



**eiopa**

EUROPEAN INSURANCE  
AND OCCUPATIONAL PENSIONS AUTHORITY

# European Insurance Industry

## Threats, opportunities and regulatory developments

Dimitris Zafeiris

*Head of Risks & Financial Stability Department*

European Insurance and Occupational Pensions Authority

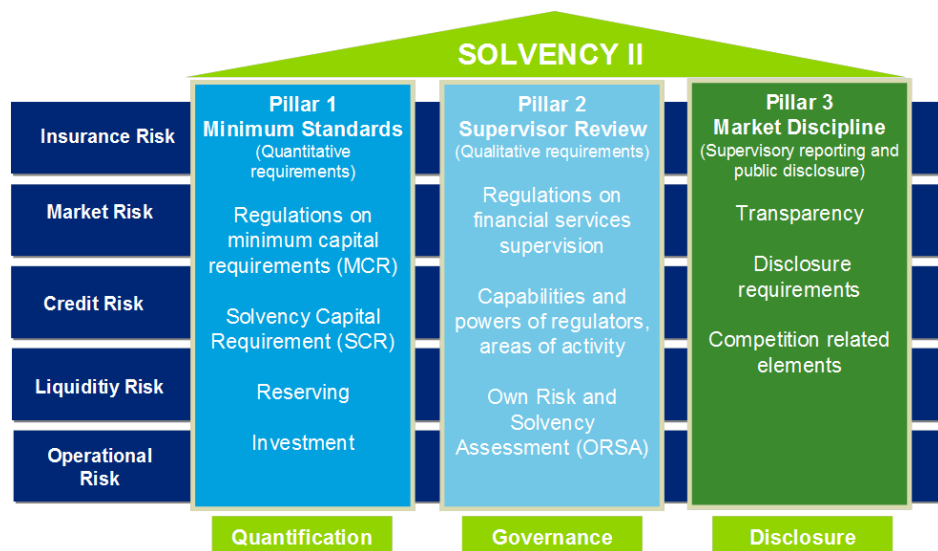
J.P. Morgan European Insurance Conference

London, 31 May 2017

1. Overview of the EU insurance industry
  - a) Solvency II at a glance
  - b) Risk overview
  - c) Portfolios
  - d) Vulnerabilities
  
