# EIOPA Risk Dashboard

--- June 2013 ---

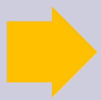
EIOPA-FS-13-047

# Systemic risks and vulnerabilities

On the basis of observed market conditions, data gathered from undertakings, and expert judgment, EIOPA assesses the main systemic risks and vulnerabilities faced by the European insurance industry over the coming quarters to be:

- <u>Macro risks:</u> Recessionary pressure in a number of economies in the EU illustrates the macro-economic risks which are still at an elevated level. The measures set at both European and national level had a notable effect in decreasing market volatility, though some uncertainty remains with regard to the implementation of forthcoming measures. In addition, the combination of austerity measures, rising unemployment and a prolonged period of subdued growth could have negative effects on insurance demand. Uncertainties in the macro outlook are not limited to the EU, but a concern in other world regions as well, thereby affecting the business of EU insurers' subsidiaries.
- <u>Credit and market risk:</u> As a result of the weak macro environment, interest rates in Western Europe have reached new historic lows in the last months, thereby constituting a major challenge for insurance undertakings (cf. guaranteed interest rates, search for yield, new business etc.). In this surrounding, the trend of decreasing credit spreads has continued. In addition to the effects of increased investor confidence, this development is also driven by excess liquidity, the difficult global financial investment environment and investors' risk appetite striving for an appropriate balance of yield versus risk. A reversal in the assessment of risk premia is a notable risk on its own.
- <u>Profitability and solvency:</u> Profitability has improved, mostly driven by on average favourable underwriting results. Investment returns have declined in the first quarter of 2013, partially mirroring the capital market environment.

# Risk summary

| Risk | Score | Impact | Timing | Qualification |
|---|---|---|---|---|
| Macro * |  | High | Short- to medium-term | • Weak worldwide growth outlook with a significant dispersion in outlook within EU<br>• Political risk with regard to sovereigns |
| Credit * |  | Very High | Medium-term | • Sovereign and corporate spreads somewhat declining<br>• Corporate spreads might not fully capture default risk |
| Market |  | High | Medium-term | • Low-yield environment increases re-investment risk<br>• equity and property markets have shown a recent strengthening in many countries, but this might be driven by cheap liquidity |
| Liquidity/ Funding |  | Medium | Medium-term | • Slight decline in liquid short-term assets<br>• Lapse rates stabilised |
| Profitability/ Solvency * |  | Medium | Structural | • Favourable underwriting results (low combined ratios)<br>• Profitability indicators in general positive (RoE), though low-yield environment depresses investment returns |
| Interlinkages/ Imbalances |  | High | Medium-term | • Risk of banking crisis spillovers<br>• Insurance groups decrease their debt/equity ratio |
| Insurance * |  | Medium | Structural | • Fewer natural catastrophes, higher reserves of reinsurers<br>• Uncertainty about medium-term sustainability of growth and future demand for insurance (and savings) products |

For more definitions see legend on slide 8.

* Expert judgment applied, see slide 4.

# Use of expert judgment, sample size

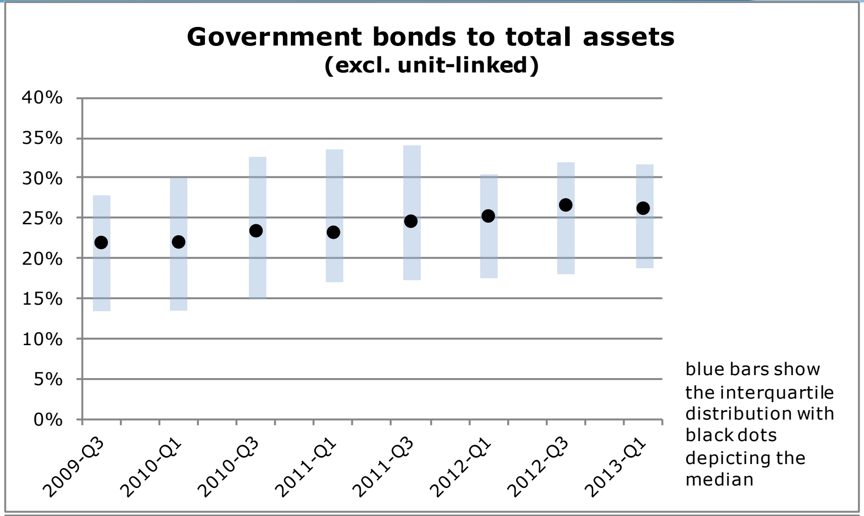
**Use of expert judgment after the mechanical aggregation:**

