RISK DASHBOARD

April 2017[1]

Risks	Level	Trend
1. Macro risks	High	→
2. Credit risks	Medium	→
3. Market risks	Medium	↘
4. Liquidity and funding risks	Medium	→
5. Profitability and solvency	Medium	↓
6. Interlinkages and imbalances	Medium	→
7. Insurance (underwriting) risks	Low	→
Market perceptions	**Level**	**Trend**
8. Market perceptions	Medium	↗

Key observations:

- According to this assessment, risks for the insurance sector remained overall stable in Q4 and some improvements were observed. Solvency II ratios are stronger due in part to higher market values of assets and the increase of the risk free curve used for discounting the technical provisions. Volatility has decreased and inflation rates have slowly started to converge to desired target levels.
- Despite these positive signs, the continuing low-yield environment and the observation that market fundamentals might not properly reflect the underlying credit risk still represent important concerns for the EU insurance industry. This is also reflected by the slightly deteriorating market perception and the recent underperformance of insurance stock prices.

[1] Reference date for company data is Q4-2016, while the cut-off date for most other indicators is end-March 2017.

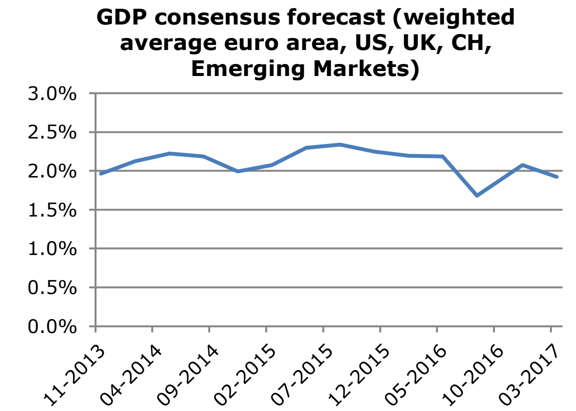
Macro risks

Level: high

Trend: constant

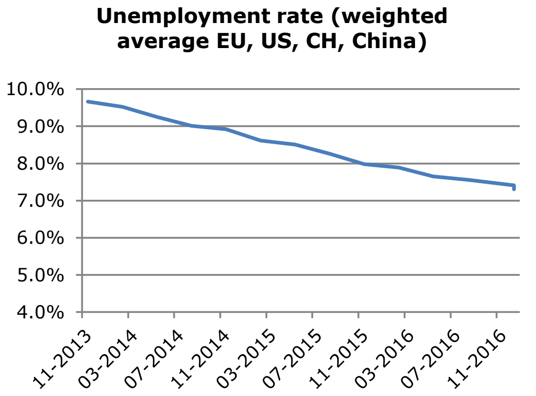
The macroeconomic environment characterised by an enduring low-yield environment remains fragile, especially for the insurance sector. Some sign of improvements are noted as inflation rates have further converged to desired target levels and unemployment rates are decreasing, but some dispersion among European countries can be observed.

The GDP forecast remains around 2% expected real growth.



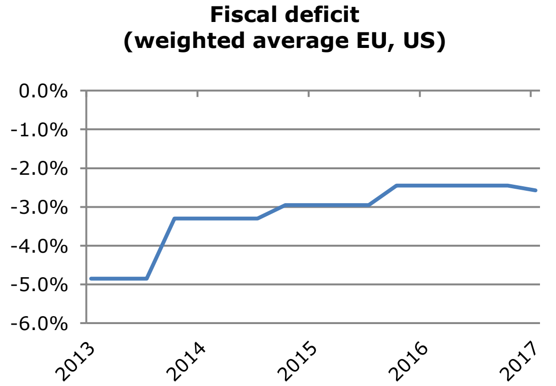
Source: Bloomberg Finance L.P.

Unemployment rate decreases over the last few years, while some dispersion among European countries continues to exist.



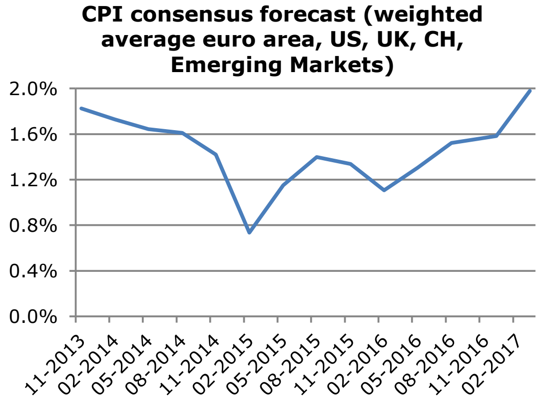
Source: Bloomberg Finance L.P.

The fiscal deficit is slightly widening in the last months.



