



EUROPEAN  
COURT  
OF AUDITORS

## Background paper



# European Insurance and Occupational Pensions Authority's (EIOPA) contribution to the supervision of and financial stability in the EU's insurance sector

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The 2008 financial crisis illustrated that the European Union (EU) was not yet adequately equipped to ensure effective cooperation and coordination between national financial supervisory bodies, or consistent application of the EU legal framework across all Member States. Three European Supervisory Authorities were established on 1 January 2011 to improve financial supervision at European level. One of them was the European Insurance and Occupational Pensions Authority (EIOPA). EIOPA's main goals include ensuring an effective and consistent level of regulation and supervision across the EU, improving consumer protection, fighting systemic risks, rebuilding trust in the financial system, and strengthening the oversight of cross-border insurance groups.

Our audit will examine whether EIOPA effectively contributes to the supervision of and financial stability in the insurance sector. It will focus mainly on the two key areas of EIOPA's activities, i.e. market supervision and stress testing, which underlie its objective of ensuring financial stability.

The auditors will use a range of information sources, including discussions with EIOPA and stakeholders, review of documents underlying EIOPA's actions and two surveys.

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## **INSURANCE MARKET IN EUROPE**

The insurance sector plays an important role in the EU economy. Insurance allows businesses and individuals to transfer the risk of uncertainty and its potentially costly financial outcome. It contributes to economic growth and financial stability by taking on risks and mobilising savings. Failure on the part of insurance companies to play this role could potentially disrupt the operation of the financial sector and thus negatively affect the real economy and consumers' well-being.

The insurance industry forms a significant part of the EU's financial sector in managing assets that, according to EIOPA, are valued at around two-thirds of the EU's annual GDP. The insurance market relies mainly on two main types of product: life and non-life insurance. In 2016 life-insurance contracts generated 65 % of all premiums paid in the EU. Due to the current low interest-rate environment, insurers have considerable problems earning the guaranteed interest rates payable on products sold in earlier years. Hence, life insurers' business models are currently undergoing far-reaching changes that involve, among other things, additional risk-taking by insurers.

## **REGULATORY FRAMEWORK GOVERNING THE INSURANCE MARKET**

The 2008 financial crisis demonstrated that the EU was not yet adequately equipped to ensure effective cooperation and coordination between national financial supervisory bodies or consistent application of the EU legal framework across all Member States. Moreover, in recent years technological developments and changes in insurers' business models have prompted a need for reform of the sector's regulatory framework.

The key legislative change was the adoption of the Solvency II Directive (2009/138/EC), which laid down the overall prudential regulatory framework for European insurers. It was adopted in 2009, amended in 2014 by Directive 2014/51/EU (known as Omnibus II), and entered fully into force in January 2016.

Other legislative measures applicable to the insurance sector followed in the area of consumer protection. In 2002 the Insurance Mediation Directive (2002/92/EC) imposed minimum requirements on insurance brokers and intermediaries. It was amended by the Insurance Distribution Directive (2016/97/EU), which had to be fully incorporated into national legislation by 23 February 2018<sup>1</sup>. The latter Directive increased transparency so as to better protect consumers, and broadened the scope

of the previous Directive's requirements to cover all sellers of insurance products, including the insurers themselves.

Another important part of the regulatory framework is the Regulation on packaged retail and insurance-based investment products (1286/2014/EU). It sets out the key information on such products with which investors must be provided, the aim of which is to increase understanding and the comparability of products, including their risks and costs.

## **EIOPA: ORGANISATION AND ENVIRONMENT**

### **The Agency's mission**

EIOPA is an independent advisory body to the European Commission, the European Parliament and the Council. It was established as part of the reforms to the supervisory structure of the EU's financial sector in the wake of the financial crisis.

EIOPA carries out specific legal, technical and scientific tasks and gives evidence-based advice to help shape informed policies and laws at EU and national level. It acts with regard to insurance undertakings, reinsurance undertakings, financial conglomerates, institutions for occupational-retirement provision, and insurance intermediaries.

