



Europe Economics

The UK insurance market: Overview and potential impacts of IFRS 17

Final Report

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Executive Summary

This study is an input to the work of the Financial Reporting Council looking at the possible impact of the use of IFRS 17 on the UK's economy and, in particular, the UK insurance industry. One of the objectives of IFRS 17 is to introduce a consistent and truly international standard. It replaces IFRS 4, the current standard applicable to insurance companies which largely allowed insurers to keep their previous (usually national) accounting practices. The IFRS standard is optional in the UK, although all insurance companies listed on the London Stock Exchange have to prepare accounts on this basis.

We seek to provide background information that might be relevant when thinking about how IFRS 17 could affect the interests of UK customers wanting to buy insurance, the size and competitiveness of the UK insurance industry, investors in insurance companies, and the UK macro-economy. We have relied primarily on desk-based research, supported by a small stakeholder engagement exercise.

The UK represents the fourth largest insurance market worldwide, with a total value of gross insurance premiums underwritten by UK insurers and reinsurers reaching almost €400 billion in 2018, a level that has risen steadily since 2011. However, the number of firms with authorisations to write insurance has declined in recent years. There was a 21 per cent fall in PRA authorisation for life insurance and a 17 per cent fall in general insurance authorisations. The presence of authorised insurers has been recently shifting from UK-based firms towards EEA-based companies. Despite this, the total amount of insurance services exported from the UK has increased in recent years, from £18.8 to £20.1 billion between 2016 and 2019. Europe appears to be the main source of competition for UK insurers in the UK market. In 2019, the share of imports from the EEA was more than 50 per cent of the overall import figure, standing at more than £1.7 billion (exports to Europe accounted for £7.2 billion in that same year).

The general impression gained from insurer interviews was that IFRS 17 will not affect the competitiveness of UK insurers materially. While the costs associated with the change are significant, these spread out across all the policies sold are unlikely to affect the price competitiveness of UK insurers. It is possible that at the margins the new reporting standards may lead to greater global harmonisation, reducing marginally the barriers to entering the UK market.

The effects of IFRS 17 on product mix and pricing across the whole insurance sector are unlikely to be major. Insurers we spoke with did not envisage major changes in their product mix or pricing, observing that the standard changes how they report results rather than the underlying activity. It is possible that the reporting requirements concerning onerous contracts may deter offering products that serve as 'loss leaders', although regulatory initiatives already in train may be more significant in this regard.

The UK is one of the most active capital markets, attracting investors from all over the world. Between 2010 and the first half of 2020, we found data showing that insurance companies raised £28,388 million on the UK debt market, and £5,062 million in the UK equity market. UK insurers account for more than £23,500 million of the former, and £5,053 million of the latter. All of the insurers we spoke with were keen that their investor base should not become less diverse as a result of IFRS 17. There were no major concerns raised about the possibility that their geographic spread of investors will be significantly curtailed. When grouping investors, it was more common to distinguish between institutional investors focused on the insurance sector and general investors than by geographic location.

The cost of capital for the insurance sector is significantly higher than for banking, another regulated sector. A benefit often cited to justify reporting standards, such as IFRS 17, is that it will lead to a lower cost of capital as greater transparency will remove some investor uncertainty. The potential impacts of IFRS 17 on the cost of capital for insurers could differ depending on the main business on which the insurers are active,

but overall uncertainty is the main feeling we got from insurers about the effects of the new reporting standards on insurers' cost of capital. In general, they do not expect the change to have the intended effect of reducing the cost of capital in the sector, at least in the short run. There are concerns that even specialist investors will feel less sure about how to interpret financial reports in the early years of the new standard. We estimate that the weighted average cost of capital for the insurance sector was higher in December 2019 than seven years earlier. The low gearing in the sector means that the cost of equity is relatively more important than the cost of debt.

Insurers are themselves important investors. One source suggested that the total investment assets held by UK undertakings amounted to £1.60 trillion in assets at the end of 2019. In 2018, the same figure amounted to £1.74 trillion, the majority of which, £1.6 trillion, was held by life insurers. IFRS 17 seems unlikely to have much effect on the asset mix held by UK insurers. Insurers observed that current UK accounting practices already measure contract liabilities at current values and insurers predominantly value investment assets at fair value, so it is unlikely that the standard will change their incentives on asset mix; this conclusion may not extend to the situation facing some non-UK insurers.

For the UK macro-economy, the implications for tax policy seems to be the area where IFRS 17 could have a material impact. According to a recent report published by Statista, in 2019 the sector made the largest tax contributions of any sector, approximately £75 billion (representing over 12 per cent of the total HMRC tax receipts). Because IFRS 17 will change the way profits are reported, the tax due in a given year will change absent changes in the tax code. Parties we spoke to said that they are in discussions with HMRC but do not yet know exactly how the changes will affect their business, much less the wider insurance community. It is also possible that dividend payments will be affected by IFRS 17 not because of any change in the underlying profitability of insurers' activities, but because of changes in how profits are reported. However, the insurers we spoke with suggested that Solvency II will remain the main constraint on dividend payments and none planned any change in dividend payments in the immediate future. The sector's importance to the UK economy in terms of GDP and employment seems unlikely to change due to IFRS 17. In 2018, just over 300,000 jobs were linked to the insurance and reinsurance sectors, representing just less than 1 per cent of total UK employment.

1 Introduction

This study is an input to the work of the UK Endorsement Board secretariat looking at the possible impact of the use of IFRS 17 on the UK's economy and, in particular, the UK insurance industry.¹ IFRS 17 is a new accounting standard that will replace IFRS 4, the current IFRS standard applicable to insurance contracts. The IFRS standard is optional in the UK, although all insurance companies listed on the London Stock Exchange have to prepare accounts on this basis.

1.1 Background to the Study

The IFRS Foundation seeks to develop globally accepted accounting standards and to promote their adoption. It claims that this standardisation of financial reporting rules brings three main benefits: (i) transparency, since they enable the comparability of international companies; (ii) accountability by reducing the information gap between investors and management; and (iii) efficiency, by allowing investors to evaluate opportunities across the world. The International Accounting Standards Board (IASB) sets the IFRS Standards.

The IASB first issued the IFRS 17 Insurance Contracts in May 2017. It was originally scheduled to come into force on 1 January 2021, although its effective date has recently been postponed to 1 January 2023.²

One of the objectives of IFRS 17 is to introduce a consistent and truly international standard. It replaces IFRS 4, the current standard applicable to insurance contracts which largely allowed insurers to keep their previous (usually national) accounting practices. As a result, the accounting principles currently employed by insurers around the world vary significantly between countries (and even potentially within countries).

There are a number of key changes that IFRS 17 introduces.

- Liabilities will be estimated based on (i) the net present value of best estimate cash flows, (ii) risk adjustment, and (iii) the contractual service margin (i.e. unearned profits).
- For contracts which are identified as loss-making (i.e. onerous) the loss will be recognised upfront. Expected profits for profitable contracts (i.e. non-onerous) will be recognised throughout the duration of the contract to reflect the provision of insurance services.
- Contracts will be grouped into portfolios of contracts subject to similar risks and managed together. Combined with the different treatment of onerous and non-onerous contracts described above this will prevent insurers from offsetting losses from onerous contracts by grouping them with profit-making contracts.
- Income statement will distinguish between “Insurance service result” (comprising insurance contract revenue, and incurred claims and other expenses) and finance income/expenses.

The diversity in current accounting practice means that the impacts of these changes are likely to differ from country to country and, indeed, from one insurer to another.

1.2 Objectives and structure of the present study

An assessment of the likely impact of IFRS 17 needs to think about how it will affect UK insurers and financial groups directly (how will the sector's global competitiveness be affected?) and the knock-on implications for

¹ The Endorsement Board (EB) is currently being established; during this period the government and the Financial Reporting Council (FRC) are overseeing the work of the EB in developing advice for consideration by the Secretary of State.

² IFRS website (2020). *IASB decides on new effective date for IFRS 17 of 1 January 2023*. [Link](#).

UK consumers and other interested parties. This study reports information that helps to understand these impacts.

We start by describing the current UK insurance market (chapter 2).

We then look at competition in the product market. We think about this both from the perspective of UK-based insurers trying to compete (in the UK and globally) and UK consumers of insurance products. In Chapter 3 we provide a brief analysis of how UK insurance firms currently compete. We look at the competition from insurers based in other countries, such as countries from the European Economic Area (EEA) and the US, and then look at the activities of UK-based insurers overseas, analysing to what extent UK insurers compete in other countries. Chapter 4 looks at the insurance products available in the UK and the pricing of them. It looks at how the IFRS 17 could impact the product mix offered by UK insurance companies and their prices, assessing also if the new standards could affect the innovation of the market.

The study then looks at data that might be relevant when thinking about IFRS 17's possible implications on the capital markets, first looking at evidence relevant to questions about UK insurance firm's ability to raise money in the capital markets. In Chapter 5 we look at the evidence on competition from non-UK insurers in UK capital markets. Chapter 6 analyses the cost of capital of UK-based insurance entities and how it evolved in the last few years, comparing it to the WACC of other industries. Chapter 7 looks at the investment behaviour of UK insurers, looking into the trends of UK insurers' allocation of investment assets, to understand how insurers' investment portfolio has changed during the last years and the potential impact of IFRS 17.

Finally, we study other potential impacts of IFRS 17 (chapter 8). How might it affect economic output, the employment, government revenue and the dividends paid by insurers and reinsurers?

1.3 Research methodology

Our research methodology has relied primarily on desk-based research, supported by a small stakeholder engagement exercise.

For the desk-based research, we used materials that are freely available. This included a review of previous relevant studies, including the study for the European Financial Reporting Advisory Group (EFRAG) looking at the impact of IFRS 17 on the European insurance market and various Association of British Insurers (ABI) publications. We also analysed a number of secondary data sources, including:

- EIOPA,
- Insurance Europe,
- Thomson Reuters,
- the Blue Book from the Office of National Statistics (ONS), and
- the OECD database.

There are limits to the quality of information that can be derived from secondary data sources. The datasets present various discontinuities and report numbers that do not always correspond with one another for a variety of reasons (such as different sample periods, different definitions, different primary data sources). It was outside the scope of this study to conduct a detailed reconciliation exercise. Instead, our focus has been on identifying key trends and gaining an idea of the likely magnitudes rather than precise values. Our analysis of these datasets has been integrated with the review of other relevant studies, which helped in closing the gaps left by the datasets.

We spoke with four stakeholders active in the UK insurance sector to gather directly from market participants information and opinions on matters where the desk-based research would not suffice. The parties we approached for an interview were agreed with the Endorsement Board secretariat, with the aim to include a mix of insurers (large and small, life and non-life). In the interviews we sought to gather views

on possible future developments in the sector generally, and more specifically how IFRS 17 might affect product mix, pricing, and innovation. We also sought to understand how IFRS 17 might affect firms' competitiveness, the likely implications for investor behaviour, and possible wider economic impacts such as future dividend and tax payments.

2 The Insurance Market in the UK

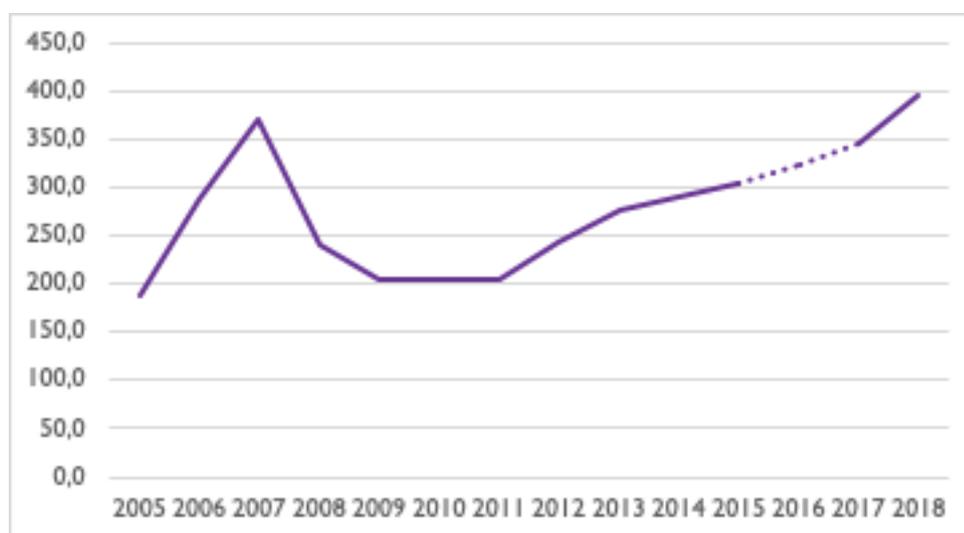
2.1 Sector overview and relevance of the market

The insurance sector has long been an important part of the UK economy. The UK is often considered to be modern insurance's birthplace, with the first companies providing services such as accident, fire and life insurance established in the UK in the 1700s.³ Today the UK insurance market is the largest in Europe and the fourth largest in the world, and the London market is the global centre for commercial and specialty insurance risks. The three largest life and health insurance companies in Europe (by market value) were Prudential, Legal and General Group and Aviva, all UK firms.⁴ Another, Phoenix Group holding, was the eighth largest. Four out of five UK adults have at least one insurance product.⁵

The UK also has important offshore insurance business. The most important is the British Overseas Territory of Bermuda, which has been a leading centre for US property catastrophe insurance. Many Lloyd's insurers domicile on the island or have established subsidiaries there. The Crown Dependencies of Guernsey, Jersey and the Isle of Man are also important offshore domiciles. All have their own specific insurance legislation.

In 2018, the total value of gross insurance premiums underwritten by UK insurers and reinsurers was almost €400 billion. This exceeds the peak reached in 2007, before the financial crisis. The level of premiums has risen steadily since 2011, although the changes in regulatory regime between Solvency I and Solvency II means that there is a discontinuity in the data.

Figure 2.2.1: Evolution of total value of UK gross insurance and reinsurance premiums (€ billion)



Source: EIOPA, Europe Economics calculations.⁶

Note: Insurance undertakings subject to Solvency I (for the period 2005-15) and to Solvency II (for the period 2017-18) reporting requirements.

³ Swiss Re (2013). *A History of UK Insurance*. [Link](#).

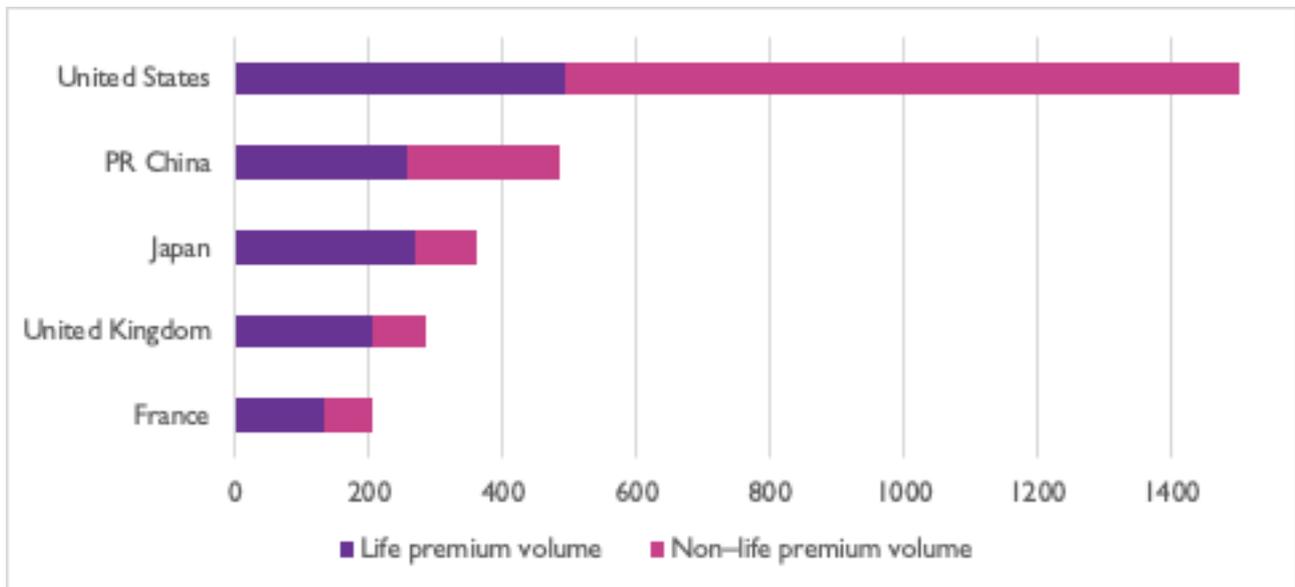
⁴ Statista (2019). *Leading European life and health insurance companies on the market as of May 2019, by market value*. [Link](#).

⁵ FCA (2020). *Sector Views*. [Link](#).