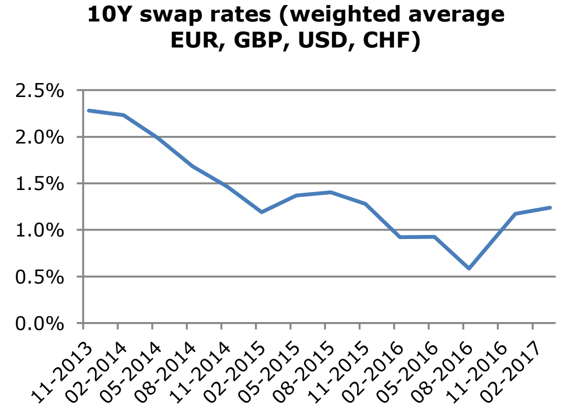
Source: Bloomberg Finance L.P.

The inflation consensus forecast is further approaching desired target levels around 2%.



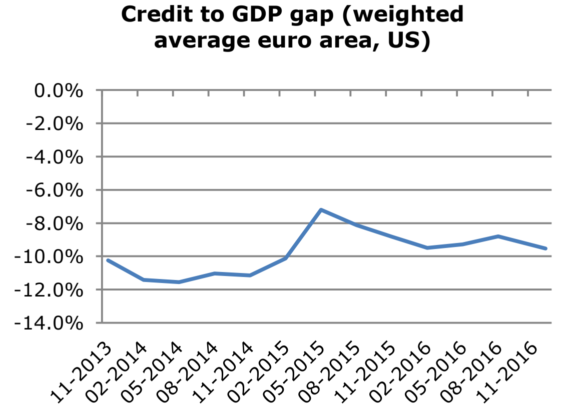
Source: Bloomberg Finance L.P.

After a prolonged period of interest rate decreases, the swap rates rebounded since mid-2016.



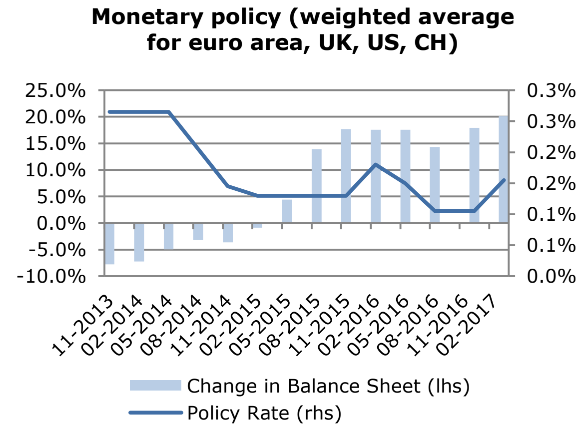
Source: Bloomberg Finance L.P.

The Credit-to-GDP gap is still largely negative.



Source: BIS

Policy rates increased following monetary policy changes in the US. Central Banks' balance sheet further expanding due to QE interventions.

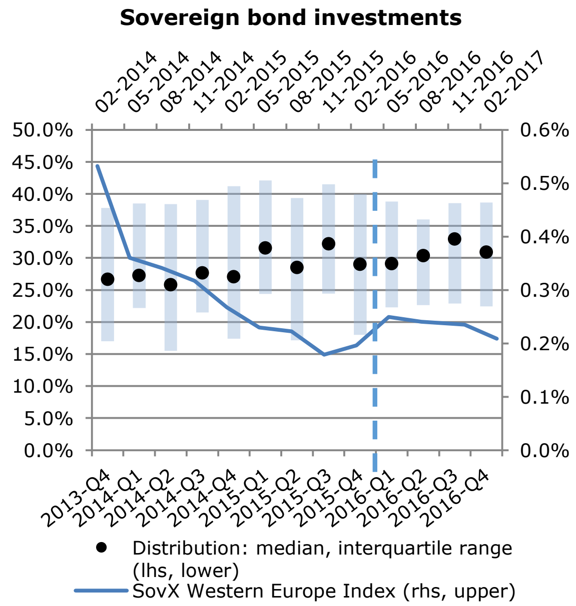


Source: Bloomberg Finance L.P.

Credit risks	 Level: medium Trend: constant	

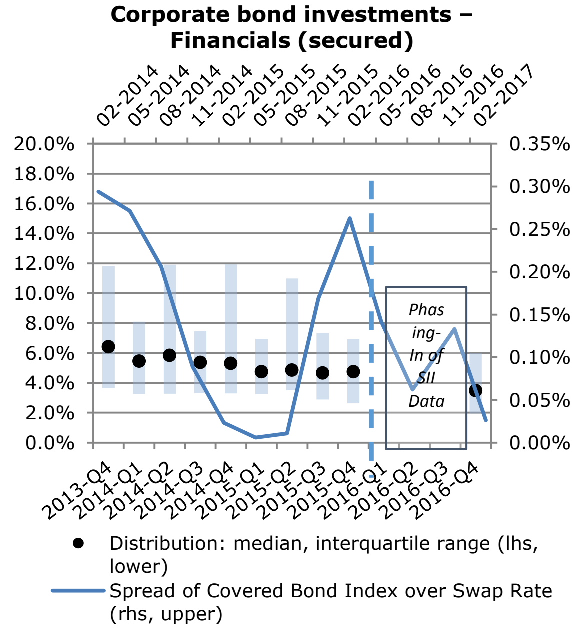
Indicators covering the exposure towards corporate bonds were enhanced by increasing the granularity of the indicators. The enhanced approach confirms the medium risk level previously obtained.

