EIOPA Risk Dashboard
--- March 2013 ---

EIOPA-FS-13-022

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:

- Macro risks: Recessionary pressure in a number of economies in the EU exemplify the macro-economic risks which are still at an elevated level. Although several important steps have been taken recently both at the European and national level, uncertainty remains with regard to any remaining implementation risks. 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 global concern, e.g. the failing agreement in the US on the federal budget could affect the business of EU insurers' subsidiaries.
- Credit and market risk: The trend of decreasing credit spreads has continued. In addition to the effects of increased investor confidence, this development is also driven by accommodative monetary policy, the difficult global financial investment environment and investors' risk appetite striving for an appropriate balance of yield versus risk. Market risks are still dominated by the low-yield environment with 10-year swap rates in Western Europe though rates have slightly increased over the last weeks. Guaranteed interest rates in life insurance are currently, on average, some 50 basis points lower than four years ago.
- Profitability and solvency: Although profitability has improved with particularly strong ROE this quarter, this has been offset with a slight deterioration in solvency ratios in both life and non-life business following the slight improvement last quarter.

Risk summary

Risk	Score	Impact	Timing	Qualification
Macro *		High	Short-term	• Political risk with regard to sovereigns and Eurozone • Weak worldwide growth outlook with a significant dispersion in outlook within Eurozone
Credit *		Very High	Short-term	• Sovereign and corporate spreads somewhat declining • Corporate spreads might not fully capture default risk
Market		High	Medium-term	• Low-yield environment increases re-investment risk • Equity and property markets appear robust in many EU countries, but might be driven by cheap liquidity
Liquidity/ funding		Medium	Medium-term	• Lapse rates stabilised • Funding via cat bonds intact
Profitability/ Solvency		Medium	Structural	• Solvency ratios slightly declining • Profitability indicators in general positive (return on equity, combined ratio and investment income)
Interlinkages/ Imbalances		High	Medium-term	• Risk of banking crisis spillovers • Some balance sheet deleveraging in the insurance sector
Insurance *		Medium	Structural	• Uncertainty about medium-term sustainability of growth

For more definitions see legend on slide 8.

* Expert judgment applied, see slide 4.

Use of expert judgment, sample size

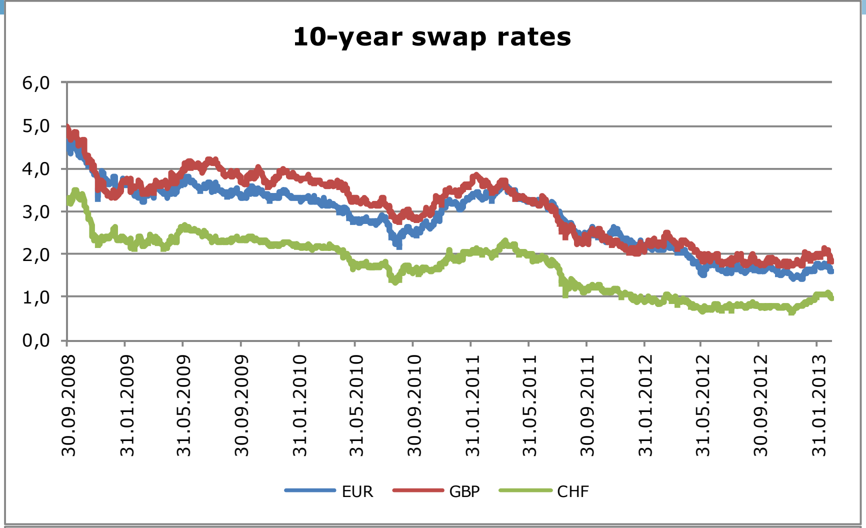
Use of expert judgment after the mechanical aggregation:

