

Guidelines on recognition and valuation of assets and liabilities other than technical provisions

1. Introduction

- 1.1. These Guidelines are drafted according to Article 16 of Regulation (EU) No 1094/2010 of the European Parliament and of the Council (hereinafter EIOPA Regulation)¹.
- 1.2. The Guidelines relate to Article 75 of Directive 2009/138/EC of the European Parliament and of the Council (hereinafter Solvency II Directive)² and to Articles 7 to 16 of Commission Delegated Regulation (EU) 2015/35³.
- 1.3. These Guidelines are addressed to supervisory authorities under the Solvency II Directive.
- 1.4. These Guidelines are intended to facilitate convergence of professional practice across Member States and support undertakings in recognizing and valuing assets and liabilities other than technical provisions.
- 1.5. The Solvency II Directive and Delegated Regulation (EU) 2015/35 generally provide for undertakings to recognize and value assets and liabilities other than technical provisions in accordance with the International Financial Reporting Standards (hereinafter "IFRS") adopted by the European Commission in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council⁴, except where this is not consistent with Article 75 of the Solvency II Directive.
- 1.6. Delegated Regulation (EU) 2015/35 clearly defines in which cases the valuation methods are not consistent with the valuation approach set out in Article 75 of the Solvency II Directive, and therefore, other valuation principles or adjustments than IFRS shall be applied.
- 1.7. Article 9 (4) of Delegated Regulation (EU) 2015/35 laid down those criteria which must be met if an undertaking wishes to recognize and value an asset or a liability based on the valuation method it uses for preparing its annual or consolidated financial statements. EIOPA has intentionally not assessed which local accounting principles, used in annual or consolidated financial statements, would be consistent with Article 75 of the Solvency II Directive. EIOPA has, however, provided information on the principles laid down in the Accounting Directives.
- 1.8. These Guidelines refer to Delegated Regulation (EU) 2015/35, which specify recognition and measurement principles for the valuation of assets and

¹ Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48)

² Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 335, 17.12.2009, p.1)

³ Commission Delegated Regulation (EU) No 2015/35 of 10 October 2014 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) (OJ L 12, 17.01.2015, p. 1)

⁴ Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ L 243, 11.9.2002, p.1)

liabilities other than technical provisions. Where the Guidelines refer to “valuation” it is defined as a valuation in accordance with Article 75 of the Solvency II Directive.

- 1.9. If not defined in these Guidelines, the terms have the meaning defined in the legal acts referred to in the introduction.
- 1.10. The Guidelines shall apply from 1 January 2016.

Guideline 1 – Materiality

- 1.11. When valuing assets and liabilities, undertakings should consider the materiality principle as set out in Recital 1 of Delegated Regulation (EU) 2015/35. With regard to the assessment of materiality, it should be recognised that quarterly measurements may rely on estimates and estimation methods to a greater extent than measurements of annual financial data.

Guideline 2 – Consistency in applying valuation methods

- 1.12. Undertakings should apply valuation techniques consistently. Undertakings should also consider if as a result of a change in circumstances, including those listed below, a change in valuation techniques or their application is required on the basis that such change would result in a more appropriate measurement in accordance with Article 75 of the Solvency II Directive.

Such changes may include the following:

- a) new market developments that change market conditions;
- b) new information becomes available;
- c) information previously used is no longer available;
- d) valuation techniques improve.

Guideline 3 – Investment property and other properties: alternative valuation methods

- 1.13. For the purposes of Article 10 of Delegated Regulation (EU) 2015/35 when valuing investment property and other properties, undertakings should select the method in accordance with Article 10(7) thereof that provides the most representative estimate of the amount for which the assets could be exchanged between knowledgeable willing parties in an arm’s length transaction. In accordance with Article 10(6) of that regulation these methods should be based on the following:

- a) current prices in an active market for properties of a different nature, condition or location, or subject to different lease or other contractual terms, adjusted to reflect those differences;
- b) recent prices of similar properties on less active markets, with adjustments to reflect any changes in economic conditions since the date of the transactions that occurred at those prices;

- c) discounted cash flow projections based on reliable estimates of future cash flows, supported by the terms of any existing lease and other contracts and, when possible, by external evidence such as current market rents for similar properties in the same location and condition and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows.