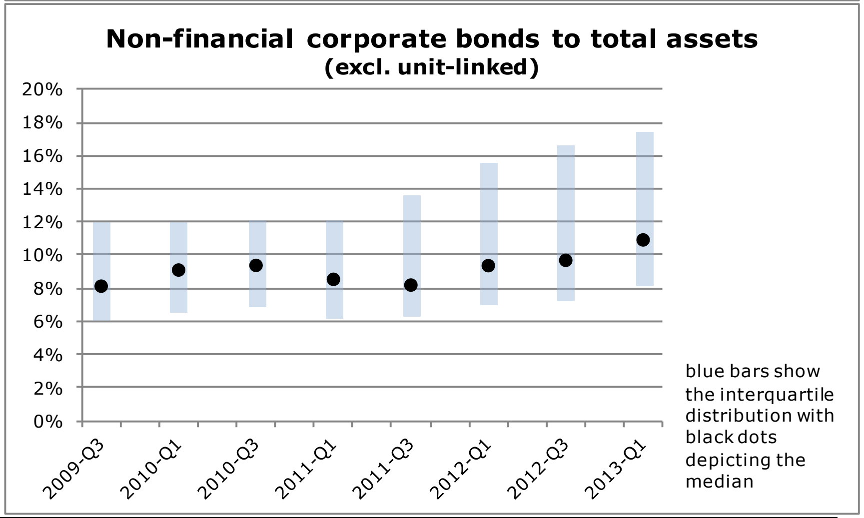
- Macro risk: slightly upwards due to high heterogeneity in growth figures across EU countries and general uncertainty about the medium-term growth potential and its implications for the demand of insurance products. In addition, implementation risks around the various crisis management tools used in the sovereign debt crisis are non-negligible.
- Credit risk: slightly upwards due to the uncertain macro outlook which could eventually trigger higher default rates in the corporate sector. As an additional factor, the potential distortion of bond prices needs to be considered: This is a result of excess liquidity while at the same time investors have limited alternatives to substantially reduce their credit risk exposure.
- Profitability/Solvency: slightly upwards due to uncertainties regarding the impact of the low-yield environment on future investment returns and ultimately profitability.
- Insurance risk: slightly upwards assuming that in a longer term perspective it could be argued that the insurers’ business model might be impacted in a low-yield environment when lower investment returns cannot counter-balance potential underwriting losses. In addition, insurers might be forced to amend their product strategy in light of current market experience in the low-yield environment. This implies an uncertainty whether these changes are accepted by customers/investors and risks are adequately managed.

# Detailed assessment: Market and credit risk

**Market risks of insurance undertakings are traditionally dominated by interest rate risks.**

- In the current surrounding of historically low long-term interest rates it could prove difficult to earn guaranteed interest rates, especially in life business where guarantees are a common feature in many jurisdictions.
- With regard to the asset allocation of insurance groups it is seen that the relative share of financial bonds is slightly declining, while holdings in government and non-financial corporate bonds tend to increase. These changes might be driven by search-for-yield as well as by flight-to-safety (which could also imply a more pronounced home bias) and motivations vary across countries.
- Equity and property markets are, at the moment, seen as less imminent risks. The direct exposure of the insurance sector towards these asset classes is in most jurisdictions relatively limited.