EIOPA began operating in 2011, having replaced the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)<sup>2</sup>. EIOPA's mission, tasks and organisation are set out in Regulation No 1094/2010/EU of 24 November 2010<sup>3</sup>.

### **EIOPA's governance**

EIOPA's governing structure consists of two governing bodies: the Board of Supervisors and the Management Board.

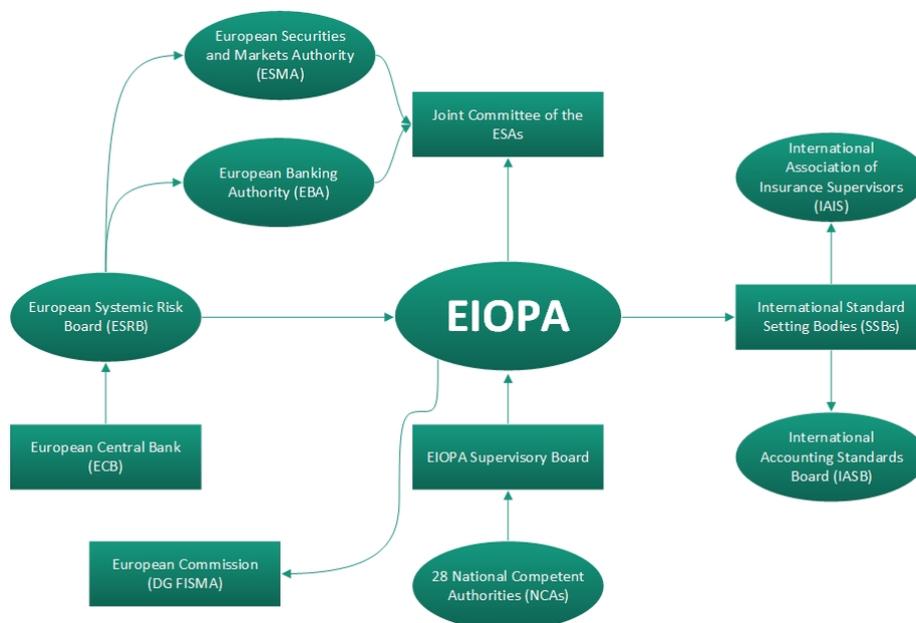
The Board of Supervisors has ultimate decision-making responsibility in a broad range of policy matters. The body is composed of 28 representatives, i.e. one from the supervisory authorities of each Member State, as well as EIOPA's Chair, and observers. It is supported by a number of working groups that deal with technical issues and bring together EIOPA staff and national experts in specific fields to develop policy. The Executive Director heads the Management Board, which is responsible for the day-to-day running of EIOPA.

## EIOPA within the European System of Financial Supervision

EIOPA is part of the European System of Financial Supervision (ESFS), which comprises three European Supervisory Authorities ((ESAs) (the European Banking Authority, the European Securities and Markets Authority and EIOPA)) and the European Systemic Risk Board (ESRB) under the European Central Bank. To achieve its mission, EIOPA cooperates closely with the National Competent Authorities (NCAs). While the NCAs remain in charge of supervising individual financial institutions in their own Member State, the objective of EIOPA and the other two ESAs is to improve the operation of the internal market.

EIOPA must keep its key stakeholders and, in particular, the ESRB broadly abreast of developing risks by providing regular risk assessments and reports (see [Figure 1](#)). EIOPA also cooperates with the Commission, in particular its Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA), the European Parliament and the Council in reaching decisions as to whether any action is necessary.

**Figure 1: EIOPA and its institutional environment**



Source: ECA.