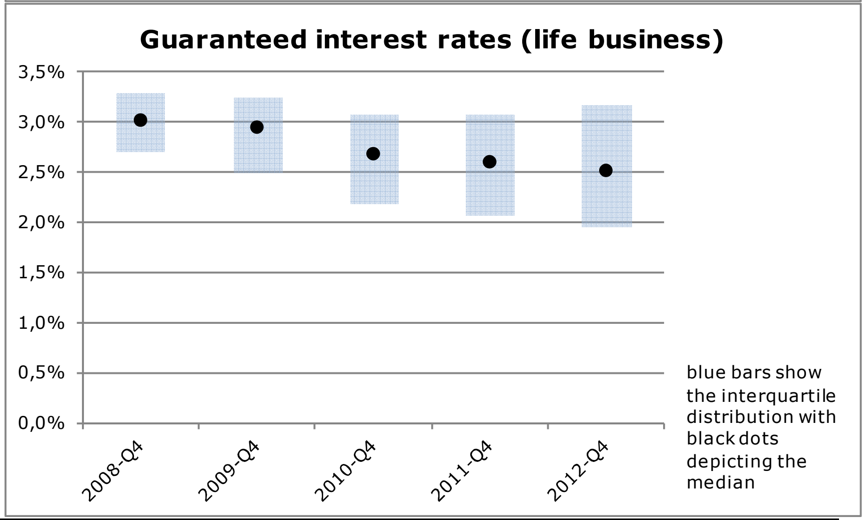
- Macro risk: slightly upwards due to high heterogeneity in growth figures across EU countries and general uncertainty about the medium-term growth potential and its implications for the demand of insurance products. In addition, implementation risks around the various crisis management tools used in 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 duly considered: This is a result of accommodative monetary policy while at the same time investors have limited alternatives to substantially reduce their credit risk exposure.
- Insurance risk: slightly upwards due to reduced buffers of reinsurers for catastrophe losses after Hurricane Sandy. In a longer term perspective it could additionally 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 the market and risks are adequately managed.

Detailed assessment: Market 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 potentially prove difficult to earn guaranteed interest rates, especially in life business where these guarantees are a common feature in many jurisdictions.
- It is, however, noted that the guaranteed interest rates on average declined over the last years from around 3% in 2008 to roughly 2.5% in 2012 – though with some variation across jurisdictions.[1]
- Equity and property markets are, at the moment, seen as rather robust. Also the exposure of the insurance sector towards these asset classes is in most jurisdictions relatively limited.



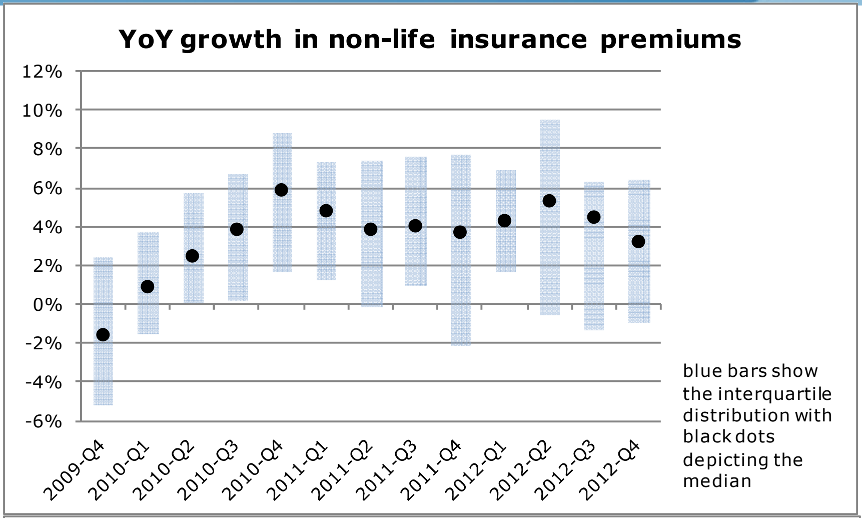


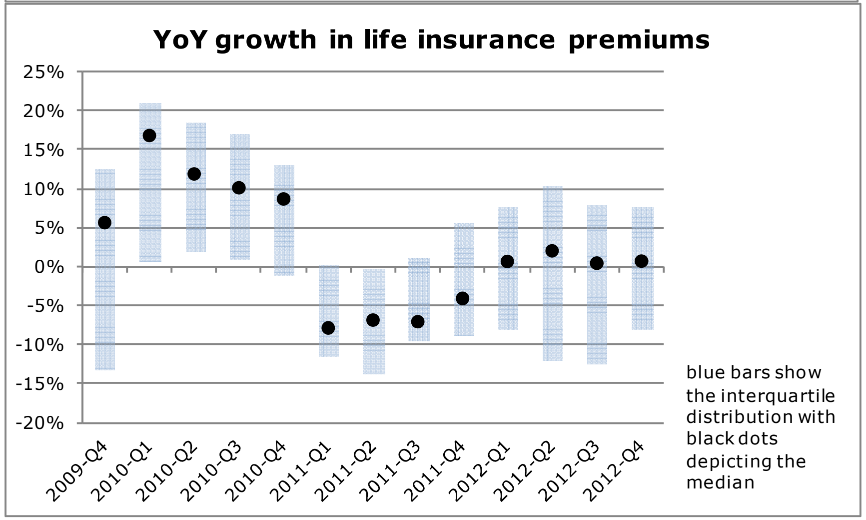
1 The increase of the guaranteed interest rate for the upper quartile is due to a smaller sample size in 2012-Q4 as compared to 2011-Q4.