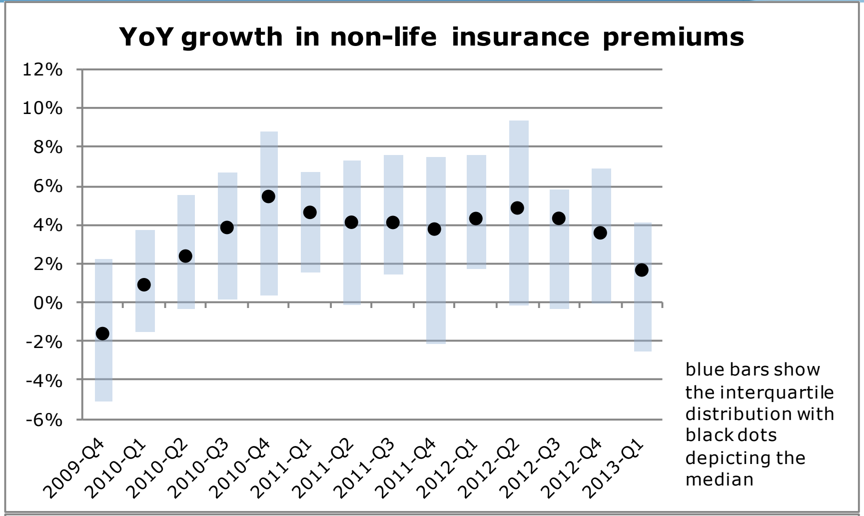


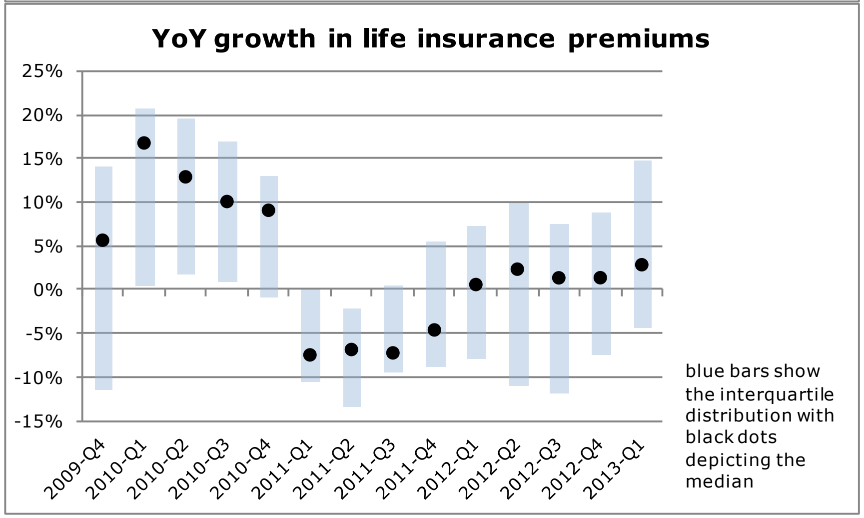



# Detailed assessment: Insurance risk

**Insurance risk is currently characterised by positive premium growth, lower insurance leverage and the smaller number of large-scale natural catastrophes in the recent months.**

- Growth in non-life premiums has slowed down over the last quarters. In life insurance, the median growth in the sample is still small compared to the growth rates in 2010, but overall the trend of declining life premiums which was observed in 2011 seems to have reverted.
- Insurance leverage, i.e. the ratio of premiums to capital and reserves has declined since the beginning of 2012.
- Given the smaller number of natural catastrophe events and lower losses reinsurance undertakings are currently well-capitalised.