⁶ European Insurance and Occupational Pensions Authority (EIOPA) insurance statistics Solvency I Table 2 (for the period 2005-15), and EIOPA insurance statistics Solvency II Premiums, claims and expenses (for the period 2017-18). [Link](#).

Figure 2.2 shows, the largest five insurance industries across the world (United States, PR China, Japan, United Kingdom, and France). The relative share of the life insurance sector in many of them, including the UK, is about two thirds. In the US, instead, 60 per cent of the total premium stems from the non-life insurance sector. China has also recently seen an increase in its non-life insurance segment, which has reached a share of almost 50 per cent in 2019.⁷

Figure 2.2: Total premium volume in the 5 largest markets worldwide, 2019 (£ billion)

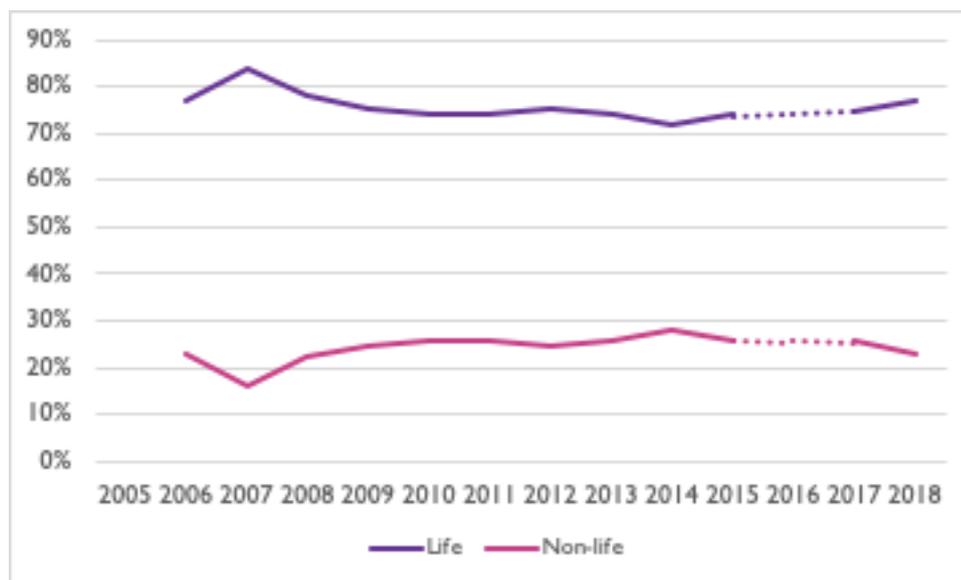


Source: Swiss Re, Sigma No 4/2020, Europe Economics calculations.

Analysing the share of life and non-life insurance premiums in the UK, we notice that after an initial steep increase (by 7 percentage points) in the relative relevance of the gross premiums collected by the life sector by 2007, this slowly decreases until 2014, losing 12 percentage points in 7 years and reaching a level of 72 per cent, the lowest in the series at stake. Since then, the data show a slight increase, which allows in 2018 to have a situation similar to the one in 2006, with 77 per cent of the UK insurance premiums being collected by the life sector.

⁷ Swiss Re Institute, Sigma No 4/2020. *World insurance: riding out the 2020 pandemic storm.* [Link](#).

Figure 2.3: Market share of life and non-life UK insurance premiums (direct business only)



Source: EIOPA, Europe Economics calculations.⁸

Note: Insurance undertakings subject to Solvency I (for the period 2006-15) and to Solvency II (for the period 2017-18) reporting requirements. Data referring to non-life insurance gross direct premiums for 2005 are not available, thus the year is omitted from the representation.

The UK insurance industry is also active in overseas markets, with high level of exports of insurance services (direct insurance, auxiliary insurance services and reinsurance) to the Rest of the World.⁹ About 80 per cent of the premiums that London Market speciality firms write relates to international risks.¹⁰ The total amount of insurance services exported from the UK has increased, from £18.8 to £20.1 billion between 2016 and 2019, after a small decrease to £18.2 billion in 2017.

Table 2.1: Total exports, 2019

	Exports (£ bn)
Total EU27	7
Canada	0.9
US inc Puerto Rico	6.4
Rest of the world	5.8
Total	20.1

Source: ONS, Europe Economics calculations.¹¹

2.2 Regulatory Background

The first major piece of regulation concerning the UK insurance industry was the 1870 Life Insurance Companies Act, requiring insurers to record and submit their accounts and to pay a nominal deposit.¹² Since then regulations have grown.

⁸ European Insurance and Occupational Pensions Authority (EIOPA) insurance statistics Solvency I Table 3.1 and Table 4 (for the period 2005-15), and EIOPA insurance statistics Solvency II Premiums, claims and expenses (for the period 2017-18). [Link](#).

⁹ Office for National Statistics (ONS) (2020). *UK trade in services: by partner country, non-seasonally adjusted*. [Link](#).

¹⁰ Ernst & Young (2019). *2020 UK Insurance Outlook*. [Link](#).

¹¹ Office for National Statistics (ONS) (2020). *UK trade in services: by partner country, non-seasonally adjusted*. [Link](#).

¹² Swiss Re (2013). *A History of UK Insurance*. [Link](#).

Arguably the key regulations currently in place stem from the Solvency II Directive.¹³ This replaced previous European insurance directives (such as the Life Assurance Consolidation Directive¹⁴ and the Third Non-Life Directive¹⁵). Solvency II is a regulatory regime that aims to harmonise the rules that insurers across Europe have to implement to operate in the Single Market. It seeks to ensure that policyholders can buy an insurance service confident that, should they ever make a claim, the insurance company will be able to make the due payment: under the Solvency II regulations, the risk that an insurer might not be able to pay claims in a given year is supposed to be not greater than 0.5 per cent.¹⁶

Most insurance and reinsurance companies operating in the European market have to satisfy the supervisory and prudential requirements set out in the Solvency II Directive. Only very small companies do not fall within the scope of this Directive, which was enforced at the beginning of 2016 and probably represents the most radical change in more than thirty years of European insurance regulation. The stakeholders we spoke with all felt Solvency II had a more marked effect on the insurance sector and their business than the change to IFRS 17 would have.

The Prudential Regulatory Authority (PRA) is responsible for the implementation of Solvency II and its three pillars:

- Valuation of assets/liabilities and capital requirements based on risk;
- Governance and risk management requirements, and
- Supervisory reporting and public disclosure.

The PRA is part of the ‘twin-peaks’ regulatory system set up by the Government in 2013 in response to the financial crisis. It has a prudential supervision duty, and requires insurers to operate under the principles of safety and soundness. The other pillar is the Financial Conduct Authority (FCA) which is primarily responsible for regulating market conduct. It regulates the behaviour of agents competing in the insurance market and on the general integrity of the industry’s functioning.

2.3 Major Developments and Changes in the Sector

Perceptions on what major developments there have been or will be in the insurance sector depend in part on what features of the industry are considered important. For example, insurance for risks associated with new products and services that were not marketed a decade ago may be very important to people operating in those industries, but arguably they do not alter the basic features of the market (assessing risk and pricing premiums, investing premium incomes and paying out claims). A recent survey found that nearly a quarter of premium volume is associated with products not offered five years ago, and that in five years’ time a third of premiums will similarly relate to products not currently offered.¹⁷

In the life insurance sector, there have been a number of important regulatory changes. Aside from Solvency II, a European initiative, there have been two important domestic policy changes: automatic enrolment and the Pension Freedom reforms. The effects of these changes are discussed further in Chapter 4. There were suggestions that these regulatory developments have made scale even more important in the life insurance sector. One stakeholder suggested that disruption in the sector is less likely now than it was

¹³ Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 ([link](#)) supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) ([link](#)).

¹⁴ Directive 2002/83/EC of the European Parliament and of the Council concerning life assurance. [Link](#).

¹⁵ Council Directive 92/49/EEC on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance. [Link](#).

¹⁶ European Commission website. *Risk management and supervision of insurance companies (Solvency 2)*. [Link](#).

¹⁷ Deloitte (2020). *A demanding future. Four trends that define insurance in 2020*. [Link](#).

five or ten years ago, because of the scale and expertise needed today to operate in the sector and also because the sector is highly regulated.

The UK non-life insurance market is considered to be highly competitive with low margins and increasing cost bases.¹⁸ Established insurers face competition from FinTechs and Insurtechs, and more generally technology is a major factor behind changes in the sector. It has affected how the products are distributed and priced, the ability to monitor risk in real time, and the products that are offered. Most motor insurance and home insurance contracts are sold via online platforms and aggregators. This has increased the importance of price in terms of determining which insurer a consumer chooses.¹⁹

The full effects of Covid-19 on the insurance sector are not yet known. The effect of the crisis on claims will vary by insurer, since the effect of the virus on claims will vary by line of business (motor insurance claims will be down, for example) and some insurance contracts will have clauses precluding claims due to pandemics. The FCA is involved in a ‘test case’ on business interruption coverage wordings which is likely to have wider implications on the industry.²⁰ The judgement, held in mid-September, was in favour of the arguments advanced by the FCA on most of the key issues. In particular, it states that most, but not all, of the disease clauses in the sample provide cover for customers. This will help reducing the uncertainty faced by policyholders.²¹ However, some insurers pointed out that the overall impact of this judgement should be in the range of £70-100 million net of reinsurance. This is also supported by Moody, while Fitch suggests that ratings for non-life insurers will be unaffected by the decision.²² In the longer term, the impact of the virus on the macro-economy may affect both future demand for insurance products and the returns that insurers are able to earn on their investments.

Our conversations with stakeholders did not identify any major new trends on the horizon. There was a suggestion that the regulatory changes in the last 5-10 years has reduced the likelihood of major market-driven disruption. The sector is one where size is important, making entry difficult. Instead, there was a feeling that any major changes are likely to be driven by changes in the law or regulatory focus, although no specific changes on the horizon were identified.

2.4 Data on UK insurance entities

The Bank of England listed 383 authorised insurers on 1 April 2020. This was made up of 146 life insurers and 238 non-life insurers (a further 17 had authorisations for both life and non-life insurance and 6 were authorised to conduct risk transformation). An insurer with a non-life authorisation can be authorised to undertake a number of classes of business. The table below sets out the total number of firms authorised to undertake different classes of business.²³

Table 2.1: Number of UK Insurers Authorised by Class of Business, 1 April 2020

Class of Business Non-Life	Number of Firms authorised	Class of Business Life	Number of Firms authorised
Accident & Sickness	208	Life and Annuity	101
Motor vehicle liability and other	182	Marriage and birth	42

¹⁸ Ernst & Young (2019). *2020 UK Insurance Outlook*. [Link](#).

¹⁹ LE Europe and VVA Consulting (2018). *Assistance to EFRAG for impact analysis of IFRS 17 Insurance Contracts*. [Link](#).

²⁰ Covington & Burling LLP (2020). *The UK FCA's test case concludes. What next for policyholders?*. [Link](#).

²¹ Result of FCA's Business Interruption test case. [Link](#)

²² Insurance Journal. *Insurers, Policyholders, Analysts React to UK's COVID-19 Business Interruption Ruling*. [Link](#)

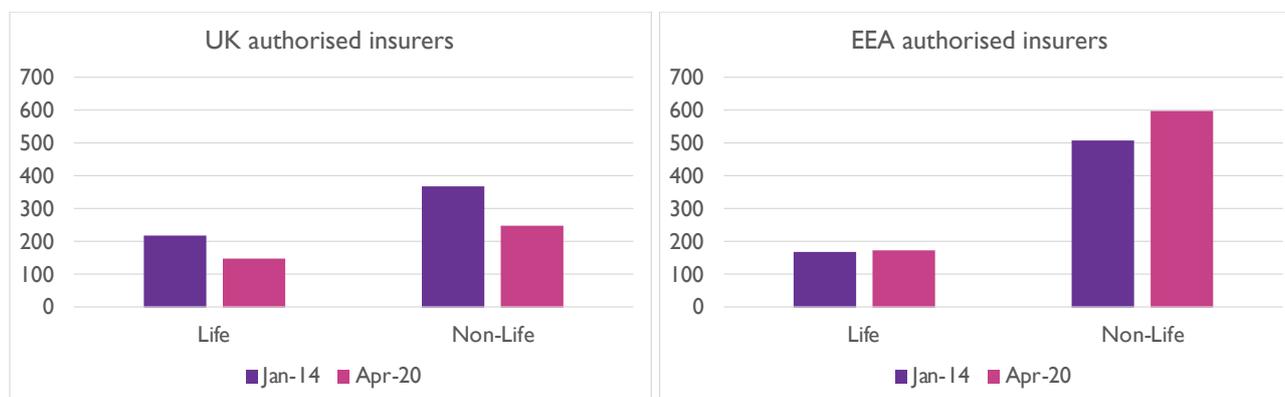
²³ Please note that a single insurance company may hold several authorisations.

motor vehicle insurance				
Fire and other damage to property	183		Linked long term	124
Marine, aviation and railway rolling stock	180		Permanent health	82
General liability	189		Capital redemption	41
Credit and suretyship	159		Pension fund management	53
Other Classes	219			

Source: Bank of England, Europe Economics' calculations.²⁴

The number of firms with authorisations to write insurance has declined in recent years. Between 2015 and 2018 there has been a 21 per cent fall in PRA authorisation for life insurance and a 17 per cent fall in general insurance authorisations.²⁵ Solvency II may have driven some of this change, encouraging firms to consolidate and restructure to better manage the regulatory capital requirements. It is also possible that Brexit has or will prompt some companies to relocate to the European mainland. As Figure 2.5 clearly shows, between January 2014 and April 2020, the active insurers in the UK market have experienced a shifting trend between UK and EEA based companies, with a weakening of the former and a consolidation of the presence of the latter.

Figure 2.5: UK and EEA authorised insurers active in the UK market, Jan-14 to Apr-20 comparison



Source: Bank of England, Europe Economics' calculations.²⁶

There are a lot of firms offering insurance in the UK market. In the life insurance sector, the largest insurers include Legal & General, Aviva, Lloyds Banking Group, Prudential Assurance, Zurich Insurance and Standard Life Aberdeen.²⁷ The largest non-life insurers are set out in the chart below.

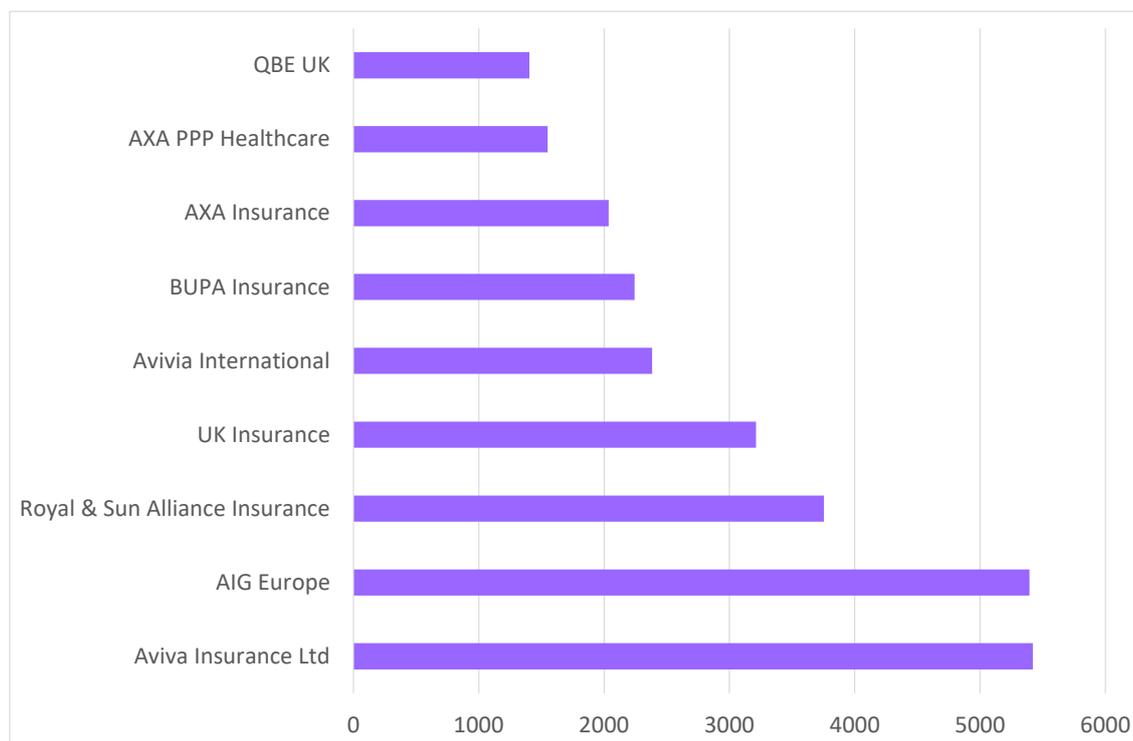
²⁴ Bank of England (2020). *List of UK insurers authorised as compiled by the Bank of England as at 01 April 2020*. [Link](#).