Detailed assessment: Insurance risk

Insurance risk is currently characterised by positive premium growth (though higher for non-life than for life), lower insurance leverage and the smaller number of large-scale natural catastrophes in the recent months.

- Non-life premiums continued their growth trend in Q4-2012 although the increase was smaller in the two preceding quarters. In life insurance, the median growth in the sample was slightly positive – 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 during the course of 2012.

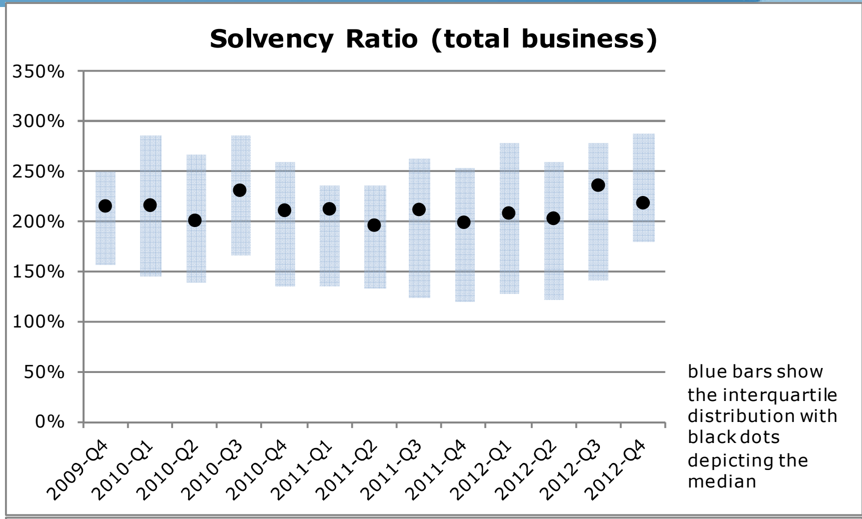


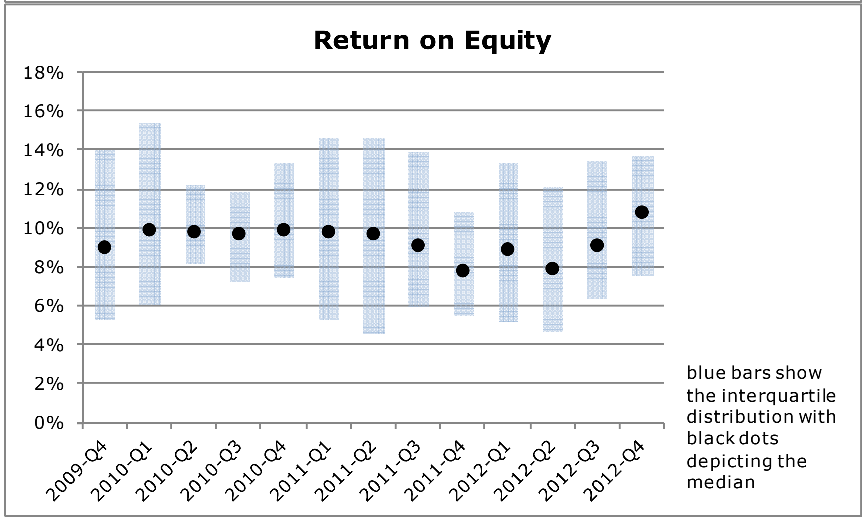


Detailed assessment: Profitability and solvency

Profitability and solvency currently signal some resilience of the insurance sector.

- Total solvency levels had decreased particularly in the lower quantiles of the distribution compared to the previous quarter, although capital levels are still relatively good when compared to historical results. Solvency ratios were fairly stable on the non-life side, there was a marginal decrease for life business. It is likely this is driven by the macro environment whereby there has been an increase in duration mismatch.
- Profitability has increased significantly with respect to the return on equity with median and 10th percentile both at 3-year highs. This is driven by improved combined ratios and investment returns. It is however too early to tell how sustainable the improvements in profitability will turn out to be in future.





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 assessment over the last three months; comparison is made with last quarter’s assessment	⇧	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