2. The regulatory front
  - a) Macroprudential policy
  - b) Recovery and resolution

# Overview of the EU insurance industry

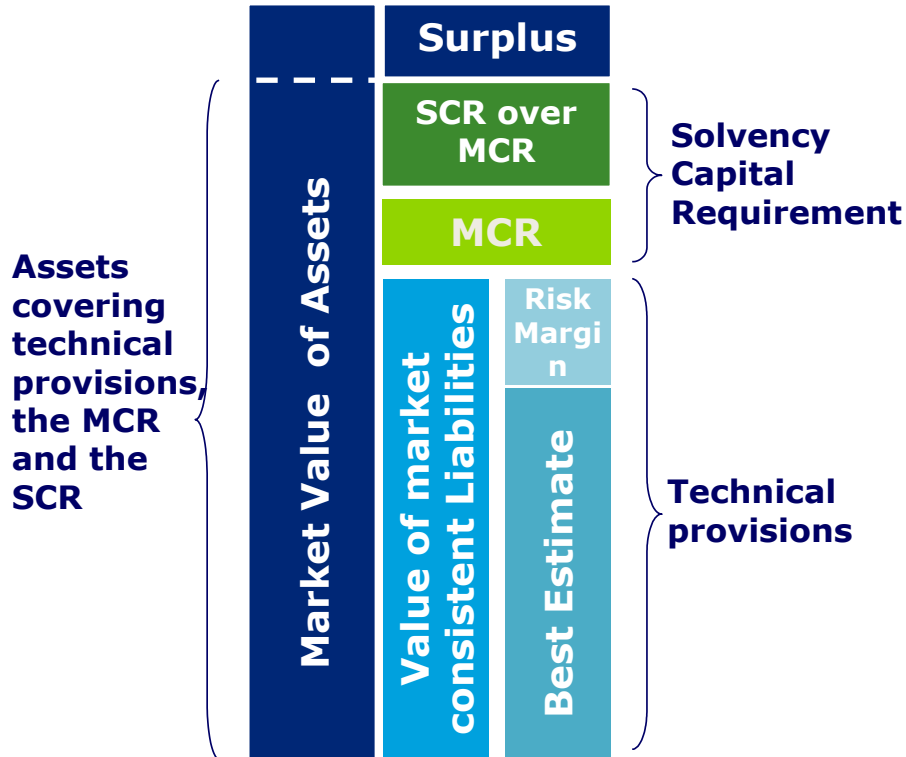
# Solvency II in a nutshell: Structure



Solvency II Directive aims at defining capital requirements and risk management standards in a framework structured in three pillars

- Pillar I: focuses on quantitative requirements, therefore SCR and MCR
- Pillar II: focuses on more qualitative elements, internal control, risk management and supervisory process
- Pillar III: focuses on Market discipline and transparency

# Solvency II in a nutshell: Focus on the capital requirements (1<sup>st</sup> pillar)

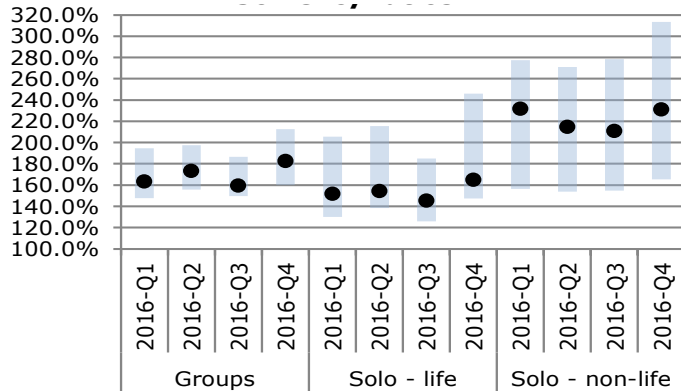


Capital requirement should be evaluated on a **total balance sheet approach** based on economic valuation of all assets and liabilities

- **Assets** should be valued at market value
- The Economic Value of Liabilities is based on the **expected present value of future liability cash flows** using best estimate assumptions
- On top of the Best Estimate of liabilities is also added a **Risk Margin** that is a part of technical provision in order to ensure that the value of technical provision is equivalent to the amount that insurance undertakings would be expected to require in order to take over the obligations

# How is the European insurance industry doing?

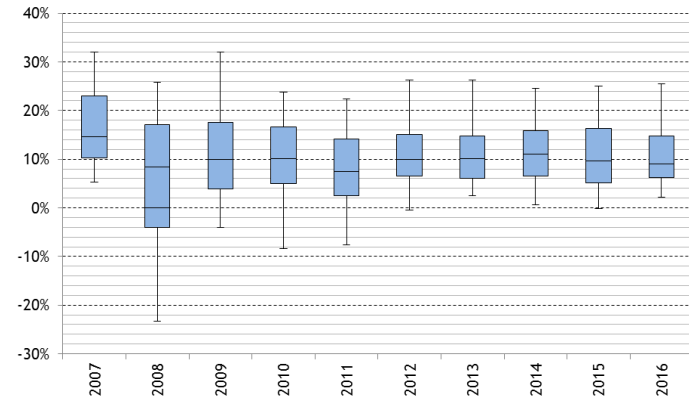
## Solvency ratios



● Distribution: median, interquartile range

Source: EIOPA Risk Dashboard – May 2017 release based on 2016 Q4 exposures (Groups = 84; Solo life=455; Solo non-life=1,067)

## Return on Equity



Source: S&P Capital IQ, 114 insurance undertakings and brokers from 23 EEA countries Reporting reference date: 31/12/2016