²⁵ Association of British Insurers (ABI) (2019). *UK Insurance and Long-Term Savings. The state of the market 2019*. [Link](#).

²⁶ Bank of England. *List of UK and EEA insurers authorised as compiled by the Bank of England as at 01 April 2020* ([link](#)); *List of UK and EEA insurers authorised as compiled by the Bank of England as at 01 January 2014* ([link](#)).

²⁷ Ibis World (2020). *Life Insurance in the UK - Market Research Report*. [Link](#).

Figure 2.6: Ten largest insurers in UK non-life sector, by 2018 gross written premium (£m)



Source: Best's Market Segment Report, January 2020.²⁸

There are a large number of other insurers. For example, in its recent review into competition in retail insurance the FCA found the largest five insurers accounted for 48 per cent of gross written premiums in motor insurance and 57 per cent in home insurance, with a long tail of smaller firms.²⁹ The non-life sector was not concentrated, with an estimated Herfindahl-Hirschman Index (HHI) of 589 for motor insurers and 862 for home insurers (the HHI is a measure of market concentration that takes account of differences in the size of participants; the Competition and Markets Authority regards a market as concentrated if it has an HHI exceeding 1000 and highly concentrated if the HHI exceeds 2000). It is less concentrated than most European non-life insurance markets.³⁰

2.4.1 Numbers Applying IFRS

Data on the number of insurance companies that apply IFRS is scarce.

Earlier this year, EFRAG published an issues paper regarding IFRS 17 and small insurers.³¹ The paper reports information on the number of insurers reporting under IFRS at the end of 2018 for each European Union Member State and the UK. The statistics are based on data provided by Insurance Europe to EFRAG on the companies that have already implemented IFRS and by a consultation paper published by European Insurance and Occupational Pensions Authority (EIOPA) on the 2020 review of Solvency II.³² The different sources used to compile the data meant that there are some discrepancies in the data. For example, for some Member States the total number of insurance companies that apply IFRS is larger than the total number of insurers reported as active in that Member State.

²⁸ Best's Market Segment Report, January 2020. [Link](#).

²⁹ FCA (2019). *General insurance pricing practices - Interim Report*. [Link](#).

³⁰ LE Europe and VVA Consulting (2018). *Assistance to EFRAG for impact analysis of IFRS 17 Insurance Contracts*. [Link](#).

³¹ EFRAG (2020). *IFRS 17 and Small insurers. Issues Paper*. [Link](#).

³² EIOPA (2019). *Consultation Paper on the Opinion on the 2020 review of Solvency II*. [Link](#).

In the UK, EFRAG reports 37 insurers were reporting under IFRS at the end of 2018. Of these 37, 18 are listed companies and they have to adopt IFRS in their group accounts by law, meaning that only 19 companies are reporting under IFRS voluntarily. This total of 37 represents 7.5 per cent of the total number of insurers EFRAG reported as active in the UK market.³³

EFRAG claims that “none or hardly any” small insurers apply IFRS 17. A ‘small insurer’ is defined as one with gross written premiums less than €5 million or gross technical provisions below €25 million, the Article 4 thresholds for being exempt from Solvency II. There were 170 small insurers, using this definition, located in the UK. Those that are part of a group that applies IFRS will need to prepare IFRS figures for consolidation purposes.

2.5 Data on investors active in UK insurance entities

Thomson Reuters provides figures on the institutional and strategic investors in the 18 largest listed companies. This data shows that, among the 3,126 institutional investors, which represent slightly more than 80 per cent of the total investors considered, half are *Investment Advisors*, and another third falls under the category *Investment Advisors/Hedge Funds*. The remaining investments are attributed to *Pension Funds, Banks and Trusts, Insurance Companies, and Sovereign Wealth Funds*. Analysing the strategic entities investing in the UK insurance sector, which account for almost 20 per cent of the total investors considered, we find that *Individual Investors* largely dominate, with a share of over 90 per cent over the 769 strategic investors reported. *Corporations* obtain the second highest share, amounting to a mere 8 per cent. Unfortunately, no information on the amounts invested by the different categories is available.

The insurers we spoke with were keen that their investor base should remain diverse, including a mix of investors, by type – specialist, active traders and passive, uninformed – and by geography. IFRS 17 represents a challenge in this context as, being a new standard, it is considered hard to understand when compared to pre-existing standards, which are now fully embedded. The industry would like general investors to understand the sector better. Most investors are not sophisticated insurance experts and, if they cannot simply and quickly understand the financial results they may invest elsewhere. There was talk of the need to educate investor about the new standard, as not only the performance bottom line but also the presentation of the results will change under IFRS 17. Some insurers saw a paradox in that the new reporting regime could result in a discontinuity of the reported values, producing significant variations in reported results even though it has not had any material impact on the underlying business. There were also suggestions that firms may continue to highlight data reported for other purposes, such as Solvency II.

³³ The total number of insurers active in the UK market at the end of 2018 is 493. (EFRAG, 2020. *IFRS 17 and Small insurers. Issues Paper*. [Link](#).)

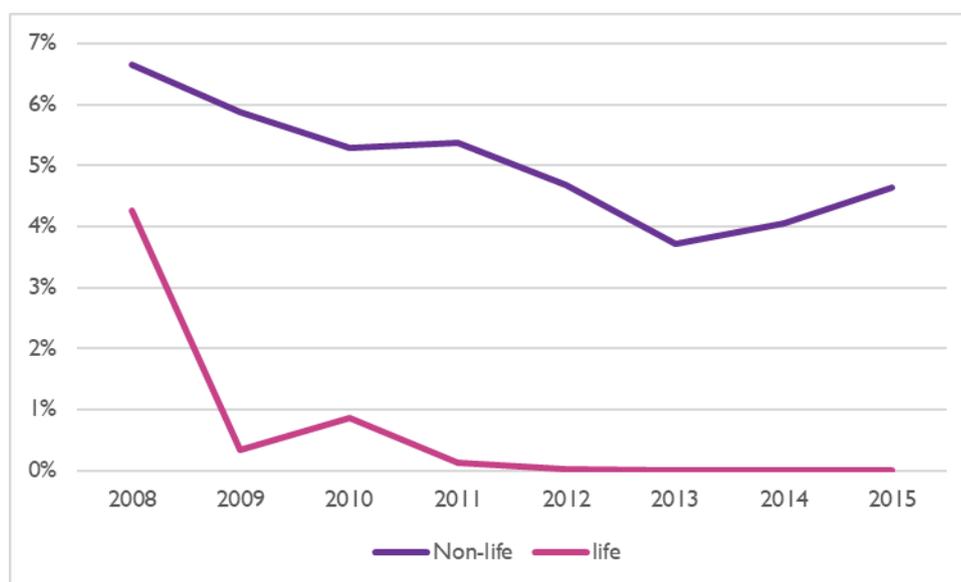
3 Competition in the product market

The chapter looks at competition in both the UK and overseas markets. To what extent is the UK market dominated by UK insurers, and where else in the world are UK insurers competing? We analyse the major changes that have affected the competitiveness in the insurance sector over the last decade, before assessing the potential implication of IFRS 17 for the overall competitiveness of the UK insurance sector.

3.1 UK Insurance Markets

The extent to which the UK insurance market is dominated by UK firms depends on what criteria are used to define UK and foreign insurers. If we define a foreign insurer as just branches and agencies of foreign undertakings, their shares are quite low. The chart below shows how these shares fell between 2008 and 2015. The foreign market share remains low in 2016 through to 2018, but discontinuities in the series mean it is not possible to infer more recent trends and Figure 3.1 only covers the period up to 2015. The market share of foreign undertakings is consistently lower in the life insurance sector than the general insurance sector. In both cases, the market share declined throughout the period, with the sharper fall in the life insurance sector, which dropped from around 4 per cent to less than 1 per cent between 2008 and 2009. This decrease is in line with data from Insurance Europe on the gross premiums written on domestic market by subsidiaries of EU/EEA enterprises.³⁴ The data shows a contraction of EU/EEA insurers activities in foreign markets and, given the size of the UK insurance markets, this could explain the steep reduction of the foreign branches and agencies' market share.

Figure 3.1: Market share of branches/agencies of foreign undertakings



Source: OECD, Europe Economics calculations.³⁵

Europe appears to be the main source of competition for UK insurers in the UK market. ONS data suggests that for the period 2016-2019 the majority of insurance service imports came from Europe. We will analyse the UK insurance services imports at the end of this section.

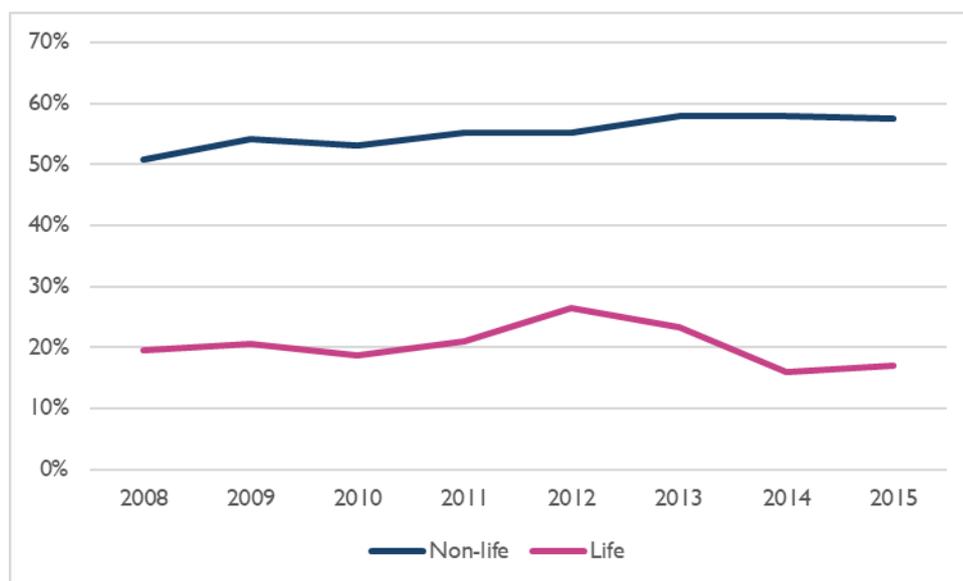
³⁴ Insurance Europe. Life insurance data. [Link](#).

³⁵ OECD.Stat. Insurance Indicators. [Link](#).

However, from another point of view, foreign controlled undertakings account for most of the UK market shares not accounted for by British companies. Indeed, if we include foreign controlled undertakings together with branches and agencies in the definition of non-UK businesses, then non-UK businesses account for significant market shares, especially for non-life insurance. The market share of non-UK insurers in the UK non-life insurance sector increased from 50 per cent to 60 per cent between 2008 and 2015 whereas in life insurance the share of non-UK insurers fell from a peak in 2012.³⁶

This definition of non-UK insurers includes undertakings that have head offices in the UK, but are controlled by parent companies headquartered outside the UK. The OECD database does not specify the main business of the mother companies for the controlled undertakings. This could mean that the parent companies are large investment funds that have shares of the insurers' capitals but are not directly involved in the insurance market. The data also does not distinguish clearly about the origins of undertakings, with non-UK insurers grouped as "foreign undertakings", with no breakdown for the regions or macro-regions of origin of their headquarters. Finally, there are discontinuities in the OECD data series after 2016 which makes it difficult to infer more recent trends.

Figure 3.2: Market share of foreign controlled undertakings and branches/agencies of foreign undertakings



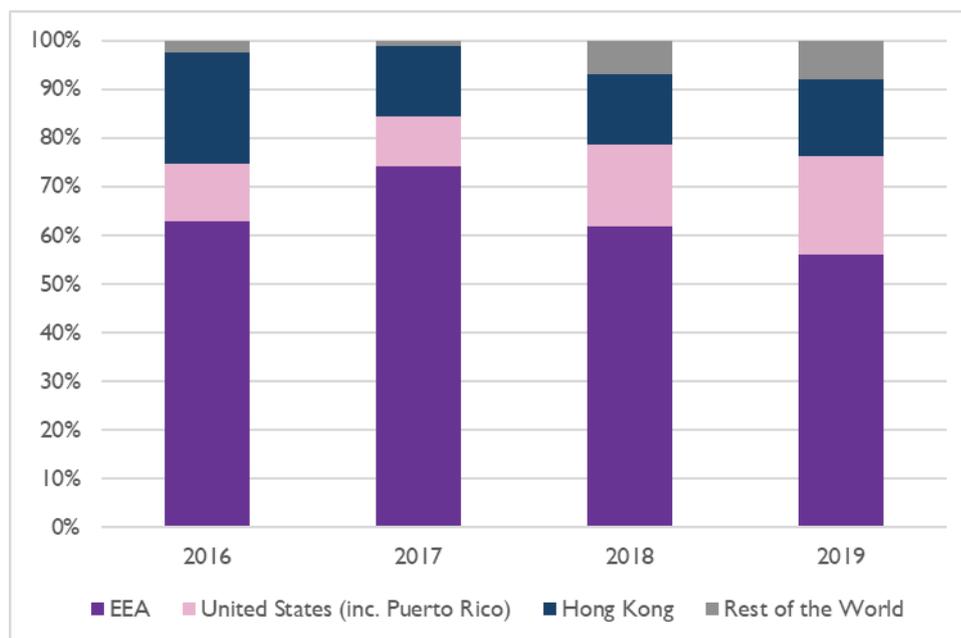
Source: OECD, Europe Economics calculations.³⁷

Figure 3.3 below displays the shares of imported insurance services from different countries. Overall, imported insurance services in the UK have expanded, with the total amount of imported insurance services increasing from £2.4 to £3.1 billion over the period 2016-2019 (see figure 3.5 in the next section). European insurers play a central role in this, being the source of more than half of the imported services in 2019. The US provides a good share of imported insurance activities, representing a fifth of the total imports of the last year. The ONS reports that the total value of the services imported from the US accounted for more than £600 million in 2019. Imports from Hong Kong varied considerably, decreasing from 556 to £319 million in the first couple of years. It eventually increased to £494 million in 2019, which represented almost 16 per cent of the insurance services imports for that year.

³⁶ OECD.Stat. Insurance Indicators. [Link](#).

³⁷ OECD.Stat. Insurance Indicators. [Link](#).

Figure 3.3: Import of Insurance services - shares of imports



Source: ONS, Europe Economics calculations.³⁸

3.2 UK activities in overseas markets

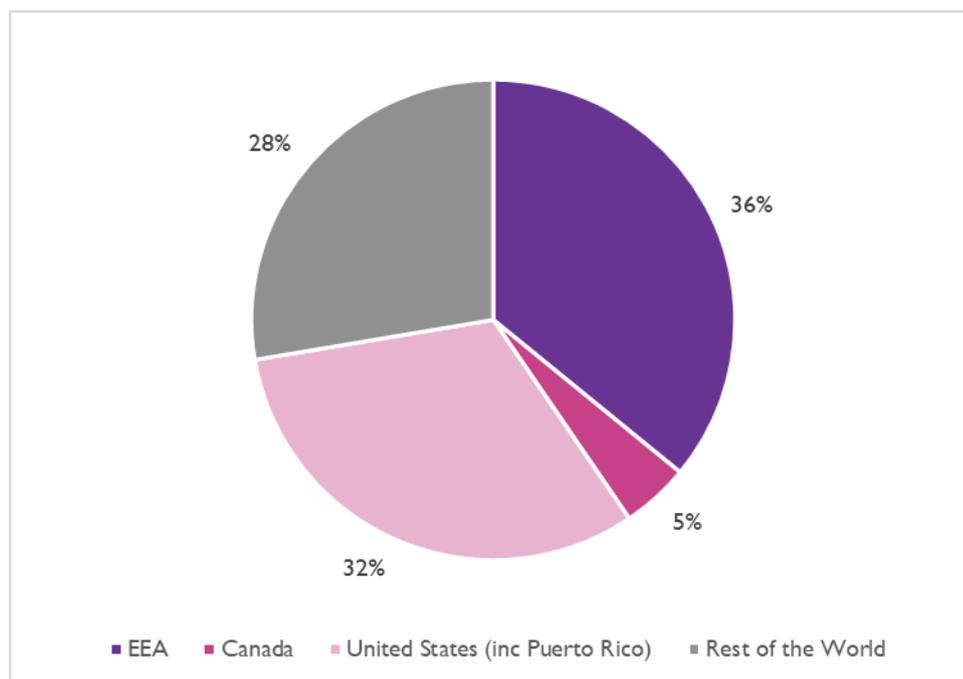
Overall, the UK exported approximately £20.1 billion of insurance services in 2019, with exports to the EEA, US and Canada accounting for more than two thirds of the total values.³⁹

The most important markets are the European Union and the United States. Total exports to the European Union increased from £5.4 billion to £7.2 billion, a 30 per cent increase over four years, as shown in Figure 3.5. These account for almost 36 per cent of the total exports of insurance services in 2019, as depicted in Figure 3.4. Exports to the US also rose, but with a smaller absolute increase, up from £6.2 to £6.4 billion (3 per cent increase). Exports to Canada, which accounts for around 5 per cent of total exports, on the other hand, were somehow stable around £1 billion, with a slow but constant reduction from £1.1 billion to £0.92 billion between 2016 and 2019. Overall, the exports of insurance services accounted for roughly 6-7 per cent over the total exports of services.