Spreads for sovereign bonds decreased slightly in autumn 2016 and remained stable afterwards. The share of investments in sovereign bond dropped slightly.



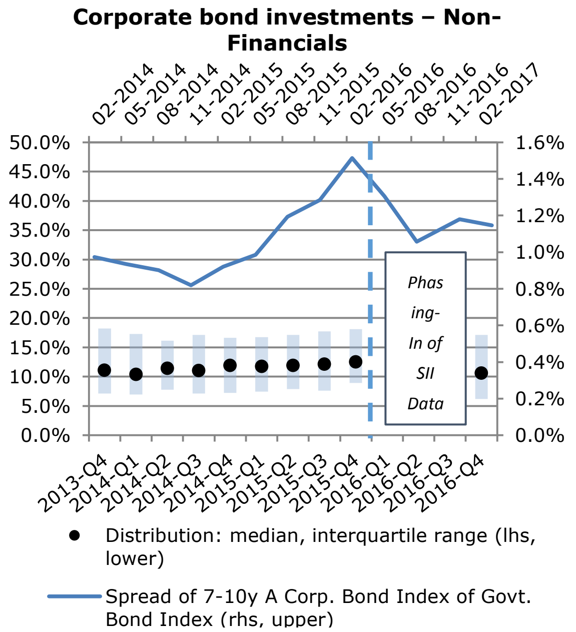
Source: Bloomberg Finance L.P., QFG (N=85); QFT prior to 2016

Spreads for secured financial bonds showed high volatility in 2016 and beginning 2017, moving close to 0%.



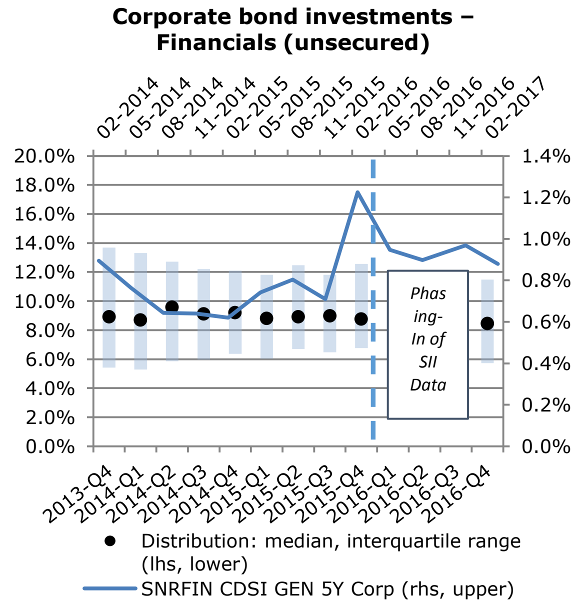
Source: Bloomberg Finance L.P., QFG (N=63); QFT prior to 2016

Spreads for corporate bonds non-financials remained stable since mid-2016.



Source: Bloomberg Finance L.P., QFG (N=63); QFT prior to 2016

Spreads for unsecured financial bonds decreased slightly after a temporary increase in the previous quarter.



Source: Bloomberg Finance L.P., QFG (N=63); QFT prior to 2016

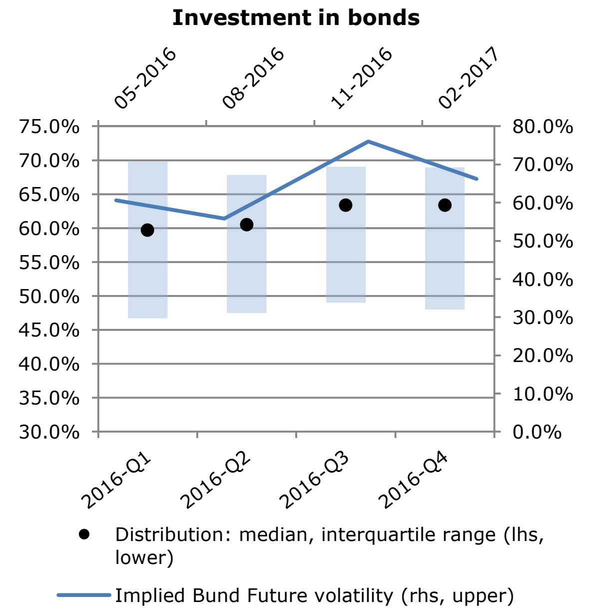
Market risks

Level: medium

Trend: decreasing

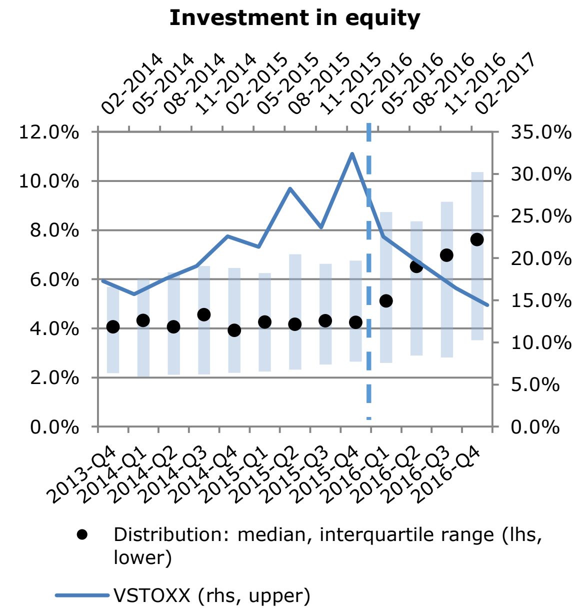
The volatility in bond prices has decreased from the third to the fourth quarter, resulting in a lower risk score. The median value of the duration mismatch between assets and liabilities is about 3 years.