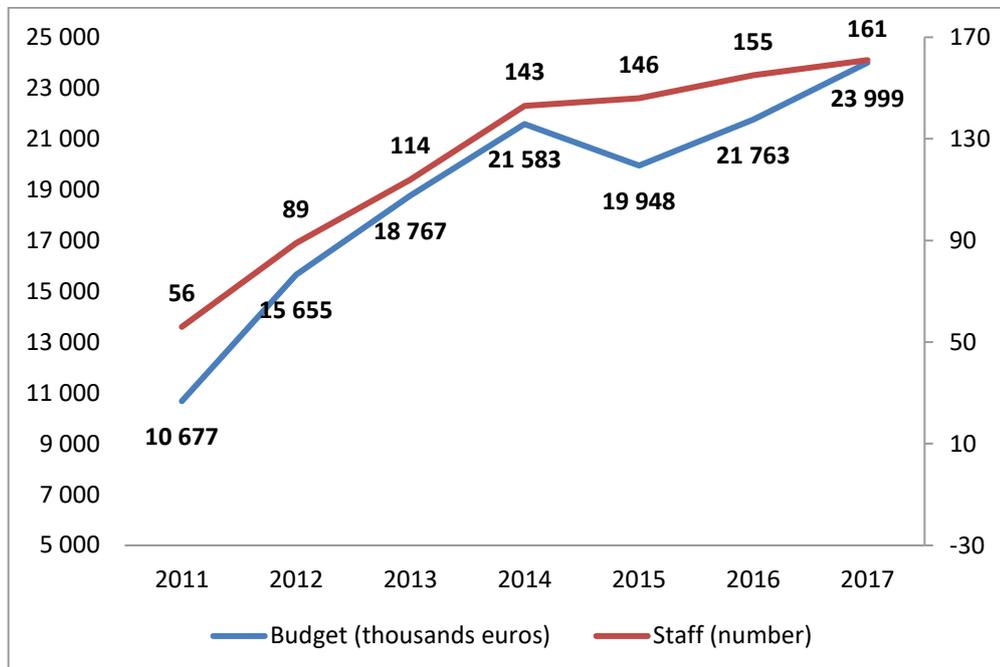
EIOPA also forms part of the Joint Committee, a forum for cooperation and information exchange between the three ESAs and the ESRB. The Joint Committee investigates and monitors potential risks to financial-market participants and the entire financial system.

Furthermore, within its remit EIOPA coordinates the European position at international level and particularly vis-à-vis the International Association of Insurance Supervisors. In this respect EIOPA contributes to the gradual development of common risk-based International Capital Standards and the convergence of international supervisory standards, and builds trust and understanding with third countries.

## RESOURCES

EIOPA's total budget in 2017 was 24 million euros (see **Figure 2**), of which approximately 40 % came from the EU budget, and the remainder from contributions from Member States and EFTA countries. In December 2016 the agency had 141 staff (compared to the 155 provided for in the budget). According to the 2017-2019 Single Programming Document, the agency's staff will increase by 31 (to 172 in total) in 2018, and then remain stable until 2020. EIOPA's head office is in Frankfurt am Main (Germany).

**Figure 2: Development of EIOPA's budget and staff (2011-2017)**



Source: EIOPA.

The materiality of EIOPA's work in ensuring supervision and financial stability in the insurance sector goes far beyond its actual budget. Effective supervision in this sector is of key importance to the

solvency of insurance institutions. Any need for State aid could have significant repercussions on the finances of both Member States and the EU itself. It is equally important to EU citizens who use insurance companies for cover in case of misfortune.

## SCOPE OF EIOPA'S ACTIVITIES

EIOPA's core responsibilities are to support the stability of the financial system and the transparency of markets and financial products, as well as protect insurance-policy holders, and pension-scheme members and beneficiaries. To this end it monitors and identifies trends, potential risks and vulnerabilities stemming from the micro-prudential level across both borders and sectors.<sup>4</sup>

EIOPA has responsibilities in the four areas set out in **Table 1**. The ECA's audit will focus on EIOPA's tasks related to supervision and supervisory convergence, as well as the stress-testing exercise carried out to help achieve the objective of financial stability.

