Maintaining stability of the EU insurance sector in times of uncertainty

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Although financial markets have gradually stabilised after the initial sharp drop in asset prices triggered by the COVID-19 outbreak, the ongoing lockdowns in most European countries cause uncertainty and medium-term risks for the economies. In addition, potential cliff-edge effects could materialise once the fiscal measures supporting economies will fade out. Strains to demand that will reflect into insurers' underwriting and overall profitability will take some time to unfold in parallel with the deterioration of the macroeconomic environment in which a reduction of economic activity and disposable income is starting to become tangible.

The outlook for the insurance sector depends critically on the future development of the pandemic and on the resilience of the economic recovery. Capital buffers of insurers were solid in the end of 2019 and proved resilient at the time of the virus outbreak. It stands out that life undertakings are affected the most due to their higher sensitivity to risk-free interest rates that reached their all-time low levels in the end of last year. The prolonged period of ultra-low yields is further negatively affecting the profitability prospects of insurers' invest¬ment portfolios, due to reinvestment risk. In addition, the risk of deterioration of corporates' ratings could affect the market value of insurers' corporate bond holdings. Nevertheless, European insurers have been able to withstand the dramatic situation as, in particular, the Solvency II regime helped them to better align capital to risk, build-up resilience and enhance their risk management practices. While risks surrounding the economic growth outlook remain high, they appear to have become less pronounced. EIOPA will assess the resilience of the sector to different recovery scenarios within the European Union-wide insurance stress test carried out this year.

In its Opinion on the Review of Solvency II, EIOPA proposes to broaden the prudential regime to incorporate the macroprudential perspective. The tools seek to enhance monitoring and add supervisory powers that might be useful to address the sources of system risk. Examples are the power to define soft thresholds for action at market level if a certain exposure increases dramatically and/or reaches a significant level, the expansion of the prudent person principle and the use of ORSA to include the macroprudential perspective, the request of pre-emptive plans (such as recovery or resolution plans) or an enhanced liquidity risk monitoring. In addition, EIOPA also proposes that supervisors should have the power to set a capital surcharge to address one or more entity-, activity- or behaviour-based sources of systemic risk or, in exceptional circumstances, additional measures to reinforce the insurer's financial position (i.e. the possibility of restricting or suspending dividend or other payments to shareholders and the possibility of restricting the purchase of the insurer's own shares).

A strong and stable insurance sector benefits the whole of society. EIOPA will therefore continue its work to ensure the early identification of risks and vulnerabilities, so that the insurance sector can continue to play a vital role in Europe's post-COVID recovery.

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