexed whilst premiums have, and this is shown due to the lower claims' ratio experienced in period 2021-2022. This argument is not substantiated by EIOPA's analysis. There are several reasons why claims ratios might decrease in a given year and the assumption that this is due to non-indexed claim amounts is very one-sided. Claim ratios could have been decreased due to improved underwriting processes, more effective claims management, better overall claim experience etc.