Bond price volatility slightly decreased. Exposures towards bonds are stable over the last quarter.



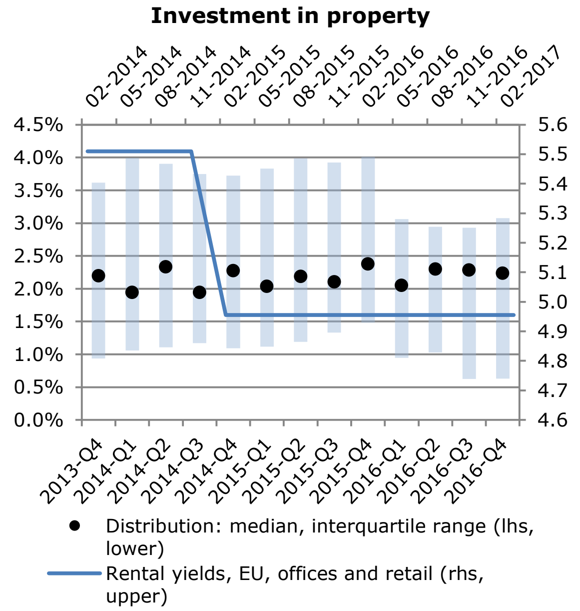
Source: Bloomberg Finance L.P., QFG (N=85)

Since beginning 2016 stock volatility has been decreasing. Exposures are also driven by increasing market values.



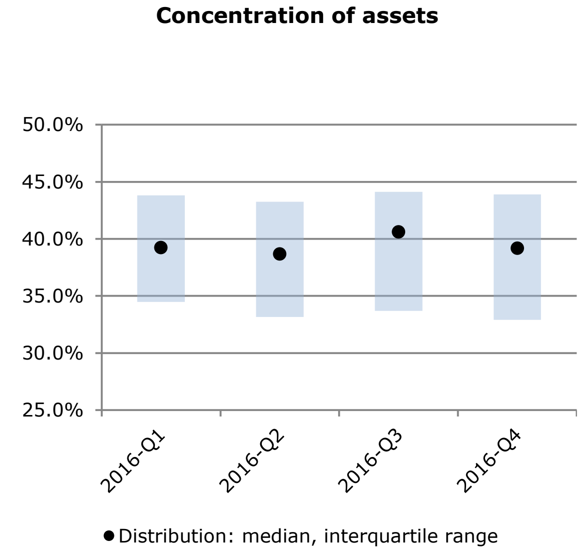
Source: Bloomberg Finance L.P., QFG (N=85); QFT prior to 2016

The indicator is stable due to the use of an annual risk measure and property investments are broadly unchanged.