³⁸ Office for National Statistics (ONS) (2020). *UK trade in services: service type by partner country, non-seasonally adjusted*. [Link](#).

³⁹ Office for National Statistics (ONS) (2020). *UK trade in services by partner country: July to September 2019*. [Link](#).

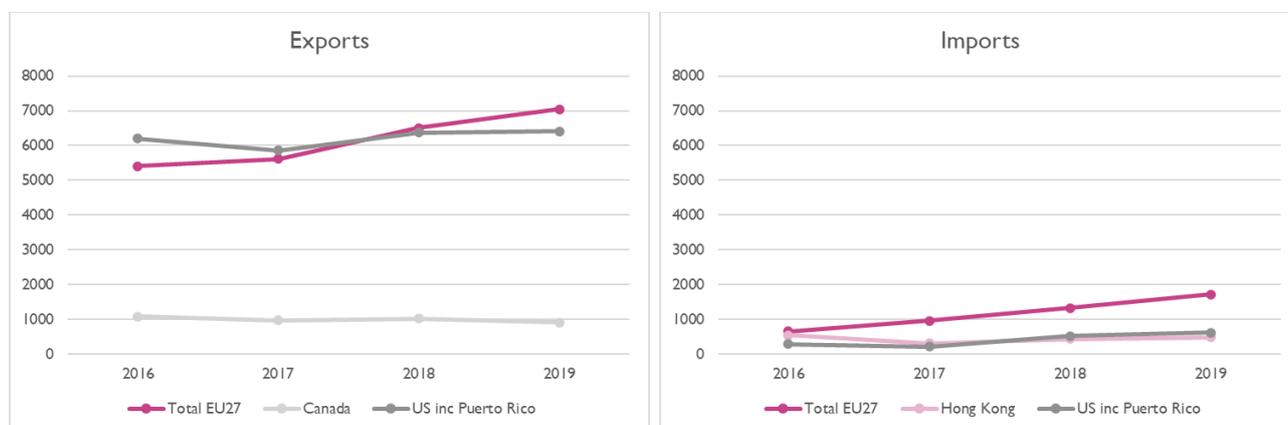
Figure 3.4: Exports of insurance services - 2019



Source: ONS, Europe Economics calculations.⁴⁰

In Figure 3.5 we present side by side the UK exports and the imports of financial services. This helps to better visualise the sizeable difference between the flows of insurance services.

Figure 3.5: UK Exports and Imports of insurance services, 2016-2019 (£ million)



Source: ONS, Europe Economics calculations.⁴¹

3.3 Competitiveness of the UK insurance market

According to the ABI, the UK is one of the most competitive places to base a new firm thanks to a low corporate tax rate.⁴²

In recent years, the pressure to be competitive on price has been especially important in the retail non-life insurance, as online platforms and aggregators have made it easy for consumers to compare prices from

⁴⁰ ONS (2020). UK trade in services: service type by partner country, non-seasonally adjusted. [Link](#).

⁴¹ Office for National Statistics (ONS) (2020). UK trade in services: by partner country, non-seasonally adjusted. [Link](#).

⁴² ABI (2018). State of market report. [Link](#).

different insurers. The new technology also means that UK insurers face competition from InsurTechs and FinTechs. The competitive threat from non-insurers is not confined to general insurance. A study conducted for EFRAG suggests that the UK life insurers have suffered competition from other financial service providers.⁴³

3.4 Potential impact of IFRS 17 on competitiveness of UK insurers

The general impression gained from insurer interviews was that IFRS 17 will not affect the competitiveness of UK insurers materially. While there were administrative costs associated with the change that were significant for the units within insurers responsible for providing financial reporting materials, these costs spread out across all the policies sold were unlikely to materially affect costs and therefore competitiveness. It is also possible that at the margins the new reporting standards may lead to greater global harmonisation, reducing marginally the barriers to entering the UK market.

One insurer pointed out that the introduction of IFRS 17 may lead to a generalised increase of costs because of increasing back-office accounting costs. This would create a more onerous regime, given that the required figures are hard to estimate and the implementation costs for IFRS 17 are quite significant. Some of these costs will get capitalised and spread over time. However, even in the worst-case scenario the cost increments would not materially affect UK insurers' competitiveness.

For life insurance, insurers active in the UK market are set up in the UK so whether the UK implements IFRS 17 will not affect the competitiveness of UK insurers in the domestic market. One insurer thought that IFRS has already had a positive impact on the UK economy, by improving investors' familiarity with reporting standards used by insurers across Europe. For pan-European businesses it would increase synergies with European offices. This might also make the UK market more attractive for insurers based in jurisdictions which adopt IFRS 17.

One insurer noted that in the non-life sector, insurers were already competing with firms using a variety of different reporting standards (UK GAAP, US GAAP, IFRS). This was not perceived to have material implications on competition.

There were different views on whether IFRS 17 may affect mergers and acquisitions. One insurer suggested that firms subject to IFRS 17 may be less inclined to engage in mergers and acquisition. The treatment of onerous contracts could in theory deter insurers subject to IFRS 17 from acquiring firms not subject to the standard. This may mean that insurers based in jurisdictions where IFRS 17 is not mandated will lead any future consolidation in the sector. However, this assumes that the behaviour of investors and senior management are driven by what appears in financial reports, rather than the underlying economics. Another insurer thought that IFRS 17 may affect takeover prices in the short term, as acquiring firms have to think about the administrative costs with bringing the target firm's reporting systems into line with the new standard, but did not foresee it having a major bearing on firms' acquisition policies.

⁴³ LE Europe and VVA Consulting (2018). *Assistance to EFRAG for impact analysis of IFRS 17 Insurance Contracts*. [Link](#).

4 Insurance products and pricing

In this Chapter, we discuss the potential impacts of the adoption of IFRS 17 on insurance product mix and pricing. We start by setting out recent pricing trends in the sector and the factors underling those, before discussing whether IFRS 17 is likely to have a material effect. We conclude that it is unlikely to have a major effect on product mix and pricing across the whole insurance sector, although some insurers may change behaviour and it is possible that the effects consequently may be more marked in some niche markets where only a handful of insurers operate to begin with.

4.1 Recent Trends

4.1.1 Life insurance

As set out in Chapter 2, life insurance accounts for the largest share of insurance premiums paid by consumers. In 2018, 77 per cent of insurance premiums (by value) were spent on life insurance. This is also the sector that arguably has faced the most significant changes in the past decade.

EFRAG describes the three main channels through which the insurance market across the European Union (including, at the time, the UK) has seen the product mix vary in the past. The identified channels are:⁴⁴

- Life insurers operate in a framework characterised by **low interest rates**. “Traditional” life products, which often offer guaranteed returns, have lost their attractiveness to consumers, who now tend to prefer obtaining less guarantees, with products that imply a shift in the individual bearing the interest risk and the market risk, and a reduction in profit sharing. One such example is unit-linked products, whose relevance is expected to continue growing in the next years. In the UK, life insurers increasingly face competition not just from other life insurers but also from other financial service providers offering asset management types of products.
- **Demographic changes**, with an increase in average life expectancy. This has generated an increasing interest for products connected with health insurance and retirement solutions.
- **Regulatory changes**, such as the reduction in tax advantages that used to characterise insurance products and the switch towards Solvency II, have affected the mix of insurance products available. In particular, the introduction of Solvency II was thought to have materially affected the products offered by the industry. Products which are less capital intensive, more fee driven and with less guarantees became more relevant and, as a result, policyholders and third-party asset managers are now bearing more of the risks.

In the UK, two important regulatory changes that the life insurance sector has undergone are associated with automatic enrolment and the Pension Freedom reforms.

Automatic enrolment has caused a significant increase in the number of savers in the pension system, with over ten million new savers. Since the end of February 2018, all UK employers have had to set up a pension scheme and automatically enrol all eligible employees (for larger employers, the obligations took effect earlier). Contribution rates have also grown, and are now at 8 per cent although concerns remain that many employees are not saving enough to meet their expectations about pension income.⁴⁵ The trend away from

⁴⁴ EFRAG Board meeting 3 September 2018. *IFRS 17 Insurance Contracts Potential impact on the insurance market*. [Link](#).

⁴⁵ Ernst & Young (EY). *2020 UK Insurance Outlook*. [Link](#).

defined-benefit schemes has continued. The Pensions Regulator reports just 13 per cent of defined-benefit schemes still open to new members (and just 10 per cent of private-sector schemes).⁴⁶

The 2015 Pension Freedoms allowed people over-55 access to defined contribution pension pots, and ended the tax restrictions that resulted in most people with defined-contribution pensions retiring each year having to buy annuities that turned their pension pot into a secure income for life. This has resulted in consumers moving away from traditional guaranteed income products and preferring instead more flexible products with drawdown options. There have also been a number of consumers who transferred from a defined-benefits pension to a defined-contribution scheme, possibly motivated by a desire to take advantage of the extra freedoms available to defined contribution pension holders. Customers purchasing an annuity are now more likely to purchase it from a different provider to the insurer that they saved with. For insurers, these trends have resulted in a change in the mix of bulk and individual annuities that they sell. The latter have become less important, as individuals are no longer effectively compelled to buy a retail annuity. Defined benefit pension schemes are converting into bulk annuities over time, although this is a gradual process.

The nature of the life insurance product, with people paying premiums during their working lives with a view to collecting pensions in retirement means that the effects of some changes only feed through with a very long lag. For example, when companies cease to offer defined benefit pensions schemes to new members, existing members will still be paying premia (if still working) and receiving pensions (if retired) under that type of scheme.

4.1.2 Non-life insurance

In the non-life sector, the main retail products continue to be home and motor insurance. In 2018 there were 27.5 million motor insurance policies and 18.2 million household insurance policies (contents, buildings or combined) sold.⁴⁷

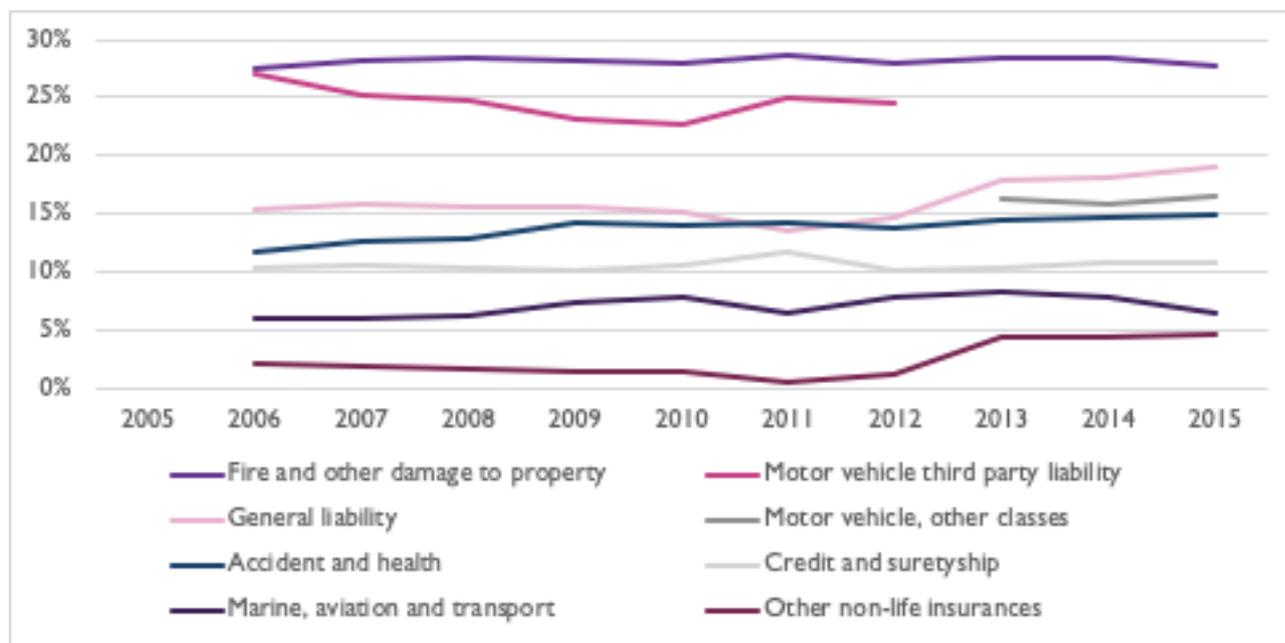
For the decade up to 2015, EIOPA data on direct business shows that the category *Fire and other damage to property* accounted for just under 30 per cent of general insurance premiums throughout, with very little variation in this share over time.⁴⁸ Motor insurance was the second most important category of general insurance sold directly, at least up to 2012. The category *Motor vehicle with third party liability* accounted for between 23 and 27 per cent of total premia. This series was discontinued in 2013, and instead only data for *Motor vehicle, other classes*, are available, which had a share almost constant at 16 per cent. *General liability* is the last category with a share over 15 per cent; it accounted for 19 per cent of premiums (direct business only) in 2015.

⁴⁶ Pension Regulator, *The DB Landscape. Defined Benefit Pensions 2019* [Link](#)

⁴⁷ FCA (2020) *Sector Views* [Link](#)

⁴⁸ The series relies on data reported under the Solvency I regime, so more up-to-date figures are not available.

Figure 4.1: Breakdown of the UK non-life insurance products by market share of premiums (direct business only)



Source: EIOPA, Europe Economics calculations.⁴⁹

Note: Insurance undertakings subject to Solvency I reporting requirements. Data referring to non-life insurance gross direct premiums for 2005 are not available, thus the year is omitted from the representation.

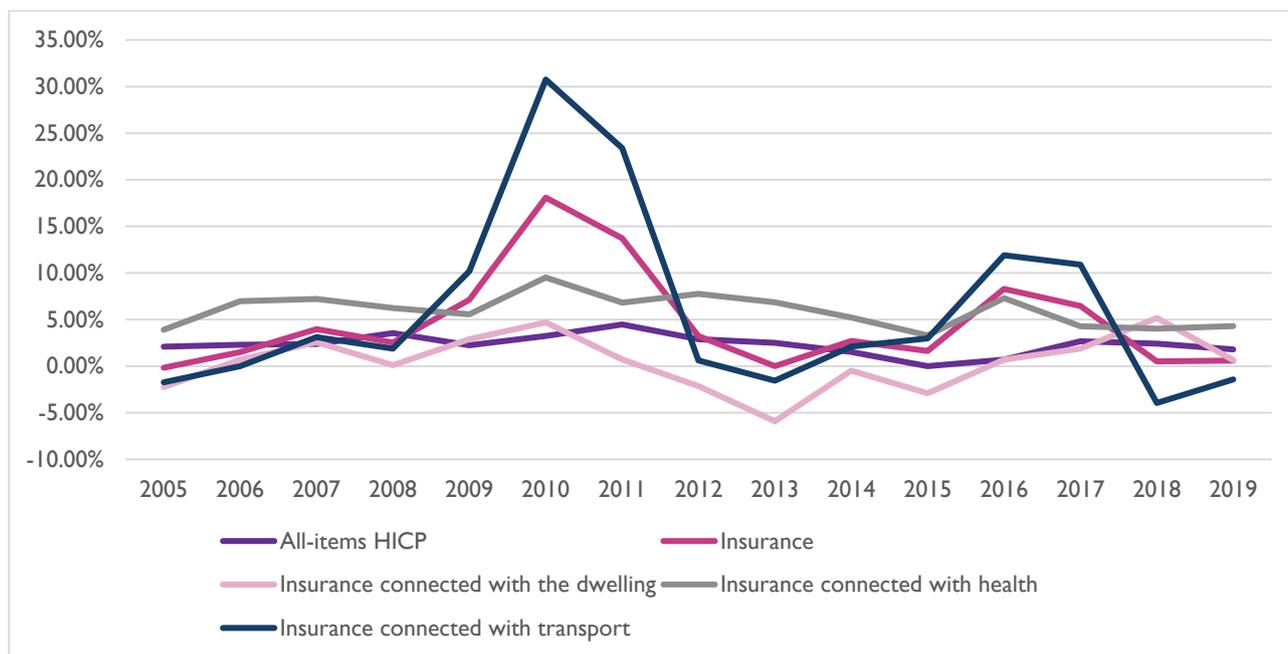
ONS data suggests that insurance prices have increased faster than the general price index since 2015. While the CPIH index in July 2020 was 109.2 (the 2015 index was equal to 100), the insurance sub-index was 121.⁵⁰ This insurance index is further broken down into house contents insurance, health insurance and transport insurance. House contents insurance prices have risen marginally below inflation, with this index standing at 108.4 in July 2020. In contrast, the transport index is 119 and the health insurance 129.4.