# Risk overview: Low interest rates and potential repricing of risk premia are the major concerns

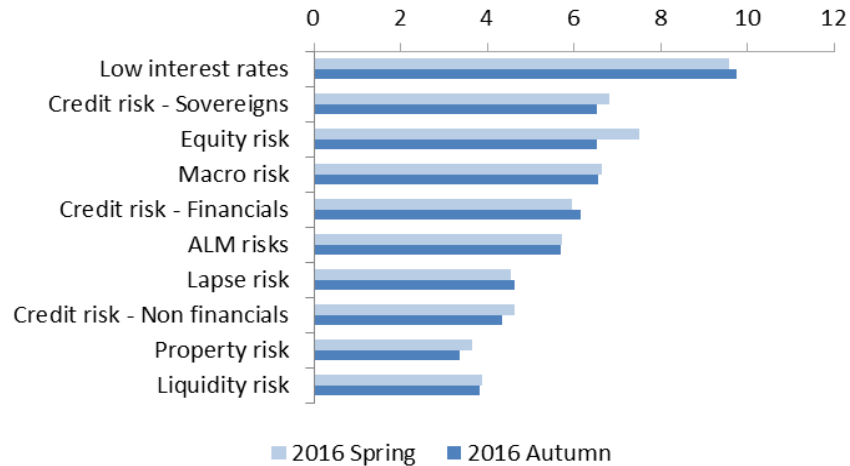
## Risk Dashboard – April 2017

Risks	Score	Trend
1. Macro risks	High	→
2. Credit risks	Medium	→
3. Market risks	Medium	↔
4. Liquidity and funding risks	Medium	→
5. Profitability and solvency	Medium	↓
6. Interlinkages and imbalances	Medium	→
7. Insurance (underwriting) risks	Low	→
Market perceptions	Score	Trend
8. Market perceptions	Medium	↗

- Risks for the insurance sector remained overall stable in Q4 and some improvements were observed:
  - Solvency ratios improved
  - Volatility has decreased and inflation rates have slowly started to converge to desired target levels
- The **continuing low-yield environment** and **potential repricing of credit risk** still represent important concerns for the EU insurance industry

# Bottom-up risk assessment

## Risk assessment for the insurance sector



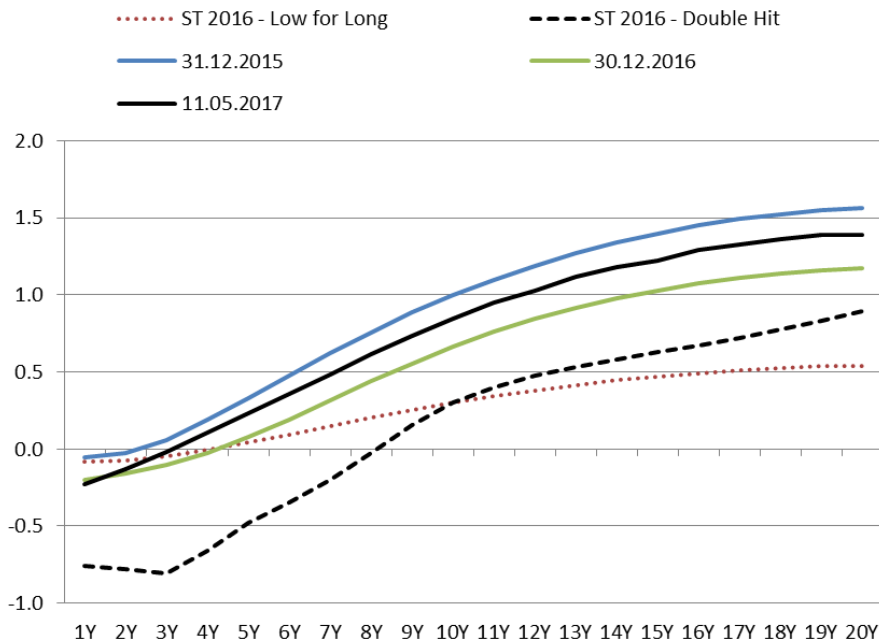
*Note: Risks are ranked according to probability of materialisation (from 1 indicating low probability to 4 indicating high probability) and the impact (1 indicating low impact and 4 indicating high impact). The figure shows the aggregation (i.e. probability times impact) of the average scores assigned to each risk*