**Table 1: EIOPA's fields of responsibility**

Field of responsibility	EIOPA's role
<b>I. Regulation</b>	EIOPA drafts technical standards that are endorsed by the Commission. The Commission cannot make changes to the draft technical standards without consulting EIOPA. Furthermore, the Commission has to seek EIOPA's advice when it puts forward proposals for delegated acts.
<b>II. Supervision and supervisory convergence</b>	EIOPA facilitates and coordinates National Competent Authorities (NCAs) in their supervisory activities in order both to establish consistent, efficient and effective supervisory practices within the European System of Financial Supervision (ESFS), and to ensure the common, uniform and consistent application of Union law. It also supports the creation of a common supervisory culture within the EU.
<b>III. Financial stability and crisis management</b>	EIOPA contributes to the macro-prudential supervision exercised by the European Systemic Risk Board (ESRB) by submitting data and reports. It conducts stress tests in both the insurance and pension sectors, and has to ensure coordinated crisis prevention and management, and preserve financial stability in crisis situations.
<b>IV. Consumer protection and financial innovation</b>	EIOPA aims to prevent consumers from being exposed to excessive risks when buying/investing in financial products by drafting regulations, monitoring market trends, improving information available, etc. EIOPA may also ban financial products if they pose a risk to financial stability in the EU, though it has not taken any such action to date. It also analyses and reports on new financial innovations/products in the market.

## Supervision and supervisory convergence

EIOPA's founding regulation specifies several objectives and activities in the field of supervision. As a legal follow-up to its analytical work in the field of supervisory convergence, EIOPA issues advice, guidelines and recommendations<sup>5</sup>. In addition to developing the tools explicitly referred in the Regulation, EIOPA can also engage in any further activities it considers necessary to ensure quality and consistency of supervision.

In practice EIOPA takes four main types of action in this respect, each covering multiple activities:

- **fostering the convergence of supervision by NCAs.** Together with other partners, EIOPA defines the supervisory culture and takes action to foster it in Europe. One example is the supervisory handbook being drawn up in cooperation with the NCAs, which can and already do apply several of the completed chapters. Moreover, to ensure a common understanding of effective supervision, EIOPA engages bilaterally with the NCAs to assess national supervisory practices. Lastly, it coordinates peer reviews of the NCAs, and its conclusions form the basis for guidelines and recommendations;
- **direct contribution to the supervision of internal models.** Under Solvency II, EIOPA issued guidelines and an opinion on the use of internal models. Consequently, it is now conducting an exercise with the NCAs to monitor action taken and consider any further measures needed. EIOPA staff also participate directly in selected workshops aimed at assessing the internal models of individual undertakings;
- **direct contribution to the supervision of cross-border groups.** Insurance groups are generally supervised by their home supervisor, which is the NCA responsible in the Member State in which the parent company is licensed. Subsidiaries in other Member States are supervised by the NCAs responsible in those Member States, termed host supervisors. EIOPA ensures smooth cooperation between these various supervisors. The authority is also in charge of mediating between the host and home supervisors of cross-border groups, and supporting information-sharing;
- **use of legal instruments to ensure compliance with Union law.** EIOPA has responsibility for overseeing the correct application of EU legislative acts relating to the insurance and pensions market, as well as compliance with the regulatory technical standards. In cases of breach of

Union law or non-compliance with standards, EIOPA can initiate an investigation at the request of either an NCA, the European Parliament, the Council or the European Commission, or a relevant stakeholder group, or on its own initiative.

### **Stress tests**

In accordance with its founding regulation, EIOPA regularly conducts Union-wide stress tests to assess the resilience of financial institutions to potential adverse market developments<sup>6</sup>. This important tool should provide an insight into risks and vulnerabilities in both the insurance and occupational-pension sectors in Europe. The results of stress tests normally allow EIOPA to draw relevant conclusions, make recommendations and contribute to the stability of the financial system and the protection of beneficiaries. EIOPA carries out stress tests annually, alternating between the insurance and occupational-pension sectors.

The **2016 insurance stress** test was aimed at assessing the robustness of the European insurance sector vis-à-vis stress situations in the financial markets, particularly that of a low interest-rate environment. Its objective was not to test the solvency of individual companies but to aggregate results and form an opinion on the life-insurance industry. The scope of the test was limited to life-insurance business, which is most susceptible to low interest rates.

The exercise was carried out in respect of a sample of solo insurance undertakings (not groups) comprising 236 companies in 30 countries and covering 77 % of life-insurance business (40 % of the insurance industry). Around 70 % of the companies tested were based in France, Germany, Great Britain and Italy.