Source: Bloomberg Finance L.P., QFG (N=85); QFT prior to 2016

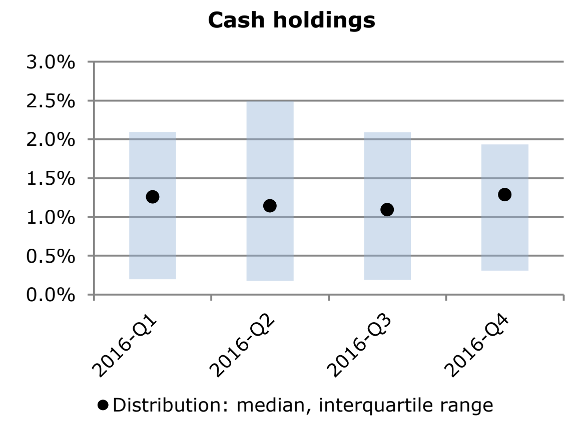
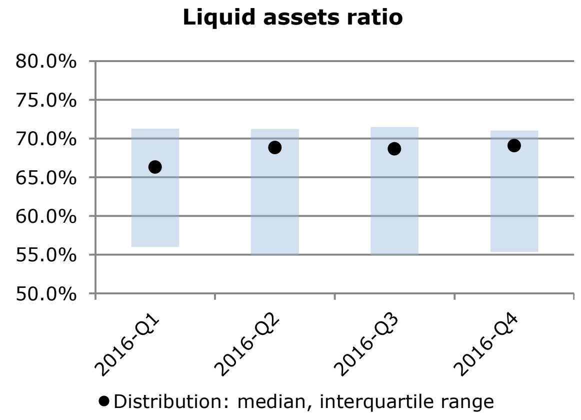
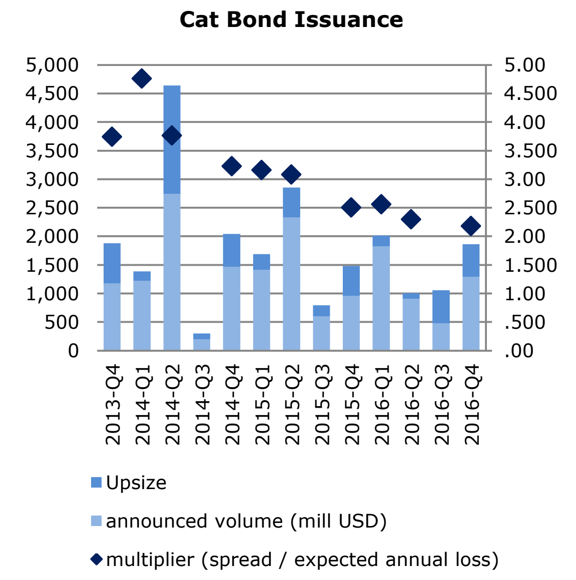
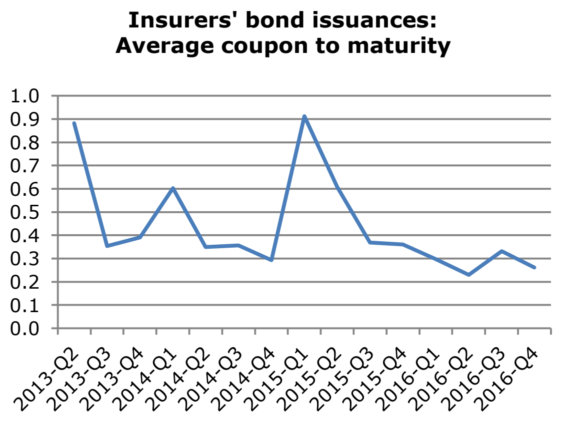
The level of concentration of assets remains stable.



Herfindal Hirshman index computed on 5 balance sheet asset classes (government bonds, corporate bonds, equities, properties and cash and equivalent)
Source: Bloomberg Finance L.P., QFG (N=85)

Liquidity and funding risks	Level: medium Trend: stable	

The overall assessment of risks relating to liquidity and funding remains rather unchanged for Q4 which confirms a stable development for the whole year. Lapse rate (for liquidity risk) is slightly above 2% and bond issuance (for funding risk) indicator reports a high demand for debt instrument issued by insurers showing a low level of risk.

The share of cash holdings increased slightly.	*The proportion of more liquid assets in the portfolios of the insurance undertakings remains on a stable level.*
	
Source: QFG (N=85)	Source: QFG (N=84)
Issuance volume has increased and the demand for cat bonds still remains at a high level.	*In recent years it has become cheaper for insurance companies to issue longer-term debt.*
	
Volumes in USD mn, spread in percent Source: www.artemis.bm	Source: Bloomberg Finance L.P

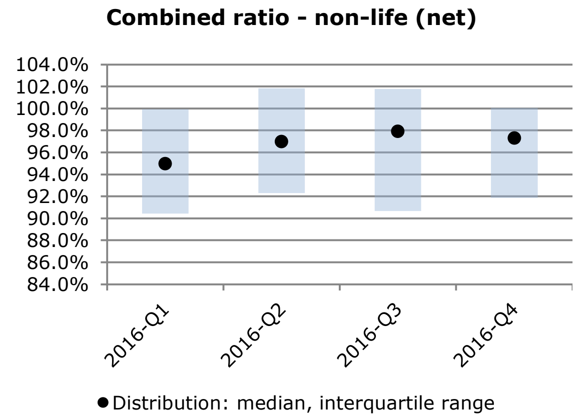
Profitability and solvency

Level: medium

Trend: substantial decrease

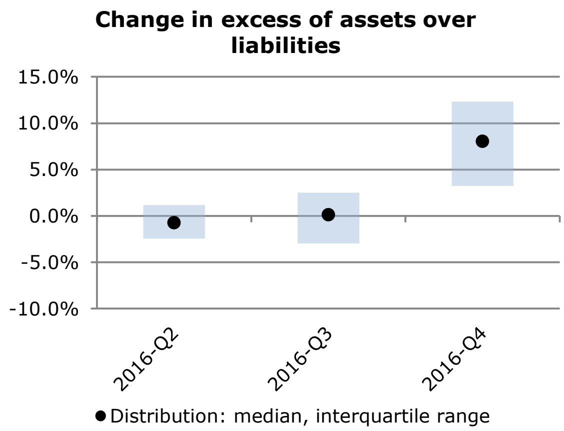
The overall improvement of the profitability and solvency risks results especially from the strong improvement observed for Solvency ratios due to the increase of eligible own funds.
The Solvency ratios have improved both in life and in non-life segment.
Profitability of the sector remains unchanged.

The net combined ratio is quite stable, averaging 97%. 25% of the market is either below 92% or above 100%.