- The most challenging risk factor remains the **low interest rate environment**
- **Credit risks** for sovereign and financials remain at a high level
- The survey points out that **lapses might rise in the future**



# Low interest rates: the 'new normal' or just waiting for 'back to normal'?

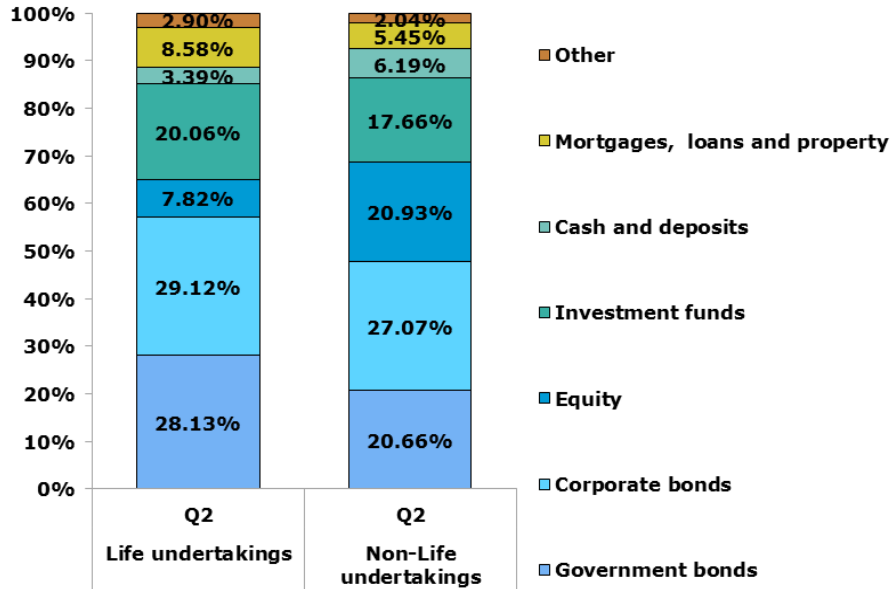
## EUR swap curve (in per cent)



- **Stressed Risk Free Rate curves** encompassed in the scenarios designed in the 2014 and 2016 EIOPA Insurance Stress test exercises **were deemed as too severe at the moment of the launch** by several counterparties
- After a prolonged period of interest rate decreases **the swap rate displayed signs of modest recovery** in the last quarter of 2016

- Low for long
- Double – hit
- Abrupt increase in yields

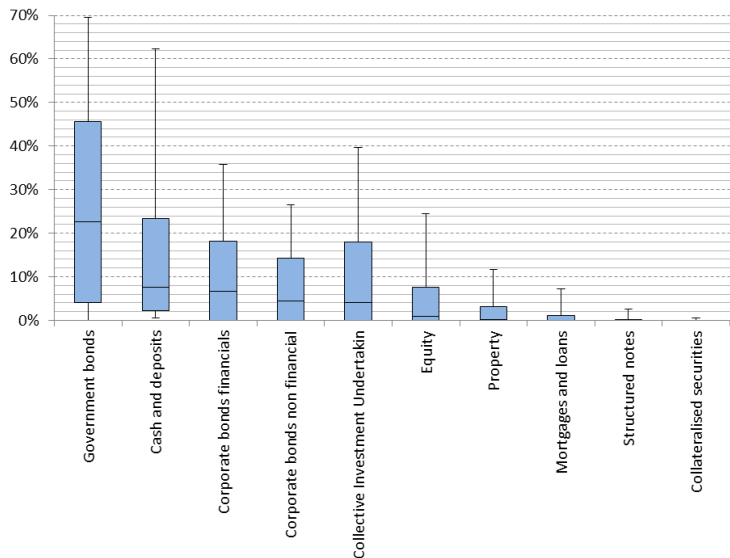
## *Investment split for life and non-life insurance companies in Q2 2016*