1.14. In some cases, the various inputs listed above may suggest different valuations of a property. An undertaking should consider the reasons for those differences, in order to determine the most representative valuation estimate within the range of estimates.

1.15. When undertakings determine the valuation of the property they should take into account a market participant's ability to generate economic benefits by using the property to its highest and best use, or by selling it to another market participant that would use the asset in its highest and best use.

Guideline 4 – Investment property and other properties: evidence supporting the valuation

1.16. If the balance sheet valuation is based on a formal appraisal, or other information, prior to the balance sheet date, undertakings should be able to demonstrate to their supervisory authority that all necessary adjustments have been made to reflect changes in the value between the date of a formal appraisal or other information and the balance sheet date.

Guideline 5 – Financial liabilities and own credit standing

1.17. When valuing financial liabilities, undertakings should use techniques to determine a value for which the liabilities could be transferred, or settled between knowledgeable willing parties in an arm's length transaction, excluding any adjustment to take account of changes in the undertaking's own credit standing after initial recognition. These techniques can be based on either:

- a) a bottom up approach; or
- b) a top down approach.

1.18. In a bottom up approach, undertakings should determine their own credit standing at recognition of the specific financial liability. The part of the spread of the discount curve that relates to own credit standing should be kept constant after its initial recognition. In subsequent valuations the value is calculated by determining the changes in the value stemming from changes in market conditions that affect the value of the financial liability, except for changes in market conditions that affect own credit risk.

1.19. When undertakings assess changes in market conditions that give rise to market risk, they should assess at least changes in the relevant risk free interest rate curve, a commodity price, a foreign exchange rate or an index of prices or rates.

1.20. In a top down approach, undertakings should determine the amount of change in the valuation of a financial liability that is attributable to changes in the undertaking's own credit risk and exclude it from the valuation.

Guideline 6 – Holdings in related undertakings: IFRS equity method

1.21. When undertakings value a related undertaking's assets and liabilities using the IFRS equity method in accordance with Article 13(5) of Delegated Regulation (EU) 2015/35, and if those related undertakings use an accounting framework other than IFRS, the undertakings should make adjustments where needed to recognise and value that related undertaking's assets and liabilities in accordance with IFRS.

1.22. When applying Article 13(5) of Delegated Regulation (EU) 2015/35, an undertaking should be able to provide justification to its supervisory authority as to why it has not calculated the excess of assets over liabilities for related undertakings according to Article 13(4) thereof.

Guideline 7 – Holdings in related undertakings: alternative valuation methods

1.23. Where undertakings value holdings in related undertakings using alternative valuation methods in accordance with Article 13(1)(c) of Delegated Regulation (EU) 2015/35, they should be able to explain to their supervisory authority why it is not possible to revalue the related undertaking's assets and liabilities using the default valuation method or the adjusted equity method.

Guideline 8 - Contingent liabilities: Contingent liabilities arising from ancillary own fund item arrangements

1.24. When entering into an arrangement that represents an ancillary own-fund item for the counterparty, undertakings should carefully assess whether to recognise the corresponding contingent liability as a liability in compliance with Article 11 of Delegated Regulation (EU) 2015/35.

1.25. Undertakings should be able to provide a justification to the supervisory authority where they have not recognised a contingent liability in circumstances where they have entered into an arrangement with another undertaking, including any other undertakings belonging to the group, and that arrangement has received approval as an ancillary own funds item.

Guideline 9 - Deferred taxes – recognition and valuation

Discounting deferred taxes

1.26. Undertakings should not discount deferred tax assets and liabilities.

Setting off deferred tax assets and liabilities on the Solvency II balance sheet

1.27. An undertaking should offset deferred tax assets and deferred tax liabilities only if, it has a legally enforceable right to set off current tax assets against current

tax liabilities; and if the deferred tax assets and the deferred tax liabilities relate to taxes levied by the same tax authority on the same taxable undertaking.