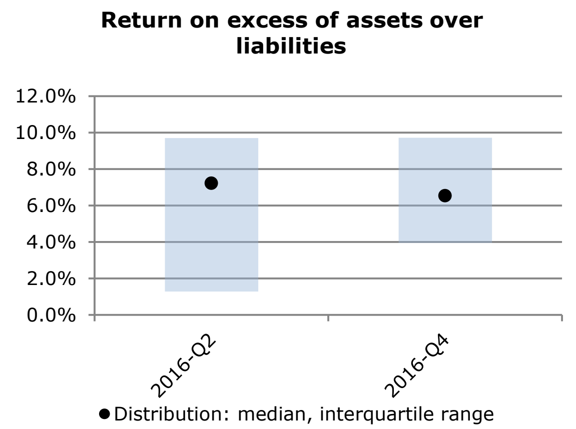
Source: QRS (N=928)

The growth of the excess of asset over liabilities increased significantly during the last quarter.



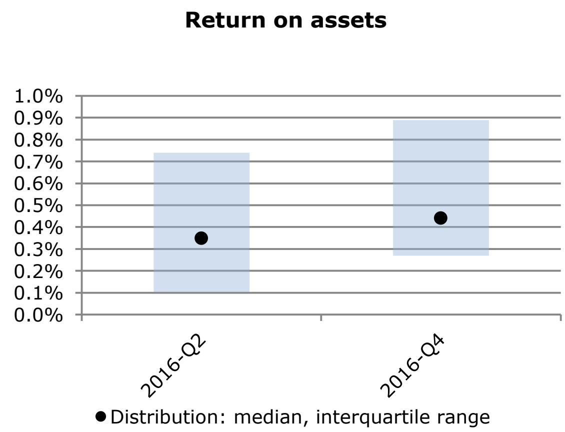
Source: QFG (N=74)

The average excess of assets over liabilities (used as a proxy of return on equity) is 7.4% and stable compared to the Q2 annualised figure. The lowest percentiles have improved in the second half of 2016.



Source: QFG (N=85)

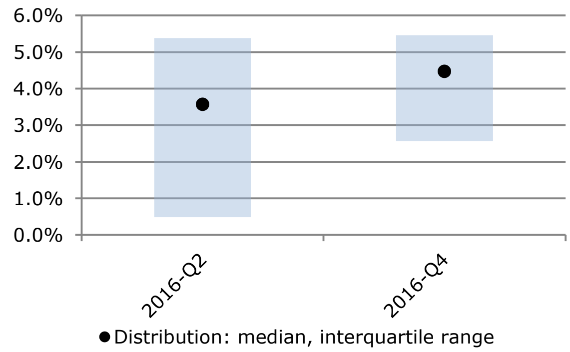
The average return on assets is 0.6%. It is slightly improved compared to the Q2 annualised figure, as is the whole distribution.



Source: QFG (N=84)

The average return to premiums amounts to 4.5%.

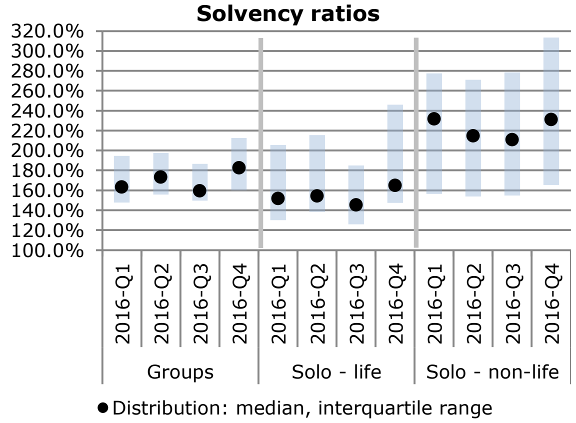
Return to premiums



Source: QFG (N=84)

The SCR coverage ratio is on average 198%. It has increased by 16 percentage points. For non-life firms it is 259% (+17 p.p.), higher than for the average life company at 208% (+36 p.p.).

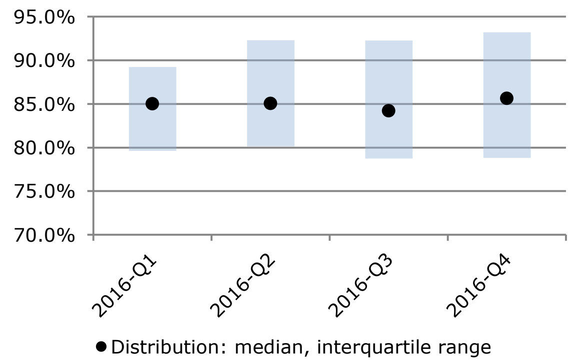
Solvency ratios



Source: "Total" QFG (N=84), "Life" QRS (N=455), "Non-life" QRS (N=1,067)

Own funds have a high weight of Tier 1 (on average around 87%). The time series shows a slight increase.