- **Fixed income assets** (no look-through for funds) are **>57%** of the total investments for life insurers, **>47%** for non-life insurers
- **High heterogeneity across insurers and countries**

# Changes in yields might have a material impact on insurers

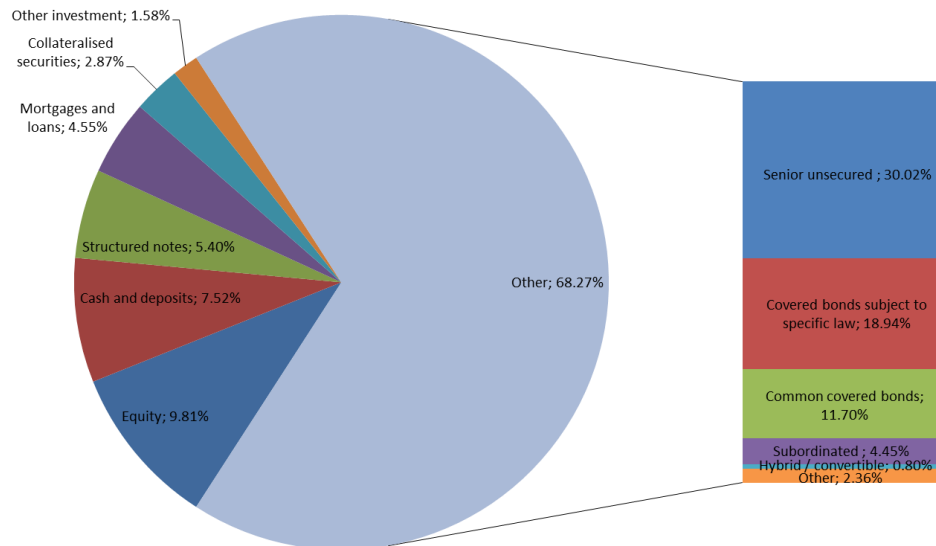
## Type of investment as a share of total investment in Q2 2016



Cross-sectional distribution in % for the median, interquartile range and 10th and 90th percentile

- The material exposure of insurers towards fixed income assets may have a direct impact on the assets driven by the market consistent valuation
- Solvency II **LTG measures** could mitigate the effects of abrupt changes on yields
- Downgrades of some assets might generate fly to quality movements

## Exposures to the banking sector



- Investments in banks (excluding look-through approach on collective investments) amount to EUR 1.61 trn and cover:
  - 31% of the total investments of insurers
  - 17% of the total assets
- 68% if the investments are in bonds, of which:
  - 30% senior unsecured
  - 30% covered

# Main stress test results



	"Double hit"		"Low for long"	
	EUR bn.	%	EUR bn.	%
<b>Change in assets</b>	- 608.5	-9.7%	282.4	4.5%
<b>Change in liabilities</b>	- 449.5	-7.8%	381.5	6.7%
<b>Change in excess of assets over liabilities</b>	- 159.0	-28.9%	-99.1	-18.0%

## Insurance is not only about financial risks

### Cyber risk:

The major challenge (and opportunity?) for the insurance sector is:

- **quantifying and pricing** virtual risks
- Carefully evaluate **accumulation of risks**
- Protecting itself against such attacks

### Fintech

Incoming innovation on:

- Use of **big data**
- **Shared economy**
- **New channels**

May have a profound impact on the fundamental of the insurance business as on the distribution, product pricing, product structure (collective products) and other