Recognition and valuation of a net deferred tax asset

- 1.28. Where there are insufficient taxable temporary differences, which are expected to reverse in the same period as the expected reversal of the deductible temporary differences, the undertaking should consider the likelihood that taxable profits will arise in the same period as the reversal of the deductible temporary differences or in the periods into which a tax loss arising from the deferred tax asset can be carried back or forward.
- 1.29. When making projections of taxable profits and assessing the likelihood that sufficient taxable profits will arise in the future, an undertaking should:
- a) take into consideration that even a strong earnings history may not provide sufficient objective evidence of future profitability;
 - b) take into consideration that the degree of uncertainty relating to future taxable profits resulting from expected new business increases as the projection horizon becomes longer, and particularly when these projected profits are expected to arise in periods beyond the normal planning cycle of the undertaking;
 - c) consider that some tax rules can delay or restrict recovery of unused tax losses and unused tax credits;
 - d) avoid double counting: taxable profits resulting from the reversal of taxable temporary differences should be excluded from the estimated future taxable profits where they have been used to support the recognition of deferred tax assets;
 - e) ensure that when making projections of taxable profits, these projections are both credible and broadly consistent with the assumptions made for other projected cash flows. In particular, the assumptions underlying the projections should be consistent with those underlying the valuations of technical provisions and assets on the solvency balance sheet.

Guideline 10 - Deferred taxes – documentation

- 1.30. Upon request, undertakings should be able to provide supervisory authorities with, at a minimum, information based on the undertakings' records:
- a) on sources of temporary differences that may lead to the recognition of deferred taxes;
 - b) regarding recognition and valuation principles applied for deferred taxes;
 - c) in respect of each type of timing difference and in respect of each type of unused tax loss and unused tax credit, the calculation of the amount of the deferred tax assets or liabilities recognised, as well as underlying assumptions related to that amount;

- d) describing the recognition of deferred tax assets, including at least:
- existence of any taxable temporary differences relating to the same tax authority, the same taxable undertaking and the same type of tax which are expected to reverse in the same period as the expected reversal of the deductible temporary difference or, as the case may be, would result in taxable amounts against which the unused tax losses or unused tax credits can be utilised before they expire;
 - when there are insufficient taxable temporary differences relating to the same tax authority, the same taxable undertaking and the same type of tax, documentation demonstrating that it is probable that the entity will have sufficient taxable profit relating to the same tax authority and the same taxable undertaking and the same type of tax in the same period as the reversal of the deductible temporary difference or in the periods into which a tax loss arising from the deferred tax asset can be carried back or forward or, as the case may be, that it is probable that the undertaking will have taxable profits before the unused tax losses or unused tax credits expire.
- e) on the amount and expiry date, if any, of deductible temporary differences, unused tax losses and unused tax credits for which deferred tax assets are or are not recognised.

Guideline 11 - Deferred tax treatment where undertakings are excluded from group supervision

- 1.31. Undertakings should apply the following principles for the recognition of deferred taxation where related undertakings are excluded from the scope of group supervision under Article 214(2) of the Solvency II Directive:
- a) where holdings in related undertakings are excluded from the scope of group supervision under Article 214(2)(a) of the Solvency II Directive, the deferred tax related to that excluded undertaking should not be recognized at either individual or group level;
 - b) where holdings in related undertakings are excluded from the scope of group supervision under Article 214(2)(b) or (c) of the Solvency II Directive, the deferred tax related to that related undertaking should not be recognised at group level.

Guideline 12 – Application of valuation methods used in annual and consolidated financial statements according to Article 9(4) of Delegated Regulation (EU) 2015/35

- 1.32. Undertakings applying the derogation in Article 9(4) of Delegated Regulation (EU) 2015/35 should consider Guidelines 1, 2, 4, 5 and 8 to 11, as well as the comparison table in Technical Annex 1 as a reference, when determining whether the valuations are consistent with Article 75 of the Solvency II Directive. The Technical Annex is an integral part of this Guideline.

1.33. Undertakings that are within the scope of consolidation of a group preparing consolidated financial statement according to IFRS should not apply the derogation in Article 9(4) of Delegated Regulation (EU) 2015/35.

Compliance and Reporting Rules

1.34. This document contains Guidelines issued under Article 16 of the EIOPA Regulation. In accordance with Article 16(3) of the EIOPA Regulation, competent authorities and financial institutions shall make every effort to comply with guidelines and recommendations.

1.35. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.

1.36. Competent authorities shall confirm to EIOPA whether they comply or intend to comply with these Guidelines, with reasons for non-compliance, within two months after the issuance of the translated versions.

1.37. In the absence of a response by this deadline, competent authorities will be considered as non-compliant to the reporting and reported as such.

Final Provision on Reviews

1.38. The present Guidelines shall be subject to a review by EIOPA.