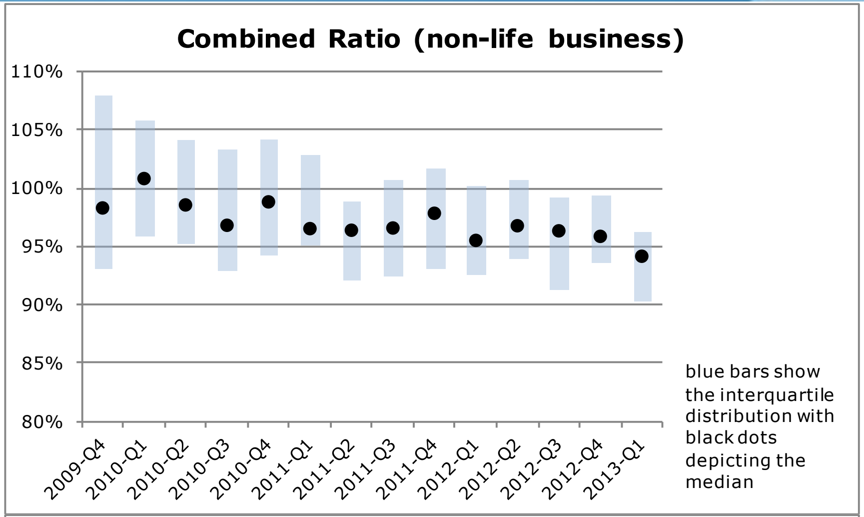


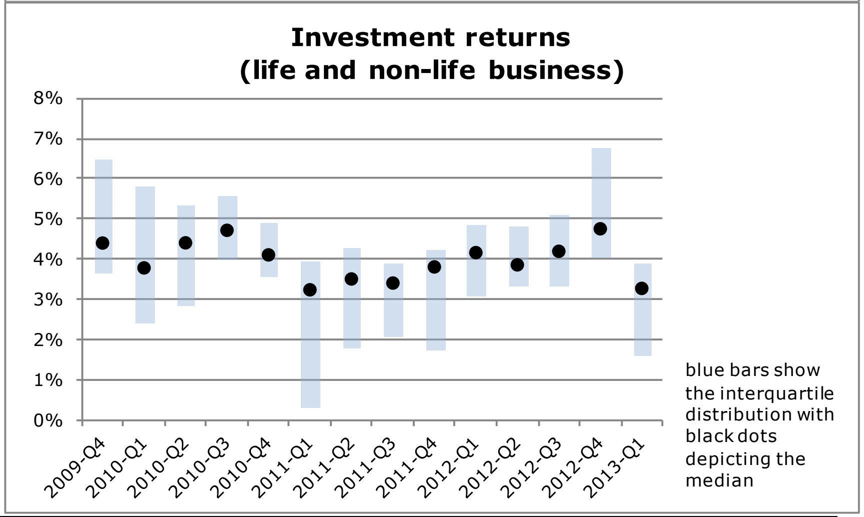



# Detailed assessment: Profitability and solvency

**Profitability and solvency currently signal some resilience of the insurance sector, particularly when focussing on overarching measures like return on equity and solvency ratios. Profitability is driven by two factors:**

- Combined ratios in non-life business are developing quite favourably, driven both by positive underwriting results and cost-cutting in the insurance sector. For insurers in some jurisdictions as well as reinsurers, losses from the May/June floods in Central Europe are likely to have some negative impact on profitability.
- Investment returns have, however, deteriorated significantly in the first quarter of 2013 – this development has been observed both in the life and the non-life sector.



# Explanatory notes

| | | | |
|---|---|---|---|
| Score | Provides an assessment of the relevance of the particular risk, and is as such, akin to a traditional risk score | | Very high |
| | | | High |
| | | | Medium |
| | | | Low |
| Change | Indicates the change of the risk score over the last three months; comparison is made with last quarter's risk score | | Substantial increase |
| | | | Increase |
| | | | Unchanged |
| | | | Decrease |
| | | | Substantial decrease |
| Impact | Provides an assessment of the effect that the materialisation of the given risk will have on the insurance industry | Very high | Severe impact (most undertakings affected or very sizeable exposure amount of the sector) |
| | | High | Serious impact (large number of undertakings affected or sizeable exposure amount of the sector) |
| | | Medium | Medium impact |
| | | Low | Low or negligible impact (limited number of undertakings affected or limited exposure amount of the sector) |
| Timing | Indicates over which future period the risk is seen as most likely to materialise | Short-term | Materialisation possible within the next months |
| | | Medium-term | Relevance over the medium-term; partly dependent on possible materialisation of short-term risks |
| | | Structural | No immediate concern, but closer monitoring may be warranted |