Tier 1 own funds to total own funds

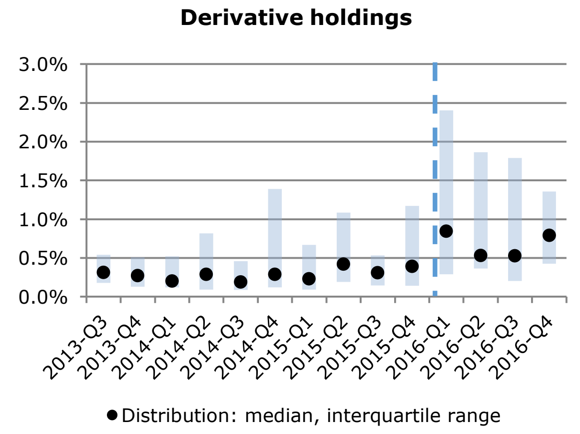


Source: QFG (N=84)

Interlinkages & imbalances		
	Level: medium	
	Trend: constant	

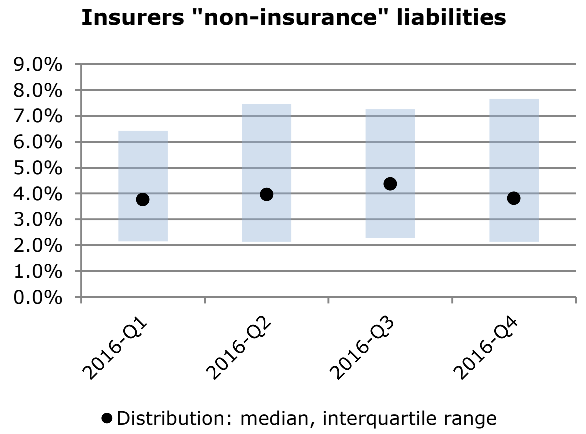
The risks observed overall remain at a medium level. The exposure to the financial sector, in particular towards the banking sector, and in domestic sovereign bonds (median slight above 10%) is captured in the risk level. Insurers' indebtedness and the reinsurance part of premium remain stable and low.

Insurers' derivative holdings median level has seen a slight increase from Q3 to Q4. However the distribution has narrowed from previous quarters. Overall the risk score remains stable.



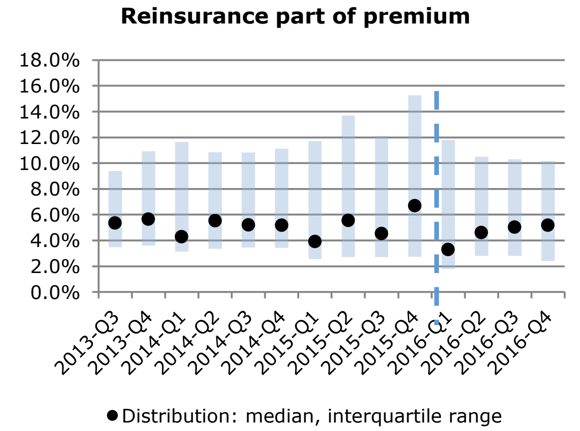
Source: QFG (N=85); QFT prior to 2016

The insurers' indebtedness indicator has been replaced by the following indicator which measures the level of non-insurance related liabilities against non-unit linked assets.



Source: QFG (N=85)

Reinsurance part of premium remains at a steady level inducing no change in the sub-risk category.



Source: QFG (N=84); QFT prior to 2016

Insurance (underwriting) risks

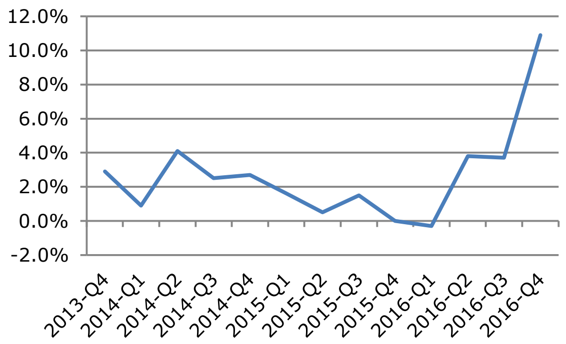
Level: low

Trend: constant

The insurance risk indicators saw a diverse movement. Whereas the catastrophe losses increased significantly (based on a small sample), this effect was overcompensated by a benign development of the general loss ratio.
General uncertainties, instabilities and events (e.g. terrorist attacks in Europe, major natural disasters and extreme weather events) remain to be a potential source of threats to the future development of insurance business. Market analysts expect the insurance marketplace to change more drastically in 2017 than before, also due to the rising threat of cyber-attacks.