In cooperation with the European Systemic Risk Board, EIOPA developed two scenarios to assess the resilience of the balance sheets of the companies being tested:

- scenario 1 (“low-for-long”) focused on a prolonged period of low interest rates, which can damage the assets side of insurers’ balance sheets;
- scenario 2 (“double-hit”) combined a low-interest-rate curve, as per the first scenario (which results in a fall in asset value), with a negative market shock (a rise in the value of liabilities).

The results were compared with a baseline scenario that reflected a pre-stress valuation of the balance sheets. The results of the 2016 stress test were as follows:

- in the “low-for-long” scenario: 100 billion euro would be wiped off the balance sheets of the Europe’s insurance sector relative to the baseline;
- in the “double hit” scenario: the outcome for the industry would be even worse in that the hit on insurers’ balance sheets would amount to 160 billion euro.

While there was no pass or fail mark, EIOPA issued a range of recommendations following the stress test, including requiring the NCAs and the life-insurance sector to modify life-insurance products and cancel or defer dividends, as well as review or cut guaranteed returns in cases where the business model was considered risky.

## **MAIN ISSUES IDENTIFIED WHEN PREPARING THE AUDIT**

When preparing our audits we carry out an issue analysis of the policy or programme that we intend to examine. Since we identify the issues before the audit work commences, they do not constitute audit observations, conclusions or recommendations. In the course of our audit of EIOPA we will look at the following questions in greater depth in relation to the issues identified:

- Do the results of the insurance stress tests provide EIOPA and the insurance sector with useful insights into the consequences of a severe shock?
- Was the 2016 insurance stress test appropriately designed, was its timing well planned and was it applied consistently across the Member States to allow comparable and meaningful results to be obtained?
- Are EIOPA recommendations that are issued to individual NCAs on a bilateral basis sufficiently specific to identify steps needed to ensure greater coherence in the insurance sector across the EU, and appropriately address cross-border risks?
- Do peer reviews carried out by the NCAs focus on areas in which EIOPA is most likely to be able to identify best practice, and common issues that should be addressed?
- Does EIOPA have enough staff with the necessary skills and experience to assess and challenge insurance companies’ advanced internal business models?

## **SOURCES OF AUDIT EVIDENCE**

A range of information sources will be used to carry out a comprehensive assessment of this complex subject during our audit. The auditors will visit EIOPA and analyse the documents underlying the actions selected for audit. The assessment will also be supported by discussions with stakeholders representing consumers, the insurance business, and national regulators. Two surveys, covering national supervisors cooperating with EIOPA and a sample of insurance companies taking part in the 2016 stress test, will also constitute an important source of information.

## **ABOUT ECA SPECIAL REPORTS AND BACKGROUND PAPERS**

The ECA's special reports set out the results of its audits of EU policies and programmes or management topics related to specific budgetary areas.

Background papers provide information in relation to an on-going audit task. They are based on preparatory work undertaken before the start of the audit and are intended as a source of information for those interested in the policy and/or programme subject to our audit.

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- <sup>1</sup> The European Commission proposed postponing the application date to 1 October 2018, subject to the agreement of the European Parliament and the Council.
  - <sup>2</sup> CEIOPS (2003–2010) was established under the terms of Commission Decision 2004/6/EC of 5 November 2003, which was repealed and replaced by Decision 2009/79/EC of 23 January 2009.
  - <sup>3</sup> Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC.
  - <sup>4</sup> [www.eiopa.europa.eu](http://www.eiopa.europa.eu)
  - <sup>5</sup> Opinions: <https://eiopa.europa.eu/publications/eiopa-opinions>  
Guidelines: <https://eiopa.europa.eu/publications/eiopa-guidelines>  
Draft Technical Standards: <https://eiopa.europa.eu/publications/technical-standards>  
Recommendations: <https://eiopa.europa.eu/publications/standards-guidelines-and-recommendations>  
Decisions: <https://eiopa.europa.eu/publications/protocols-decisions-and-memoranda>  
Supervisory Statements: <https://eiopa.europa.eu/publications/supervisory-statements>
  - <sup>6</sup> Preamble 43, Articles 23 and 32 of Regulation No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC.