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Investment of insurers and reinsurers in securitisations

Securitisation volumes in Europe have never reached their peak of 2007, before the financial crisis. Overall, the current market is smaller, but of a higher quality and more prudently regulated. The pre-crisis levels of securitisation volumes were unhealthy and unsustainable and should not serve as a benchmark to be targeted. Still, some stakeholders expect that the securitisation market should revive to a higher level than where it currently stands. In particular insurers and reinsurers are seen as a possible source of high demand, yet the appetite of insurers and reinsurers to invest in securitisations remains low.

There have been efforts to remove obstacles to insurers and reinsurers investing in securitisations and indeed the European Insurance and Occupational Pensions Authority (EIOPA) was a pioneer in this regard. As early as 2013, EIOPA proposed a preferential treatment for higher quality securitisations. The European Commission made such a change to Solvency II, and it came into effect in 2019. The amendments introduced a specific treatment for simple, transparent and standardised securitisations (STS securitisations) in the standard formula for the calculation of capital requirements under Solvency II.

According to that specific treatment, the capital requirements for investment in STS securitisations were significantly lowered. For example, the charges for senior STS securitisations are now close to those for corporate bonds of the same credit rating. In contrast, non-STS securitisations have higher risk charges.

The aim of the amendments was to support investments in securitisations by insurers and reinsurers in a prudent way. However, three years after the new treatment has come into effect, investments in securitisation have not materially changed. The volume is overall stable at a level of approximately 12.5 billion euro for the European insurers and reinsurers that apply the standard formula. This is a small fraction of the European securitisation market. It is also small compared to the total investment volume of the insurance sector. At European level, securitisation investments represent 0.33% of total investments of the insurers and reinsurers applying the standard formula. Investments in securitisations are concentrated in a small number of the insurers and reinsurers.

The appetite of insurers and reinsurers to invest in securitisations remains low.

At the end of 2021, 12% of the insurers and reinsurers were invested in securitisations. Among those undertakings, 85% do so for an amount of less than 5% of their total investments. Only a small number of insurers seem to be active players in the securitisation market. Furthermore, we can observe that the majority of securitisation investments of those companies are made in the class of non-STS securitisations which have higher capital charges.

The Solvency II framework does not seem to be a significant driver for the investment decisions of insurers and reinsurers in relation to securitisation. In a survey that EIOPA carried out in 2022, only a few insurers mentioned that the capital charges are one of the reasons that is holding them back from investing in this asset class. The vast majority of companies do not seem to be interested in securitisations because they do not match their investment preferences which are focused on the risk-return profile of the investment and asset-liability management.

Other asset classes seem to show better risk-return profiles. Securitisations do not fit into the asset-liability management of many insurers and reinsurers who are long term investors, in particular life insurers. These companies have long-term insurance liabilities and typically seek to cover them with long-term fixed rate investments in order to reduce the risk that changes in the level of interest rates lead to a deterioration of their capital. The importance of an effective asset liability management became evident during the past years when interest rates varied a lot. Another reason for the lack of demand for securitisation investments from the insurance industry seems to be that investors perceive securitisations as a complex product with extensive due diligence requirements.

Focusing only on the prudential framework makes it difficult to take account of the interlinked and complex nature of the factors in play. That is in line with recent technical advice of the Joint Committee of the European Supervisory Authorities. The Joint Committee does not advise changes to the current framework of Solvency II with regards to the prudential treatment of securitisation.

For the time being, while there is little appetite for investments in securitisations by (re)insurers, this is not a result of the current regulatory framework.