Figure 4.2 shows the average annual growth in three-year periods from 2005 to 2019. Insurance prices overall saw a great expansion during the years of the financial crisis, with an average annual growth of 9.3 per cent between 2008 and 2010, figures that for the preceding three years had reached a much lower value of 1.8 per cent. After the crisis, insurance prices in the UK still rose, but at a decelerating speed. Between 2017 and 2019, the average annual growth in insurance prices was 2.5 per cent.

The 2018 Civil Liability Act introduced reforms that were expected to result in savings from lower costs associated with claims. The process for small claims should be simpler, reducing the need for claimants to rely on Claims Management Companies and solicitors. The Act also required a review of the Ogden Discount Rate, which is used to calculate the appropriate lump-sum compensation for people who have suffered life-changing injuries given all predicted future expenses (including loss of income). In August 2019, the discount rate changed from -0.75 per cent to -0.25 per cent. A further review of the rate is due within a five-year period.

⁴⁹ European Insurance and Occupational Pensions Authority (EIOPA) insurance statistics Solvency I Table 3. [Link](#).

⁵⁰ Office for National Statistics (ONS) (August 2020). Consumer Price Inflation Detailed Reference Tables, Table 3. [Link](#).

Figure 4.2: Average annual growth rate of consumer insurance prices in the UK between 2005 and 2019

Source: Eurostat, Europe Economics calculations.⁵¹

For the entire period, general inflation has grown at almost constant rates ranging between 0 and 4.5 per cent increases, while *Insurance* has seen in general much greater year-on-year price variations. In particular, increases in house insurance prices have tended to rise more slowly than motor insurance. In 2010, motor insurance rose at an annual rate of 30.8 per cent, whereas prices for *Insurance connected with dwelling*, instead, remained almost constant in the pre-crisis period and then grew annually by 2.6 per cent on average between 2008 and 2010, with a peak in the last year, when the annual growth rate amounts to 4.7 per cent. Right after the financial crisis, this category sees a reduction in prices which, after three years of decrease rate reaching almost -6 per cent in 2013, slows its fall in the following period, to finally start growing again at an annual average rate analogous to the one during the crisis.

The increased importance of online sales, with the associated rise in aggregators who allow consumers to compare products, is often seen as a source of downward pressure on prices and profits. The FCA reports 75 per cent of new motor insurance and 67 per cent of new home insurance policies bought online in 2018.⁵² With new technologies making it harder for insurers to earn a mark-up from active consumers, regulatory measures may limit the scope to profit from more passive consumers. Recent regulatory initiatives looking at pricing models used by insurers have raised concerns about the existence of so-called “loyalty premiums” paid by consumers that do not switch providers. This regulatory interest may require insurers to change away from pricing models that offer discounts to attract new customers.

In addition, provided the great technological advancements that have taken place across the economy in the recent years, the demand for products insuring against cyber-related risks, such as cyber-attacks and information leakage, has significantly increased. A recent survey, conducted by the Department for Digital, Culture, Media and Sport in 2019, finds that 11 per cent of the businesses interviewed and 6 per cent of the charities state that they have a specific cyber security insurance policy.⁵³ This prevalence is more significant among medium businesses (31%, up from 19% in 2018) and large businesses (35%, up from 24% in 2018), as

⁵¹ Eurostat, HICP (2015 = 100) - annual data (average index and rate of change). [Link](#).

⁵² FCA (2020). *Sector Views*. [Link](#).

⁵³ Department for Digital, Culture, Media and Sport (2019). *Cyber Security Breaches Survey 2019*. [Link](#).

well as the largest charities (45% of those with incomes equal or higher than £5 million). This suggests that the cyber insurance market has indeed expanded in the last 12 months.

4.2 Potential impacts of IFRS 17 on product mix and pricing

There are numerous opinions offered on the potential impact of IFRS 17 on the industry product design and pricing. A plethora of, at times contrasting, views on the topic have been published. For example, in its overview of the lessons learnt on the application of IFRS 17, PwC argues that while the extent of the impact of the new accounting regime depends heavily on the entity considered, some areas are most likely to face disruptive changes for insurance, including product strategy.⁵⁴ Deloitte, KPMG and ifb Group find that the introduction of IFRS 17 will prompt major variations in the entire performance management process of insurers. Key performance indicators to evaluate the insurers' performance management will inevitably need to be modified, as the set of key metrics currently used for assessing performances in terms of volumes and revenues will have to be adjusted.⁵⁵

A recent study conducted by Milliman assesses the potential impacts of this new financial reporting regime on the industry's product availability and pricing.⁵⁶ Although the analysis specifically focuses on European countries adopting Solvency II, the authors are confident that similar concepts are likely to apply to other non-European insurance markets. The report argues that the actual impacts of IFRS 17 on the insurance product pricing and design will be less significant than one would initially envisage.

The implications for performance assessment, and the extent to which these affect the incentives and behaviour of senior managers are arguably the key when assessing the likely impact of IFRS 17. As commented on earlier in this report, IFRS 17 does not alter the underlying business: there is a marginal increase in administrative costs associated with transitioning to the new standard, but these will have negligible implications for the costs of individual policies. But while the underlying economics are unchanged, the way that profits are reported annually will change. It is possible that this will prompt some changes in insurers' product mix and pricing, either because they think this is necessary to secure investor confidence and a low cost of capital, reduce tax liabilities and increase the scope for dividend payments (see later chapters) or because the financial incentives of individual senior managers depend on reported profits.

The insurers we spoke with did not envisage major changes in pricing and product mix because of IFRS 17. One suggested that the general perception is that the main effect would be on annuities. Indeed, bulk purchase annuities have increased in importance, prompted by the pension freedoms. These transactions involve an insurer receiving a fixed amount from a pension scheme up front in order to fully secure all the members' future pensions and benefits. The insurer becomes therefore responsible for meeting those liabilities, along with bearing all risks associated with the benefits, and deals directly with the scheme members, who then become policyholders. IFRS 17 will not only allow, but also require, insurers to spread profits over the annuity contract coverage period, whereas under current accounting around 80 per cent the profit is typically reported upfront. The insurer therefore thought insurers would welcome this change in reporting profits around annuities, as it would allow to defer the payment of the taxes due on the incomes generated by this kind of contracts instead of representing an initial and immediate cost.

⁵⁴ PwC (2017). *IFRS 17 Insurance contracts – Lessons learned to date*. [Link](#).

⁵⁵ Deloitte, KPMG and ifb Group (2017). *IFRS 17 is an opportunity to rethink and revolutionise accounting and steering in the insurance industry*. [Link](#).

⁵⁶ Milliman (2020). *Impact of IFRS 17 on insurance product pricing and design*. [Link](#).

5 Competition in capital markets

The UK is one of the most active capital markets, attracting investors from all over the world, including insurers with headquarters in countries where IFRS 17 may not be mandated. This section seeks to identify the scale of funding that non-UK insurers currently raise in the UK capital markets. We look at both equity and debt markets, focussing on the primary market for both capital sources and drawing data from Thomson Reuters database.

All of the insurers we spoke with were keen that their investor base should not change as a result of IFRS 17. There were no major concerns raised about the possibility that their geographic spread of investors will be significantly curtailed. When grouping investors, it was more common to distinguish between institutional investors focused on the insurance sector and general investors than by geographic location.

5.1 Debt market

We included several type of debt instruments dividing them into two groups – bonds and loans – given the secondary market for the two is different, with loans tending to be less tradeable. Our sample of bonds includes 456 instruments of different natures, such as commercial papers, notes, certificate of deposits and bonds, while for loans we identified 42 instruments negotiated on the UK markets. Based on this data, UK-based insurers were the most active insurers in the UK debt market, issuing more than 80 per cent of the total bonds between 2010 and the first half of 2020 and raising to over 70 per cent of the total loans during the same period.

5.1.1 Bonds

Data on the debt markets shows that, overall, the competition faced by UK insurers on the bond market is limited.

We considered the country of domicile of all the insurance companies that have issued debt during the last 10 years. Table 5.1 presents the total debt raised by insurance companies in the UK, grouped according to country of domicile. Thomson Reuters categorise any bond issued in a European market as issued in the Eurobond market. To retrieve the amount issued on the UK market, we cross checked this information with the country of issue and the currency.⁵⁷

Table 5.1: Bond issued in the UK debt market

Country/Region of domicile	Total debt raised 2010-2020 H1 (£m)
United Kingdom	23,514
EEA	3,887
United States	660
Rest of the World	327

Source: Thomson Reuters, Europe Economics calculations.

⁵⁷ We are aware that a firm could raise debt in a foreign currency. Nevertheless, we used this data as a further check to refine our estimates.

Overall, between 2010 and the first half of 2020 insurance companies raised a total of £28,388 million on the UK debt market. The UK insurers account for more than £23,500 million and non-UK insurers with registered headquarters in the EEA raised almost £3,900 million of bonds. US insurers raised around £660 million. Among the non-UK insurers, the EEA firms are the most active in the UK market, representing the main source of competition for the UK insurers in the UK debt market.

In Table 5.2 we present a further breakdown of the bond market, providing some details of how it evolved during the past decade. We present the values for each couple of years between 2010 and 2019.⁵⁸ Throughout the period, UK insurers have been the most active bond issuers, accounting for more than 60 per cent of bond issues in all the 24-month periods we look at. European insurers have raised bond capital in the UK market throughout the past decade. Issues from insurance companies headquartered elsewhere in the world have been less frequent.

Table 5.2: Bond issued by insurers in the UK debt market, evolution through time (£m)

Country/ Region of domicile	2010-2011	2012-2013	2014-2015	2016-2017	2018-2019	2020 H1
United Kingdom	£ 5,737	£ 7,618	£ 4,201	£ 2,949	£ 1,950	£ 1,060
EEA	£ 300	£ 75	£ 2,083	£ 423	£ 803	£ 203
United States	£ -	£ 660	£ -	£ -	£ -	£ -
Rest of the World	£ -	£ -	£ -	£ 327	£ -	£ -

Source: Thomson Reuters, Europe Economics calculations

5.1.2 Loans

In Table 5.3 we present the total reported amount of debts raised through loans. Between 2010 and the first half of 2020 a total of £12,121 million was raised in the UK loan market. This includes nine deals by Bermuda-based companies. We have included companies with headquarters in Bermuda in our totals for the UK, given that it is considered a British overseas territory. On that basis, we identified only one loan raised by a non-UK insurer with headquarters outside the EEA and the US, from an Australian insurer.

Table 5.3: Loans issued in the UK debt market

Country/ Region of domicile	Total debt raised 2010-2020(H1)
United Kingdom	£ 8,760
EEA	£ 916
United States	£ 695
Rest of the World	£ 1,750

Source: Thomson Reuters, Europe Economics calculations

Looking at the breakdown in Table 5.4, we can see how the loan deals were mainly concentrated in the period 2014-2019, with the UK insurers being the only group active throughout the entire period. US and EEA insurers have been active only in a total of 6 deals, in 2016 (for the US insurers) and 2019 (for the EEA insurers).

⁵⁸ The rationale behind our way to present data is that using a more granular method (i.e. yearly) there would have been several blank cells, reducing the clarity of the table.

Table 5.4: Loans issued in the UK debt market, composition through time

Country/ Region of domicile	2010-2011	2012-2013	2014-2015	2016-2017	2018-2019	2020 H1
United Kingdom	£ -	£ -	£ 770	£ 3,278	£ 4,240	£ 472
EEA	£ -	£ -	£ -	£ -	£ 916	£ -
United States	£ -	£ -	£ -	£ 695	£ -	£ -
Rest of the World	£ -	£ -	£ -	£ -	£ 1,750	£ -

Source: Thomson Reuters, Europe Economics calculations.

5.2 Equity market

Primary market

For the equity market, we have focussed on primary issues that had London as the market of exchange and then filtered for the insurance sector, using Thomson Reuter’s categorisation. We included IPOs of several types of equity instruments such as common and ordinary shares, convertible bonds and notes and convertible loans. We identified 17 such issues in the period 2010-2020H1.

UK insurers accounted for all but one of these 17 issues. The one non-UK issue was by a US company and that raised less than 1 per cent of the total capital raised by these 17 IPOs. EEA-based insurers do not appear to have raised any equity capital in the UK market during the last 10 years, although that does not mean that UK investors have not invested in new equity that such insurers may have issued (and vice versa). EEA companies (but not insurers) raised almost £7 billion in the UK equity market over this same period,

Overall, the IPOs in the insurance industry during the last decade raised £5,062 million in the UK equity market, £5,053 million solely from companies headquartered in the UK. Only £9 million were raised by US insurers. In Table 5.5 we present the results.

Table 5.5: Equity raised in the UK equity market

Country/ Region of domicile	Total equity raised 2010-2020(H1) (£m)
United Kingdom	5,053
EEA	-
United States	9

Source: Thomson Reuters, Europe Economics calculations.

Going into the details of these transactions, we can see from Table 5.6 how UK insurers are the only group of insurers active in almost every period, taking part in 16 deals out of 17. US insurers were active only in one deal in 2014. The totals include a couple of deals from insurers domiciled in Bermuda and Guernsey, which we have included in the UK totals. In Table 5.6 presents the detailed breakdown.

Table 5.6 Equity raised in the UK equity market, composition through time

Country/ domicile	Region	of	2010-2011	2012-2013	2014-2015	2016-2017	2018-2019	2020
United Kingdom			£ 147.23	£ 3,098.47	£ 1,540.67	£ 30.89	£ 235.45	£ -
EEA			£ -	£ -	£ -	£ -	£ -	£ -
United States			£ -	£ -	£ 9.11	£ -	£ -	£ -

Source: Thomson Reuters, Europe Economics calculations.

Secondary market

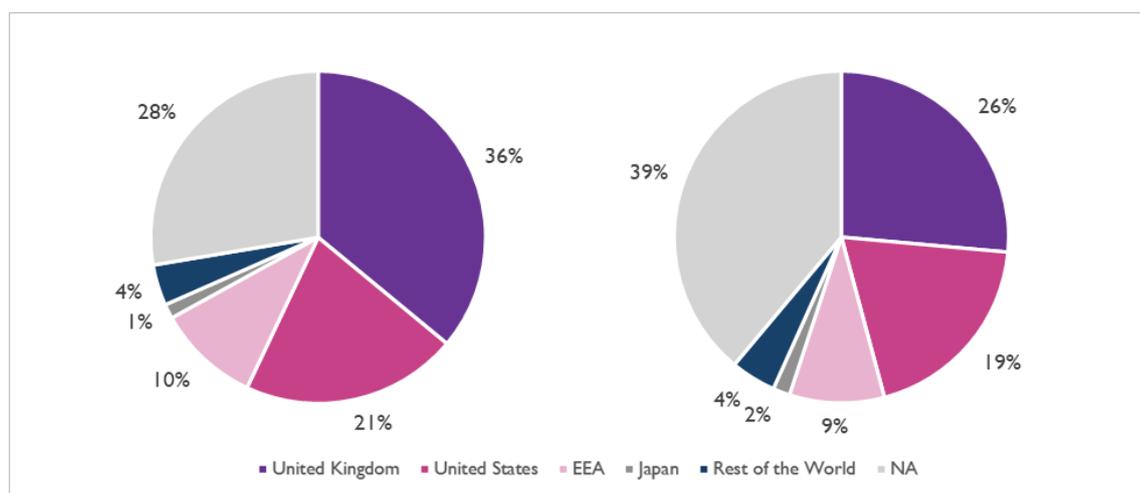
We looked also at the ownership structure of the insurers listed in the London Stock Exchange and to the country of residence of the shareholders investigating to what extent the shares of the UK-based insurers are held by non-UK investors. The ownership data collected through Thomson Reuters only provide information on the main shareholders of the companies. There is a sizeable portion of shares held by shareholders for which nationality is unknown.

For those shareholders where nationality is known, UK-based investors are the largest investor group, followed by US investors. From our analysis investors from the US holding around 20 per cent of the total outstanding shares, while UK-based shareholders have around 36 per cent of them.⁵⁹ US investors seem to hold shares in the more valuable companies (i.e. with the largest capitalisation in the market), so looking at the total capitalisation of the UK-based insurers we calculate US shareholders hold around 19 per cent of the total, while the UK investors hold 26 per cent of it. This suggests that the US investors' reaction to the introduction of IFRS 17 could be important for the share prices of UK insurers.

Investors from European countries (the EEA and Switzerland) hold a smaller number of shares compared to the US investors. Indeed, investors based in the EEA and Switzerland hold 10 per cent of the total shares of the UK insurers which worth around 9 per cent of the total capitalisation of the market.

In the chart below we present the shareholders of the listed UK-based insurance companies, grouped by country of origin.

Figure 5.1: Shareholders by country of origin, by number of shares and by capital



Source: Thomson Reuters Eikon, Europe Economics calculations.

⁵⁹ Figures calculated as the percentage of the total number of insurance companies' shares listed in the UK equity market.

6 Cost of capital in the insurance market

A benefit often cited to justify reporting standards, such as IFRS 17, is that it will lead to a lower cost of capital as greater transparency will remove some investor uncertainty. In this section, we sketch out rough estimates for the cost of capital in the sector and what has been driving changes in recent years. We also consider the potential impact of changes in investor perception driven by IFRS 17. The insurers we spoke to did not expect the change to have the intended effect of reducing the cost of capital in this sector, at least in the short run.

6.1 Weighted Average Cost of Capital for Insurers Listed in the UK

The weighted average cost of capital (WACC) is the cost faced by the company of compensating providers of capital. In this chapter we analyse the cost of capital of a theoretical insurance company listed in the UK market, using an approach similar to the approach we recommend when advising regulators on what the WACC is for companies they regulate. Much of our work looks at trends in the cost of capital up until end 2019, although at the end we do briefly comment on the emerging data for the first half of 2020 (which suggests that the cost of capital has fallen for insurers as a result of COVID-19).

We have sought to estimate WACCs for a ‘typical’ insurer. We used data for the 18 insurance companies, set out in the table below, listed on the London Stock Exchange. We collected the financial data for the 18 companies and estimated the WACC (nominal, pre-tax) for the period 2012-2019.

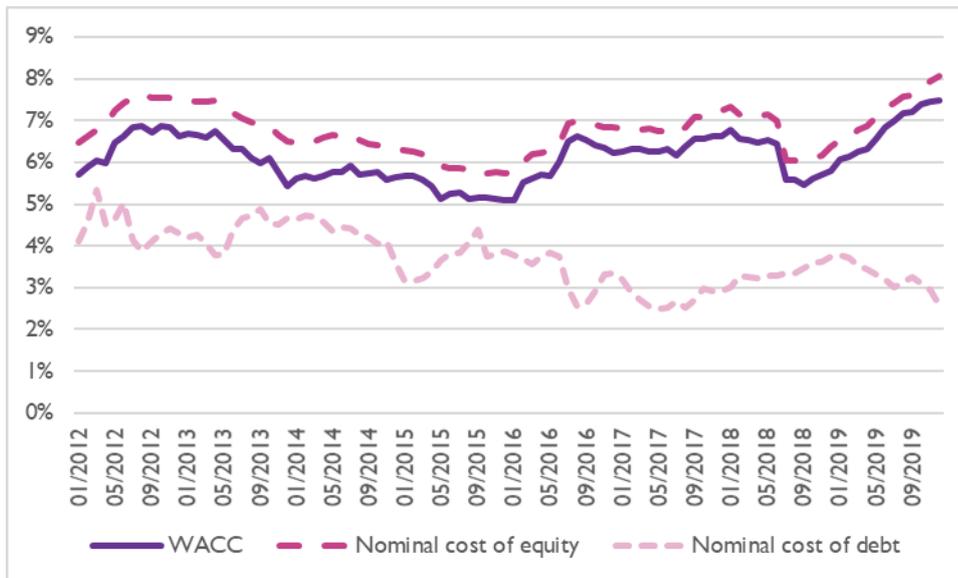
Table 6.1: Listed UK insurers

Aviva PLC	Chesnara PLC	Phoenix Group Holdings PLC
Prudential PLC	Admiral Group PLC	Sabre Insurance Group PLC
RSA Insurance Group PLC	Lancashire Holdings Ltd	Just Group PLC
Hiscox Ltd	Hansard Global PLC	Saga PLC
Personal Group Holdings PLC	Helios Underwriting PLC	Hastings Group Holdings PLC
Beazley PLC	Randall & Quilter Investment Holdings Ltd	Direct Line Insurance Group PLC

Source: Thomson Reuters Eikon.

As we can see from Figure 6.1, the cost of capital varied through the period, and ended in December 2019 at a considerably higher level compared to January 2012, with estimated values of 7.5 and 5.7 per cent, respectively. As we can see from the values of the nominal cost of debt and nominal cost of equity, the latter has been the major driver of the cost of capital for the UK insurance companies. The rate of return required by investors has been fluctuating between 5.7 and 7.6 per cent for most of the period, with a steep increase to more than 8 per cent over the last year. On the other hand, the nominal cost of debt has displayed a different pattern, with a slow but steady decrease over the 8-years period, reducing from 5.3 per cent (as of March 2012) to about 2.6 (as of December 2019).

Figure 6.1: WACC for a theoretical insurance company in the UK



Source: Thomson Reuters Eikon, Europe Economics calculations.

The WACC for insurers is closely aligned with the cost of equity. We estimate that the equity risk premium, an important component in the cost of equity calculations, rose towards the end of our sample period. Furthermore, the gearing ratio for insurers fell during the period, increasing the importance of the cost of equity in determining the WACC for insurers. Insurers’ enterprise value has increased more than proportionally compared to the net debt figures.

We briefly discuss in turn the various key components in the WACC calculations. Two of the important components, the risk-free rate and the market equity risk premium, are not specific to the insurance industry, although how changes in these variables affect insurers’ WACC will depend on the industry beta (the extent to which the industry’s returns correlate with the wider market) and gearing.

6.1.1 Cost of equity

Risk-free rate

The risk-free rate is the return that investors would expect to earn from investments that do not bear any risks. To best approximate this type of investment, we used the UK Government bonds with 10 years maturity. Figure 6.2 presents the 10-year nominal gilt yields for the period 2012 and 2019.

Figure 6.2: 10-year nominal gilt yields (%)



Source: Thomson Reuters Eikon, Europe Economics calculations.

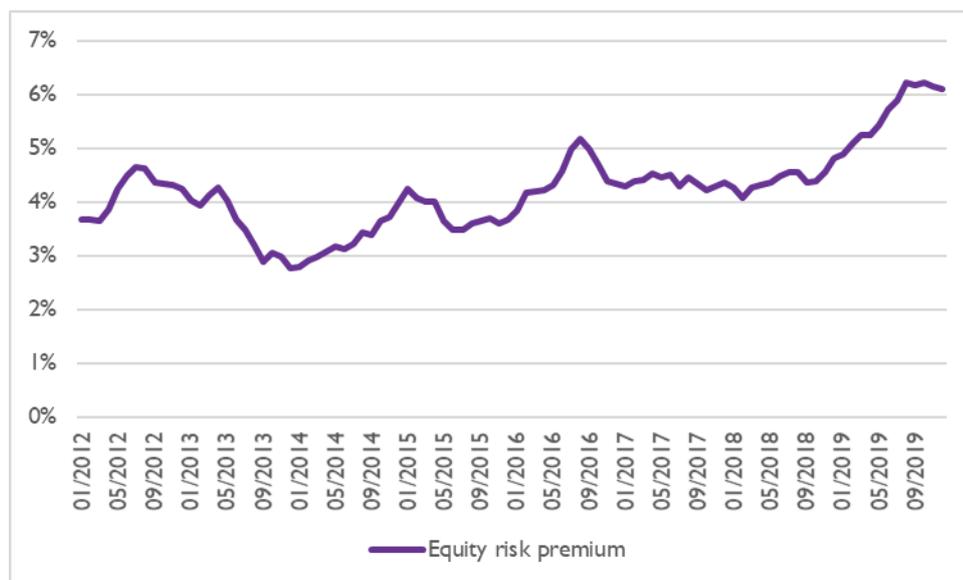
We can see that yields have decreased considerably since 2013, after a step increase from around 1.5 per cent to almost 3 per cent between May 2012 and September 2013. During the second half of the period, and especially between 2017 and the first half of the 2019, the yields have been stable between 1 and 1.5 per cent, followed by a steep decrease during the second half of the 2019.

Equity Risk Premium

The equity risk premium (ERP) is the premium that investors would expect from investing on the equity market rather than holding a risk-free asset. We first estimate the total market return, the return that investors would receive from investing in a weighted portfolio composed of equities from all companies (for simplicity, our model is based solely on companies listed on the FTSE All Shares). We use a dividend discount model, where the expected growth rate is based on forecasts of UK GDP growth. We then decompose this Total Market Return (TMR) into its components: the risk-free rate (derived above) and the equity-risk premium (the variable of interest here).

The evolution of equity-risk premium between 2012 and 2019 is illustrated in the chart below. We can see how, after several years of stable values ranging between 3 and 5 per cent, the ERP increased noticeably during the second half of the 2019, stabilizing around 6 per cent during the last months of the year. The values are broadly in line with those estimated by Dimson Marsh and Staunton (DMS), a commonly cited reference for the ERP. DMS estimate annual equity-risk premia that increased from 4.1 per cent in 2012 to around 4.5 in 2019. Part of the difference with our estimates is due to the fact that they report the geometric average whereas we estimate an arithmetic average which returns slightly higher figures.

Figure 6.3: Equity risk premium

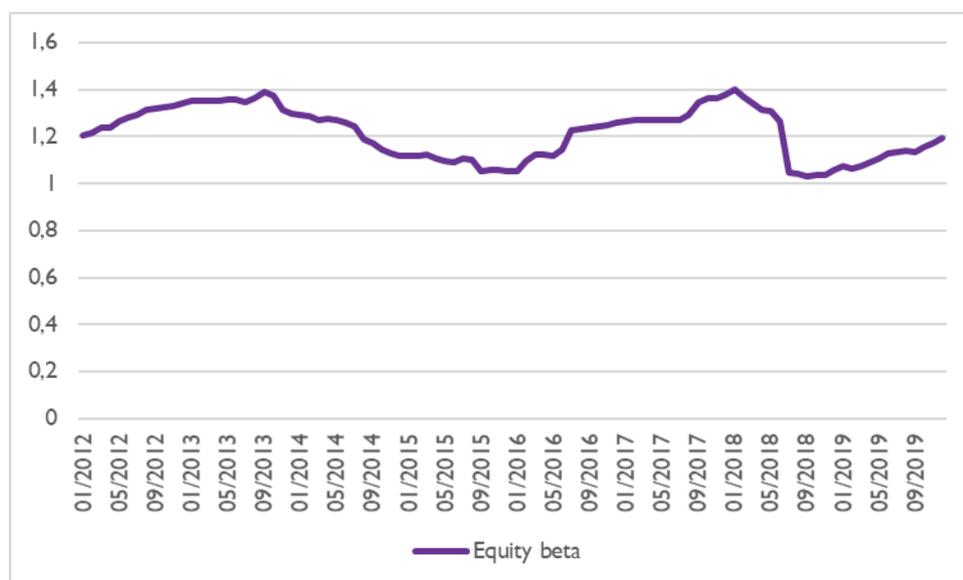


Source: Thomson Reuters Eikon, Europe Economics TMR model.

Industry equity beta

We estimate that the industry equity beta fluctuated between 1 and 1.4 during the sample period. The insurance industry is not a good hedge against general fluctuations in market risk. In the last 18 months of our sample, the equity beta rose from around 1 to end 2019 at around 1.2. Our estimate for the insurance equity beta is based on the OLS method, using a 2-year trailing window for the analysis.

Figure 6.4: 2-year equity beta

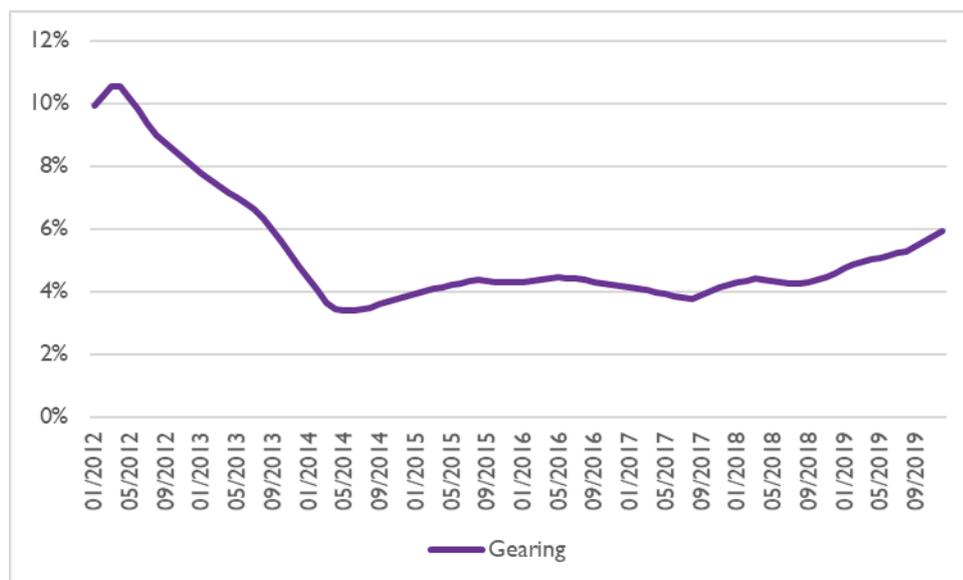


Source: Thomson Reuters Eikon, Europe Economics calculations.

6.1.2 Industry gearing

The industry gearing fell markedly in the early years of our sample period, but has risen slightly in the last couple of years. The share of insurers' capital in the form of debt was higher in 2012 than in 2019. To estimate gearing, we used a weighted average of the net debt to enterprise value for all 18 insurers in our sample. Figure 6.5 presents our estimated values of the industry gearing between 2012 and 2019.

Figure 6.5: Gearing



Source: Thomson Reuters Eikon, Europe Economics calculations.

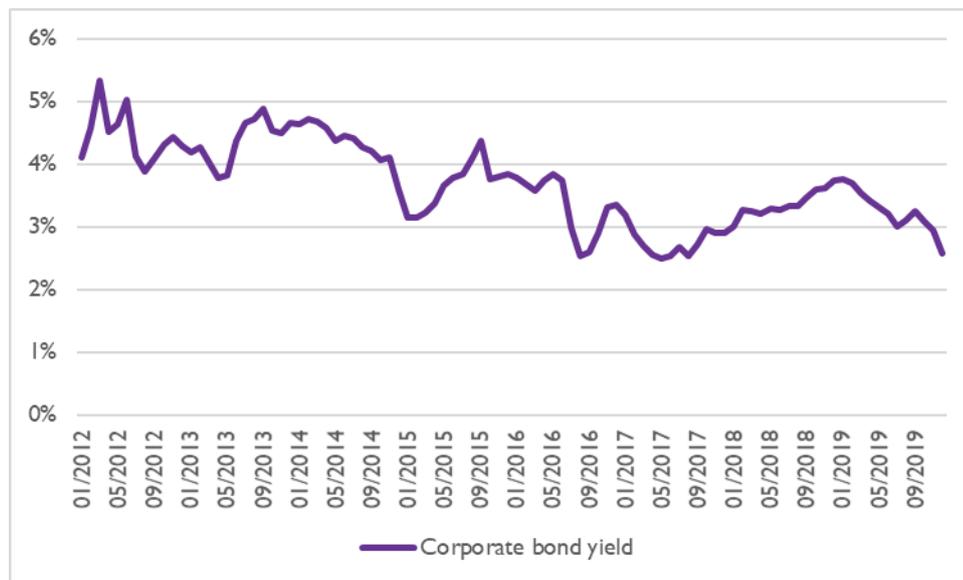
We can see how the gearing reduced quite considerably between 2012 and 2014, dropping from above 10 per cent to less than 4 per cent, staying around this level between 2014 and 2018. It then displays an increase during the last year, reaching a value of 6 per cent in December 2019.

6.1.3 Cost of Debt

To determine the cost of debt we used the index provided by Thomson Reuters database. This index is based on the yields of corporate bonds with 10-year maturity, a rating of BBB⁶⁰ and issued by companies active in the financial sector. The choice of a BBB rating is conservative, leading to a higher estimated cost of capital than if we had used the indices based on that Thomson Reuters provides. Our choice seems in line with the ratings many UK insurers' bonds have. Figure 6.6 presents the monthly average of this index for the period 2012-2019.

⁶⁰ A rating of BBB is generally considered to be the lower threshold of a medium credit quality, ratings below this threshold (e.g. BB, B, CCC) are deemed to describe low credit quality.

Figure 6.6: 10-year corporate bond yields



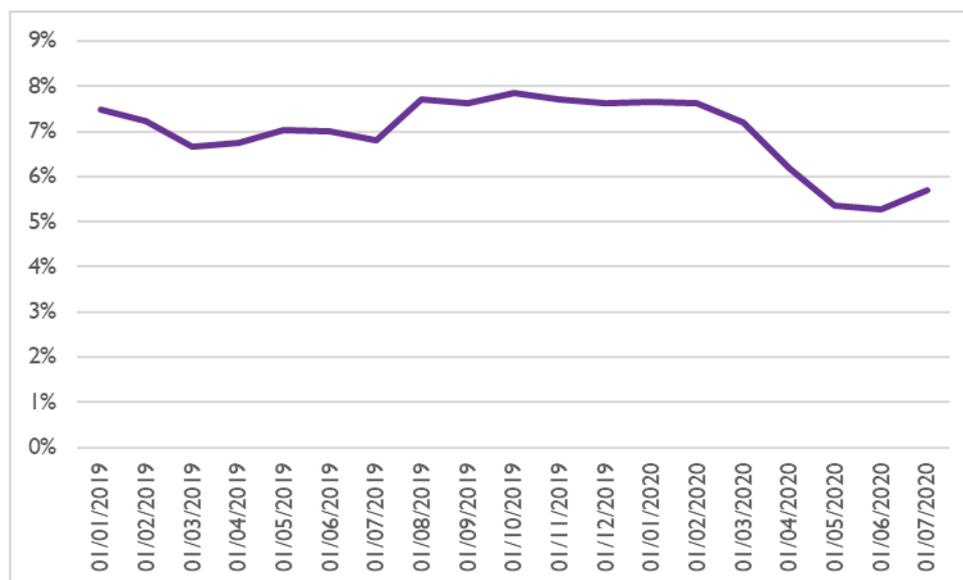
Source: Thomson Reuters Eikon, Europe Economics calculations.

We can see that the index, although volatile during the entire period, has a downward trend starting from around 5 per cent and ending in December 2019 at around 2.5 per cent. It means that the financial companies have been able to source debt capital at lower rates, following the same decrease displayed by the government bonds used for the risk free rate approximation (see Section 6.1.1).

6.1.4 WACC in 2020

Our estimates suggest that the insurance industry WACC has fallen in the first half of 2020. The fall aligns with the onset of the COVID-19 crisis. At the end of July, the WACC was 5.7. It opened the year at 7.6 and was as low as 5.3 per cent at the end of June.

Table 6.7: WACC for insurers 01-2019 to 07-2020



Source: Thomson Reuters Eikon, Europe Economics calculations.

6.2 Comparison with other industries

To gain a complete overview of the cost of capital for the insurance sector, we carried out a comparative analysis with other industries. The sectors included in the analysis were all identified as being correlated with the insurance sector in the study conducted for EFRAG.⁶¹ These sectors were defined on the basis of the correlation between the WACC of each sector and the WACC of the insurance sector. Our focus was recent movements in the cost of capital, since that study was done. The sectors were:

- Banks,
- Industrial goods and services,
- Media,
- Technology,
- Telecommunications,
- Travel and leisure, and
- Financial services.

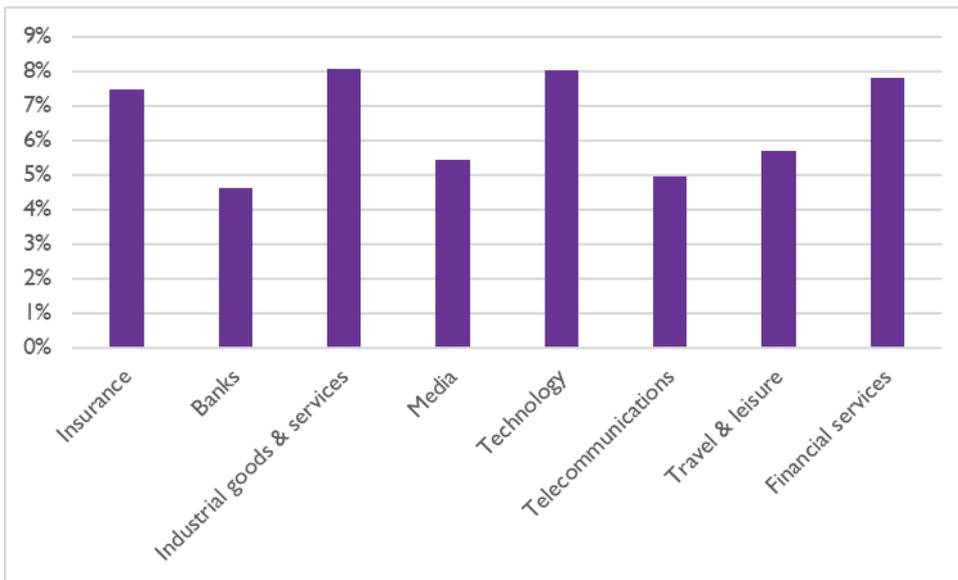
As reported in the EFRAG study, in July 2017 the UK insurance sector displayed a higher than average WACC compared to most of the other industries, reaching levels that are similar to the cost of capital for the industrial good, telecommunications, and media sectors.⁶² As we will see in what follows, by the end of 2019 the WACC from these sectors changed, but the insurers' WACC remained among the highest levels of the group.

We sourced all the relevant companies from the FTSE All share index, using the business code provided by Thomson Reuters to determine their relevant sector. We then collected the WACC and the company capitalisation for each company for 2019, determining the sector's cost of capital through an average among the companies, weighted for the market capitalisation. Figure 6.7 presents the WACC for the insurance sector and the correlated sectors. We can see that the WACC for the insurance sector is in line with the WACC for the *Industrial goods & services*, *Technology* and *Financial services*, which are at 8.1, 8 and 7.8 per cent, respectively. On the other hand, the other sectors here considered display a considerable gap with the insurance sector. *Banks*, *Media*, *Telecommunications* and *Travel & leisure* have a cost of capital of 4.6, 5.4, 4.9 and 5.7 per cent, respectively.

⁶¹ LE Europe & VVA (2018). Assistance to EFRAG for impact analysis of IFRS 17 Insurance Contracts. [Link](#).

⁶² As can be seen on chart at page 71 of LE Europe & VVA (2018). Assistance to EFRAG for impact analysis of IFRS 17 Insurance Contracts.

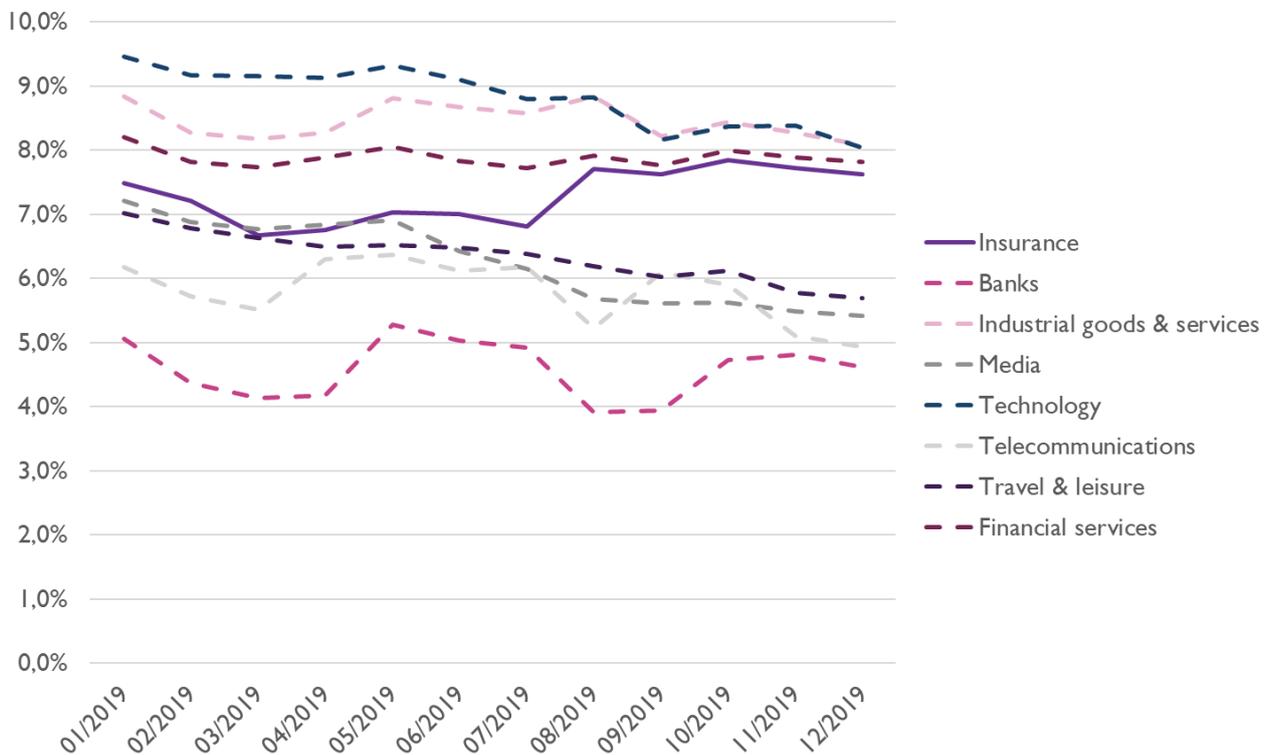
Figure 6.7: December 2019 WACC for insurance and correlated sectors



Source: Thomson Reuters Eikon, Europe Economics calculations.

Looking at the evolution during 2019, we can see how insurance was the only sector with a higher cost of capital at year end than at the start of the year. The correlations with other industries are not perfect. Indeed, the study for EFRAG found that the insurance sector’s cost of capital had declined steeply since mid-2016 while it was increasing around July 2017 for financial service and the telecommunications sectors. The relatively low gearing in the insurance sector means that shifts in the cost of equity have a more noticeable impact on this sector’s WACC than on other industries (notwithstanding the Modigliani-Miller theorem).

Figure 6.8: WACC for insurance and correlated sectors: January to December 2019 evolution



Source: Thomson Reuters Eikon, Europe Economics calculations.

6.3 Potential impacts of IFRS 17

Uncertainty is the main feeling we got from insurers about the effects of the new reporting standards on insurers' cost of capital. Insurers suggested that the potential impacts of IFRS 17 on the cost of capital for insurers could differ depending on the main business on which the insurers are active.

The transparency implied by the new reporting standards should benefit life insurers more, since existing problems with understanding financial reports in the sector are more pronounced in that sector given the longer duration of policies in this sector. Life insurance liability calculations are based on assumptions that may have been set around 30 years ago. In contrast, it is easier to measure actual performance for non-life insurers, particularly in retail insurance, since contracts last for shorter periods (one to three years typically).

However, even in the life insurance sector IFRS 17's claimed benefits associated with increased transparency may be modest for UK insurers. One insurer claimed that the UK's regulatory regimes already had characteristics similar to those of IFRS 17, with a high level of transparency. It is unlikely to see any significant improvement in investors' understanding of the data included in UK insurers' financial reports, and therefore little effect on UK insurers' cost of capital.

One issue raised in our interviews with the insurers was that in the short-run, the change in reporting standard may reduce transparency as investors will not be familiar with the changes. Investors may not immediately understand why insurers are reporting different headline levels of profits, and their reaction may be to invest in other sectors where they feel better able to understand the reported results rather than undertake further analysis. This problem may be more acute with general investors, rather than investors who specialise in trading in the insurance sector.

However, the concerns extend to the possibility that even specialist investors will feel less sure about how to interpret financial reports in the early years of the new standard. The data will be presented in a more granular manner than before, which may prompt additional questions from investors trying to analyse the findings. Moreover, it is possible that insurers will require their own time to adapt, with different restating and transition approaches, thus increasing the time required before a steady state is reached and insurance companies are on the same page.

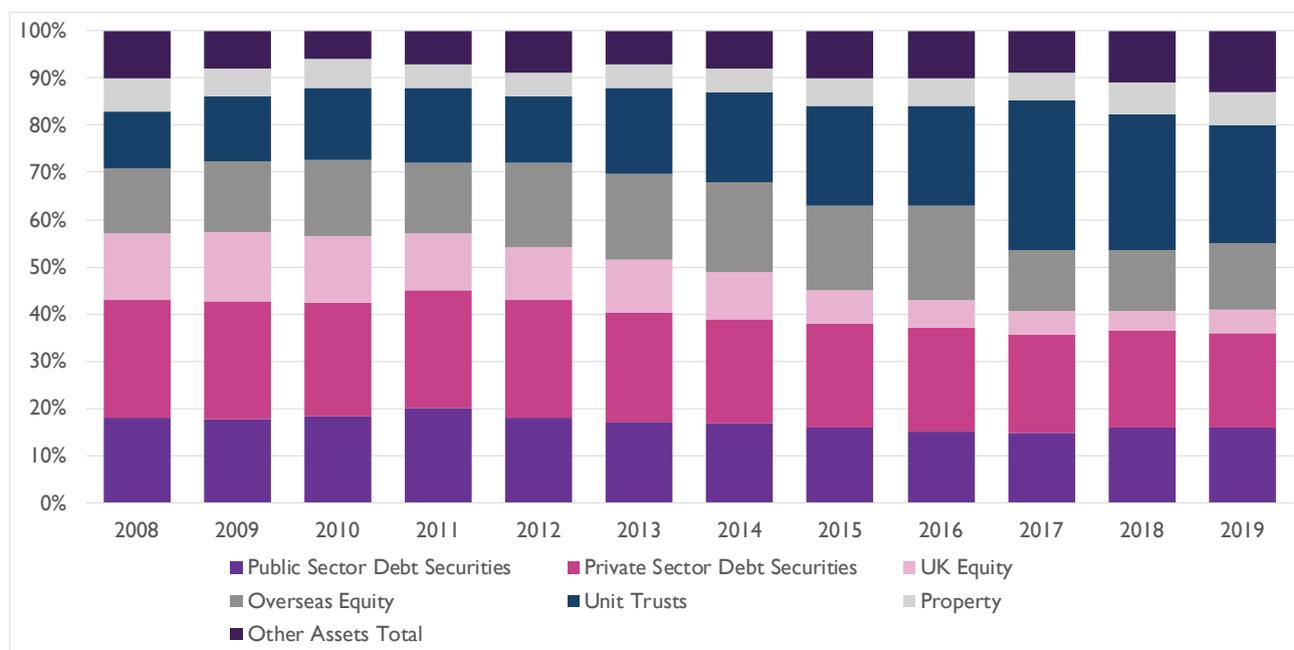
7 Investing behaviour of insurers

In this Chapter we analyse the investment assets mix held by UK insurers, looking at changes that have affected insurers' investing behaviours over the last decade. We also assess whether and how the potential endorsement of IFRS 17 might influence insurers in their investment activities.

7.1 Trends in UK insurers' allocation of investment assets

The ABI reported that its members held £1.74 trillion in assets at the end of 2018.⁶³ The majority (£1.6 trillion) was held by life insurers. For the purpose of this study, the ABI has also provided Europe Economics with data for 2019. These show a fall in the value of assets held by insurers of 8 per cent, as the total invested assets held by ABI's member was £1.60 trillion.

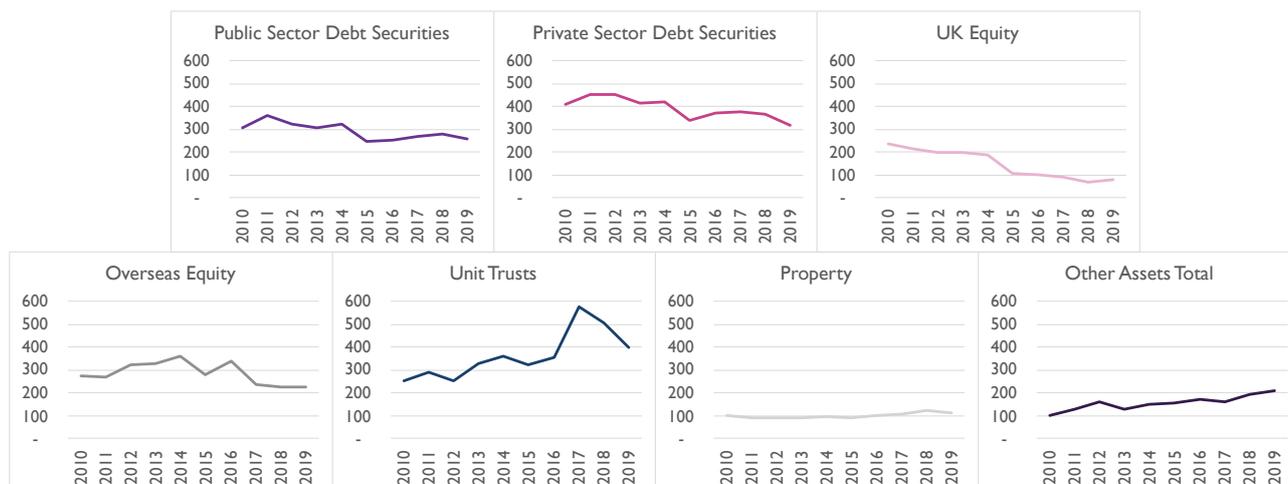
Figure 7.1: Investment assets allocation of UK insurers (2008-2019)



Source: ABI, Europe Economics calculations.

Figure 7.1 compares the breakdown of the total investment assets of UK insurers, across different classes from 2008 to 2019. Over this period, the share held in *Unit Trusts* grew significantly from its 12 per cent share in 2008. It reached a 32 per cent share in 2017, although this share has declined more recently and stood at 25 per cent in 2019. In contrast, the share of the portfolios accounted for by both *UK Equity* and *Private Sector Debt Securities* have declined since 2009. The fall was from 15 per cent to 5 per cent in 2019 for *UK Equity*, and from 25 per cent to 20 per cent for *Private Sector Debt Securities*.