# **The regulatory front**

**Current initiatives with a financial stability perspective**



## Some observations

- **Solvency II is undoubtedly a great achievement** for the EU insurance sector and for the protection of policyholders
- The **framework will be reviewed** according to a structured process;
  - ✓ By 2018, the review of the Solvency Capital Requirement (SCR) and
  - ✓ By 2021, the overall review of the regime (incl. LTG)
- Possible further **areas that need due consideration** in order to enhance the protection of policyholders and the stability of the financial system:
  - ✓ Macroprudential policy in insurance
  - ✓ Recovery and Resolution framework

## Macroprudential policy in insurance

- **The insurance sector plays a relevant role** in achieving a stable financial system, supporting long-term sustainable economic growth
  - ✓ Mitigating the likelihood and the impact of a systemic crisis in insurance should be an important policy objective
- A **debate on extending the macroprudential framework** to insurance is currently taking place in different fora.
- **Macroprudential tools may be needed** where there is a risk that the (collective) behaviour of insurers, or their failure, would have wider effects on the real economy
  - ✓ It therefore supplements the microprudential/supervisory approach
- Need to **strike a proper balance** between maintaining the stability of the financial system and avoiding an overreaction

## Macroprudential policy in insurance

- **EIOPA is working for some time** on this topic:
  - ✓ A potential macroprudential approach to the low interest rate environment in the Solvency II context (2016)
  - ✓ EIOPA's response to the EC's Consultation on the Review of the EU Macroprudential Policy Framework (2016)
- Need to properly **take into account the existing micro-prudential Solvency II** framework
  - ✓ Although SII is a micro supervisory regime it contains macroprudential elements
- **Issues that need further work**
  - ✓ Sources of systemic risk in insurance
  - ✓ Development of an insurance specific macroprudential framework
  - ✓ Elements with macroprudential impacts in the SII framework
  - ✓ Consideration of other potential tools

## Recovery and resolution

- An adequate **EU recovery and resolution framework is fundamental**, particularly in the current environment
  - ✓ Reduces the likelihood of failures by enhancing preparedness
  - ✓ Reduces the impact in case of failures
  - ✓ Enable national authorities to intervene in failing institutions with sufficient time
  - ✓ Enhances cooperation and information sharing
- **There is no harmonised recovery and resolution approach for insurers in the EU**
- Any initiative in the field of recovery and resolution should consider the **specific features of the insurance sector**
- EIOPA **published a discussion** paper to gather views from stakeholders<sup>(\*)</sup>
  - ✓ *See next slide*

---

(\*) Discussion Paper on Potential Harmonisation of Recovery and Resolution Frameworks for Insurers (2016)

## Discussion Paper on Potential Harmonisation of Recovery and Resolution

### Overview of existing national frameworks

EIOPA conducted a **stock taking exercise** to obtain information on existing national recovery and resolution frameworks in the EU

The survey covers **crisis management** aspects like early intervention, resolution, cross-border cooperation and IGS.

### Rationale for harmonisation

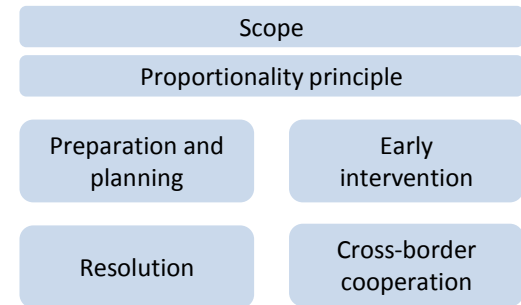
EIOPA analyses **whether there is a need** for a harmonised recovery and resolution framework for insurers

**Pros:** Avoidance of fragmentation, enhancement of cross-border coordination, fragile market environment.

**Cons:** Normal insolvency procedures might be suitable, national frameworks might reflect national specificities in a better way, administrative burdens and costs

### Building blocks of recovery & resolution

EIOPA analyses what the **building blocks** could be for a **minimum** harmonised recovery and resolution framework



**Thank you**

**European Insurance and Occupational Pensions Authority**  
**[www.eiopa.europa.eu](http://www.eiopa.europa.eu)**