Eiopa outlines key financial stability risks of the European insurance and pensions sector

- *Risk of a prolonged low yield environment has intensified over the last 6 months and remains the key challenge for European insurers and pension funds, putting pressure on both solvency positions and long-term profitability*
- *Combination of weakening economic outlook, concerns over debt sustainability and stretched valuations across financial markets could also give rise to a sudden reassessment of risk premia*
- *Emerging cyber and climate change related risks continue to demand attention from insurers, pension funds and supervisors*
- *Interconnectedness with banks and home-bias in investments remain high for European insurers and could lead to potential spillovers of risks from other sectors*

Frankfurt, 18 December 2019 – Today, the European Insurance and Occupational Pensions Authority (EIOPA) published its December 2019 Financial Stability Report of the (re)insurance and occupational pensions sectors in the European Economic Area.

The risk of a prolonged low yield environment has intensified over the last 6 months, as a combination of weakening economic outlook, growing trade tensions and increased downside risks have ushered in a new round of monetary policy easening by central banks, which has been accompanied by sharp decline in longer-term yields. The low yield environment remains the key risk for both the insurance and pension fund sector and continues to put pressure on solvency positions. While the European insurance sector remains overall well capitalized with a median Solvency ratio of 212%, significant disparities remain across undertakings and countries. Overall solvency positions have also deteriorated in the first half of 2019 and the low interest rate environment is expected to put further pressures on the capital positions going forward, in particular for life business. The low yield environment also has implications for long-term profitability, as it becomes increasingly difficult to meet promises and guarantees issued in the past. This could trigger further search for yield behaviour by insurers and pension funds, which could add to the build-up of vulnerabilities in the financial sector if not managed properly. Moreover, a combination of weakening economic outlook, concerns over debt sustainability and stretched valuations across financial markets could give rise to a sudden reassessment of risk, in particular for riskier assets, which could trigger losses in the investment porfolios of insurers and pension funds. EIOPA will therefore continue to monitor closely this risk to identify at an early stage any potential vulnerabilities.

Furthermore, cyber risk and climate change risks continue to demand attention from insurers, pension funds and supervisors, as insurers and pension funds are increasingly susceptible to cyber risks as the digital transformation continues, while also bringing new opportunities for insurers in the form of cyber underwriting. Regarding climate risk, insurers and pension funds can play a key role in the transition towards a low carbon economy as major institutional investors, but this transformation carries significant investment risks as well. It is therefore crucial that both insurers and pension funds actively incorporate climate change risks in their own risk management frameworks. At the same time, climate change can also have a significant impact on the liabilities of non-life insurers and reinsurers, as extreme weather related events become more frequent and severe. EIOPA has taken several initiatives to pro-actively tackle the climate challenge, by analysing potential climate-sensitive exposures in insurance investment portfolios, while the stress test for IORPs in 2019 also included an assessment of potential transition risks for pension funds. Furthermore, EIOPA published an Opinion on integrating sustainability and climate change risks into the Solvency II framework in September 2019. Going forward, EIOPA will continue to build on this work to assess both physical and transition risks for insurers and pension funds and assess potential misalignment with the Paris agreement climate goals.

The reinsurance industry has seen a relatively benign first half of 2019 in terms of catastrophic events, with global insurance losses significantly below long-term levels and the record losses observed in 2017 and 2018. Coupled with the overall positive stock market developments, this has benefited the profitability and solvency position of the reinsurance sector, although losses in the second of half of the year could still have significant impact. Growth in global reinsurance capital has been supported mostly by traditional capital, although outstanding alternative reinsurance capital has also continued to grow despite concerns related to the potential effect of climate change on the occurrence of natural disasters. The issuance of new ILS instruments appears to be more moderate in 2019 compared to the previous two years however.

Finally, the challenging economic environment has also taken its toll on the financial situation of the European occupational pension fund sector. The persistently low interest environment affects the current values of DB pension obligations and in almost all Member States, cover ratios (ratio of assets covering the pension obligations) decreased with the outlook continuing to look challenging in light of the slowdown in the global economy and the pressure on the interest rates. Asset values also impaired significantly towards the end of 2018, wiping off substantial values in equity investments which also affected the accumulated savings of members and beneficiaries in DC funds. Going forward, the improved reporting framework for the IORP sector will allow for an enhancement monitoring and assessment of potential vulnerabilities and financial stability implicatinos of European pension funds.

Gabriel Bernardino, Chairman of EIOPA said: *“Over the past six months, we have seen the risks for a prolonged low yield environment intensify. A combination of a weakening economic outlook, increased downside risks and* *ongoing uncertainties about trade disputes and Brexit have ushered in a new round of monetary easing by central banks, which has been accompanied by a sharp decline in longer-term yields. In this regard, we continue to see the clear benefits of Solvency II, as the market-consistent and risk-based regulatory framework has helped price in the risk of low interest rates, build resilience and enhance the risk management practices of insurers. At the same time, it is important that the regulatory framework continues to remain robust in the future and adequately reflects the risks faced by insurers in a low for long environment. As such, it is crucial that these elements are addressed in the currently ongoing Solvency II review to ensure that promises can continue to be met in the future."*

This Financial Stability Report also includes two thematic articles, focusing on i) a climate risk assessment of the sovereign bond portfolio of European insurers and ii) the impact of variation margining on EU insurers' liquidity.

EIOPA's Financial Stability Report – December 2019 is available via this link.

Notes for Editors

The **European Insurance and Occupational Pensions Authority (EIOPA)** was established on 1 January 2011 as a result of the reforms to the structure of supervision of the financial sector in the European Union. EIOPA is part of the European System of Financial Supervision consisting of three European Supervisory Authorities, the National Supervisory Authorities and the European Systemic Risk Board. It is an independent advisory body to the European Commission, the European Parliament and the Council of the European Union. EIOPA's core responsibilities are to support the stability of the financial system, transparency of markets and financial products as well as the protection of insurance policyholders, pension scheme members and beneficiaries.