⁶³ ABI (2019). *UK Insurance & Long-Term Savings Key Facts*. [Link](#).

Figure 7.2: UK insurers' investment assets value (2010-2019, £billion)

Source: ABI, Europe Economics calculations.

Figure 7.2 shows the amounts invested by insurers in each investment class in billion pounds. The value of insurers' investments in *Unit Trusts* fell £176 billion, from £576 billion in 2017 to £400 billion in 2019, a 44 per cent fall.

7.2 Potential impacts of IFRS 17

IFRS 17 seems unlikely to have much effect on the asset mix held by UK insurers. Current UK accounting practices generally already measure contract liabilities at current values and insurers predominantly value investment assets at fair value. It is therefore likely that the impact of the introduction of this standard will be limited even when considered in conjunction with the application of IFRS 9.⁶⁴

One insurer we spoke with mentioned that IFRS 9 is not yet mandatory, as insurers have been able to defer its implementation until IFRS 17. This standard requires reporting at fair value through P&L any "non-vanilla" financial instrument (e.g. property assets, equities, derivatives, etc.). Although current requirements are different from those in IFRS 9, the interviewee noted that UK insurers have always had a P&L model based on fair value so UK insurers are used to managing that level of volatility in the P&L. In contrast, the change may affect European insurers more. It is possible that the implementation of IFRS 17 (and IFRS 9) may disincentivise some non-UK insurers from holding non-vanilla assets, including property.

⁶⁴ LE Europe & VVA (2018). Assistance to EFRAG for impact analysis of IFRS 17 Insurance Contracts. [Link](#).

8 Other economic effects

This Section provides an overview of the wider economic effects of the insurance sector in the UK. In particular, we consider the industry's contributions to the nation's economic output, number of jobs, government's revenues from taxation, and the dividends paid by insurers. We also focus on how these contributions may be impacted by the potential endorsement of IFRS 17.

There is one area – tax revenues – where it is not possible to conclude that IFRS 17 is just an accounting exercise without any implications for underlying business fundamentals. Because the reported profits will change under the new regime, the tax due in a given year will change absent changes in the tax code. Parties we spoke to said that they are in discussions with HMRC but do not yet know exactly how the changes will affect their business, much less the wider insurance community.

8.1 Economic output

The economic output of the UK insurance industry is commonly measured by the Gross Value Added (GVA) of the sector to the wider economy. The GVA is often used to identify the contribution of a specific part of the economy, whether this is a region or, as in this case, an industry.

According to data published by the ONS, insurance and reinsurance directly contributed £27.0 billion to the UK economy in 2019, which represents 1.5 per cent of the total.⁶⁵ Table 8.1 shows the sector's contribution to the economic growth of the country over the last 30 years. The figures include not only insurance and reinsurance, but also pension funds. In its publications prior to the first quarter of 2020, the ONS estimated figures also for this specific class of financial services, but now their model's assumptions have changed to highlight that pension funds, by having no employees, and therefore producing no GVA, should not be considered as contributing to economic output.

Table 8.1: Economic output of the UK insurance and reinsurance industry

Year	£billion, current	£billion, constant (2016 prices)	Change on previous reported year (constant)	% of total economy
1990	5.7	26.8	-	2.6%
1995	17.9	27.2	1.7%	2.4%
2000	11.9	28.5	4.6%	2.1%
2005	26.2	30.0	5.4%	2.0%
2006	20.3	32.1	6.9%	2.0%
2007	27.7	31.5	-1.9%	2.0%
2008	22.8	31.3	-0.6%	1.9%
2009	24.3	31.4	0.3%	2.0%
2010	20.1	29.5	-6.1%	1.9%
2011	22.1	29.2	-0.9%	1.8%
2012	27.0	30.1	3.1%	1.8%
2013	29.8	30.3	0.6%	1.8%

⁶⁵ ONS, GDP output approach – low-level aggregates. [Link](#).

2014	35.5	29.6	-2.4%	1.7%
2015	25.0	29.5	-0.1%	1.7%
2016	29.9	29.9	1.3%	1.7%
2017	29.1	29.4	-1.7%	1.6%
2018	28.3	28.5	-3.1%	1.5%
2019	27.0	27.6	-3.0%	1.5%

Source: ONS, Europe Economics calculations.⁶⁶

Figure 8.1 shows the trend in the relative importance of the insurance industry, together with the reinsurance sector, on the UK economic output. Since the late 1990s, the sector's share of UK economic output has been declining. From a peak of 2.6 per cent in 1998, by 2001 the relevance of the contribution of the insurance sector to the whole UK economy had dropped by 0.5 percentage points, stabilising around 2 per cent until the beginning of 2009. In the last decade, there has been a further decline in the sector's importance to the UK economy. In the first quarter of 2020, the share of UK economic output to which the insurance and reinsurance industries had contributed, amounted to 1.5 per cent.

Figure 8.1: Economic output of insurers and reinsurers as a percentage of the UK economy



Source: ONS, Europe Economics calculations.⁶⁷

8.1.1 IFRS 17 potential impacts

Given the findings in earlier sections that IFRS 17 is unlikely to materially affect insurers' competitive positions or products and pricing, it is unlikely that the change will have a material impact on the sector's importance to the UK economy.

8.2 Employment

Although the available figures referring to the insurance industry's contribution to the country's employment are scarce and discontinuous, the ONS publishes granular data on the number of employees in the industry for a few specific years.⁶⁸ The available data provide information on employment in four main fields related to the insurance market. The *Insurance* and *Reinsurance* categories provide information on the total number

⁶⁶ ONS, GDP output approach – low-level aggregates, series: KK8H, KL7M, and KLA8. [Link](#).

⁶⁷ ONS, GDP output approach – low-level aggregates, series: KL7M, and KLA8. [Link](#).

⁶⁸ ONS, Industry (2, 3 and 5 - digit SIC) - Business Register and Employment Survey (BRES): Table 2. [Link](#).

of individuals directly employed in the UK insurance and reinsurance markets, while the categories *Pension funding* and *Activities auxiliary to insurance and pension funding* allow us to estimate the total number of jobs that exists in response to the presence of the insurance industry, and thus may be considered as indirectly employed by the sector.

The only years for which complete information concerning the employment in all the categories above is available are 2012, 2014 and 2018. Table 8.2 includes the available relevant data, and shows the total number of individuals directly and indirectly employed in the insurance and reinsurance industries. It highlights that, in the first two years for which data are available, for every job in the insurance and reinsurance sectors there were a further 2 in related activities. In 2018, the ratio falls to 1.7 jobs, a still sizeable multiplier to the direct numbers employed in insurance and reinsurance.

By comparing the total number of employees in the UK insurance industry and across the UK economy, we estimate that, in 2018 the industry generated 305,400 jobs, which represent 0.87 per cent of the total employment in the UK. This is down from the 0.99 per cent we estimate when looking at the 2012 data. The fall is due to reductions in the number of indirect employees. People employed directly in insurance and reinsurance increased between 2012 and 2018.

Table 8.2: Insurance direct, indirect, and total employment

Year	UK insurance industry's direct employees	UK insurance industry's indirect employees	UK insurance industry's total employees	Share of UK insurance industry's employees over total UK employees
2012 Q3	104,900	210,700	315,600	0.99%
2014 Q3	100,600	210,300	310,900	0.93%
2018 Q3	113,400	192,000	305,400	0.87%

Source: ONS and Nomis, Europe Economics calculations.⁶⁹

8.2.1 IFRS 17 potential impacts

Employment numbers in the sector are unlikely to materially change due to IFRS 17. One insurer suggested it is possible that it will reinforce incentives to pursue automatization, but the contribution of IFRS 17 is not likely to be material. Lots of industries, including insurance, are looking at the potential to save costs by using machines where these can execute processes more efficiently than employees.

8.3 Government revenue

Significant tax revenues collected by HMRC can be traced back to the insurance sector. In 2019, one report claimed that the sector made the largest tax contributions of any sector, paying approximately £75 billion.⁷⁰ – total HMRC tax receipts in 2018/19 were £617 billion.⁷¹ The ABI's most recent fact sheet reports taxes paid by the sector of £11.8 billion, albeit this refers to 2014.⁷²

⁶⁹ ONS, Industry (2, 3 and 5 - digit SIC) - Business Register and Employment Survey (BRES): Table 2. All available years considered in their revised version, with the exception of 2018, for which only provisional data were provided. [Link](#).
Nomis, workforce jobs by industry (SIC 2007) - seasonally adjusted. [Link](#).

⁷⁰ Statista (2020). *Insurance industry in the United Kingdom - Statistics & Facts*. [Link](#).

⁷¹ Her Majesty's Revenue and Customs (HMRC) (2019). *A disaggregation of HMRC tax receipts between England, Wales, Scotland & Northern Ireland*. [Link](#).

⁷² Association of British Insurers (ABI) (2019). *UK Insurance & Long-Term Savings Key Facts*. [Link](#).

The different figures reported will in part reflect choices about what counts as tax revenue attributable to the insurance sector. For example, there are taxes paid by insurance companies and taxes paid by consumers. A 2019 study found that 52.5 per cent of the total taxes contributed by insurers was collected from customers, 20.6 per cent related to employment taxes, and 26.9 per cent from corporation tax, VAT and other taxes levied on the company.⁷³

About 1 per cent of total HMRC receipts, and almost 9 per cent of the Government revenues from the insurance industry, are from the Insurance Premium Tax.⁷⁴ In 2019/20 the ONS reports tax revenues of £6.5 billion from the Insurance Premium Tax.⁷⁵ This is three times as much revenue as the Government collected from this source a decade ago. The tax is due on premiums for most forms of general (non-life) insurance. Since 2015 the standard rate has doubled, from 6 per cent to 12 per cent.⁷⁶ In that period, total revenues from the tax have risen 98 per cent. A higher rate of 20 per cent applies to travel insurance, and certain forms of insurance related to motor vehicles and domestic appliances.

According to figures reported in the ONS' Blue Book 2019, in 2018 insurance corporations, together with pension funds, contributed almost £1.9 billion in taxes on income to the UK Government. This represents almost 14 per cent of the total contribution to the income tax receipts from the financial services industry, and 1 per cent of the total UK government revenues from taxes on income.⁷⁷

Corporation tax generated 17 per cent of the taxes borne by insurance companies, rather than collected from their customers, in a 2019 study for the City of London Corporation.⁷⁸

8.3.1 IFRS 17 potential impacts

Assuming that predictions about IFRS 17's impact on product mix, pricing and employment are borne out, the new reporting standard is unlikely to materially affect Government revenues from the insurance sector, as it relates to income taxes or taxes collected from consumers (including Insurance Premium Tax revenues). The fact that a sizeable share of tax revenues that might be associated with the insurance industry falls on consumers rather than firms means that a smaller share of tax revenues from the sector is vulnerable to companies relocating than might be true for other financial services sectors.

Nevertheless, the endorsement of IFRS 17 could affect government revenues because of the effect on taxes paid by insurance companies. IFRS 17 will change the timing of profit recognition, and this forms the basis on which corporate taxes are levied on insurers. The insurers we spoke with all said that HMRC is aware of the issue and that they are in discussions with it, but at this stage they do not know what the outcome will be for them or for the overall industry.

The profiling of profits will be different. On balance, the insurers interviewed all expect IFRS 17 to require greater deferral of profits vis-à-vis current accounting under IFRS 4, while losses from onerous contracts have to be recognised immediately. This could have significant tax cashflow implications. This issue is compounded by the need to address concerns about the possibility of double taxation. To date, taxes have been paid on profits reported under the current standards, which have allowed more upfront reporting of profits. The new standard will require insurers to restate these profits and they will be deferred into the future. The industry expects HMRC to find a solution to this issue before the standard is implemented.

⁷³ City of London Corporation (2020). *Total tax contribution of UK financial services in 2019*. Twelfth edition. [Link](#).

⁷⁴ Europe Economics calculations based on HMRC (2019). *A disaggregation of HMRC tax receipts between England, Wales, Scotland & Northern Ireland*. [Link](#).

⁷⁵ Office for National Statistics (ONS). *Insurance Premium Tax Bulletin*. [Link](#).

⁷⁶ Association of British Insurers (ABI) (2020). *It's a sin – new figures reveal extent of IPT stealth tax raid*. [Link](#).

⁷⁷ ONS, United Kingdom National Accounts: The Blue Book 2019. [Link](#).

HMRC, National Statistics: HMRC tax receipts and National Insurance contributions for the UK, Tax and NIC receipts: statistics table (Jun 2020). [Link](#).

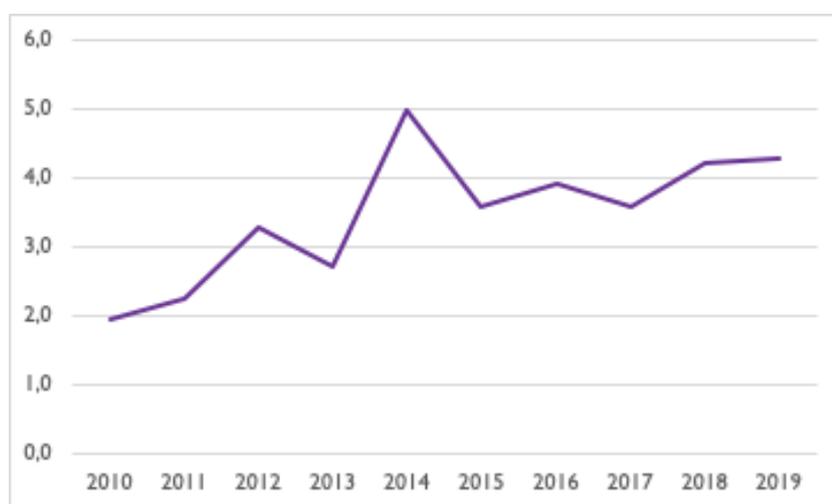
⁷⁸ City of London Corporation (2020). *Total tax contribution of UK financial services in 2019*. Twelfth edition. [Link](#).

Assuming the principle of no double taxation is respected, then the effects of the changes should be broadly neutral. However, this could have significant implications on the timing of tax incidence. New contracts, for which double taxation concerns are not an issue, will have a profile of profits that imply taxes due further into the future. For older contracts, the re-profiling of profits would suggest higher tax liabilities today, except that the insurers will have already paid taxes on the profits attributable to these contracts.

8.4 Dividends paid by insurers and reinsurers

Another component to consider when thinking about the insurance industry's impact on the wider UK economy are the dividends paid by insurers and reinsurers. In 2019, the 18 largest listed insurance companies based in the UK paid a total of almost £4.3 billion in dividends. As Figure 8.2 shows, there has seen variability in the size of dividends paid out in the last decade. Perhaps unsurprisingly, the levels are higher today than they were at the start of the decade when the economy was emerging from the financial crisis. The level of dividends this decade peaked in 2014, when the dividends paid by UK insurers totalled almost £5 billion.

Figure 8.2: Dividends paid by the 18 largest listed insurance companies based in the UK (£ billion)



Source: Thomson Reuters Eikon. Europe Economics calculations.

8.4.1 IFRS 17 potential impacts

There are mixed views among insurers about the impacts on dividend payments from IFRS 17. Solvency II is likely to remain the most important consideration, but it is possible that IFRS 17 will have an impact. As with the possible implications for Government tax revenues, the change will not reflect fundamental changes in the structure of the industry, but instead will arise because of changes in how the underlying activities are reported.

Solvency II drives the amount of cash that insurers need to retain as capital in the business to enable them to write new business. What insurers consider available for dividends is the surplus over and above the risk appetite that they set. This is intrinsically tied to the credit rating that the insurance company aims to achieve. For example, a firm that aims at being rated as AA would have to consider the capital requirements that need to be satisfied in order to obtain such a result. This in turn implies that the insurance company would only pay out dividends when there is a surplus over cash requirements to be rated AA.

IFRS drives how insurers measure their distributable resources. If fewer upfront profits are recognised under IFRS 17, this could be a binding constraint on dividends for a growing business

For UK life insurance companies there are accounting complexities around reporting the exact amounts that all the relevant sides (i.e. policy- and share-holders) own. After Solvency II UK law changed what counted

as distributable profits for life companies. One of the insurers we have talked to described the current practice of exploiting a two-stage test for the distributions of a life company.

1. What is the Solvency II surplus that the life insurance company generated in the year?
2. Are the IFRS distributable reserves of the specific legal entity typology respected?

IFRS 17 impacts that second tier test. While at the moment insurers face no issue in managing dividends, IFRS 17 would represent quite a significant change that would need to be considered more attentively than before. Indeed, one of the insurers interviewed mentioned that, currently, managing the Solvency II numbers was enough to produce IFRS figures that were automatically correct. With the implementation of IFRS 17, the IFRS numbers would need to be specifically managed.