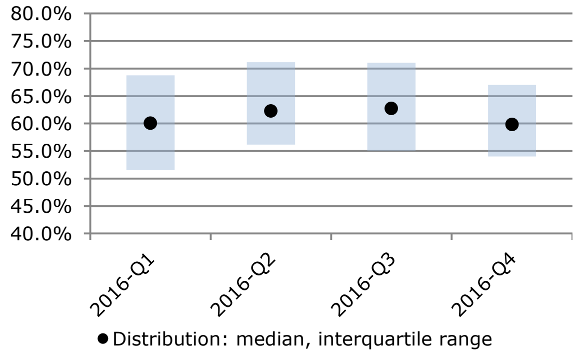
Catastrophe losses significantly increased after coming down in the previous quarter. Cumulated losses in 2016 reached a multi-year high due to devastating earthquakes and powerful storms.	*Loss ratios decreased from Q3 to Q4. The median value also decreased, remaining on a low level.*

Catastrophe loss ratio (Cumulative Year to Date figure)



Source: Munich Re

Loss Ratio (gross)



Source: QRS (N=1,299)

Market perceptions

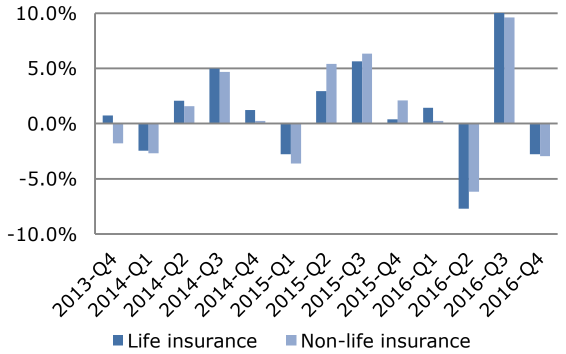
Level: medium

Trend: increase

Market perception of the insurance industry has slightly deteriorated mainly driven by the reversed outperformance indicator. Also, ratings and rating outlooks have deteriorated.

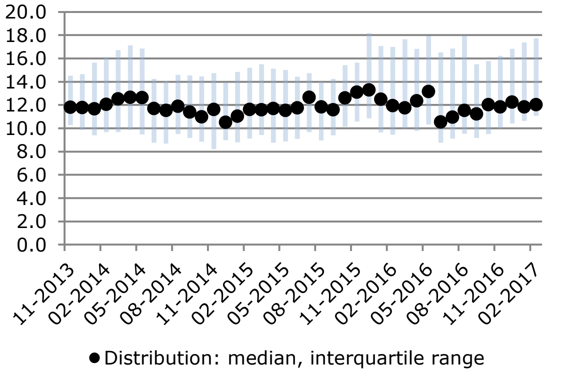
Substantial outperformance of insurance stocks in Q3. Reversed in Q4.	*Price/earnings ratios remained stable over the last quarter.*

Outperformance of insurance stock prices



Outperformance over 3-month periods
Source: Bloomberg Finance L.P.

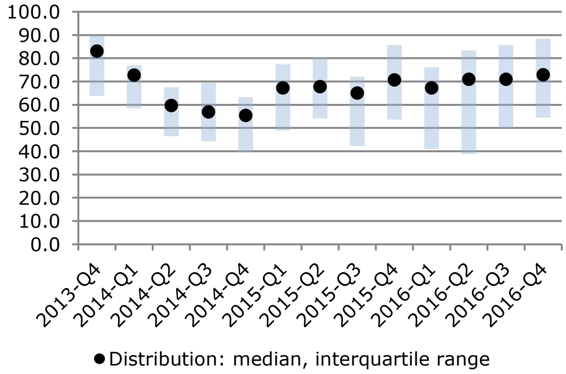
Price/earnings ratio



Source: Bloomberg Finance L.P. (N=12)

Constant median and slightly increased dispersion across the sample.

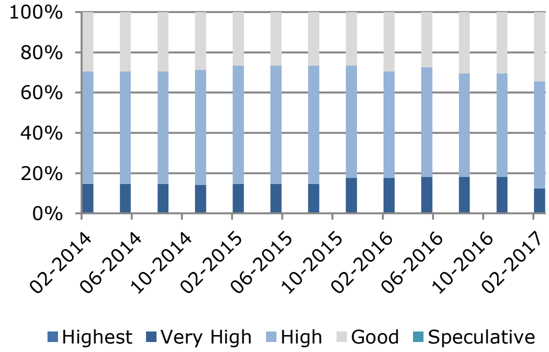
Insurers' CDS spreads



Source: Bloomberg Finance L.P. (N=16)

Overall rating quality remains good with a decrease in the highest rated category.

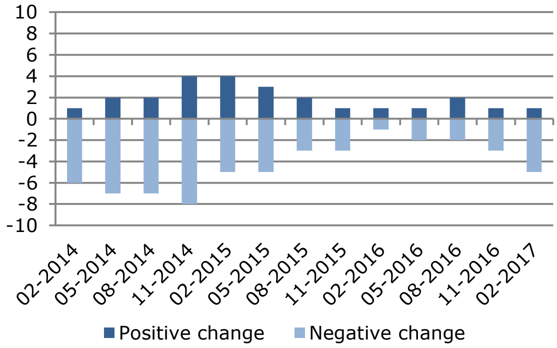
Insurers' external ratings (credit quality steps)



Source: Standard & Poor's via Bloomberg Finance L.P. (N=32)

Vast majority of outlooks is stable. The number of negative outlooks increased.

Insurers' external ratings (positive/negative outlooks)



Source: Standard & Poor's via Bloomberg Finance L.P. (N=32)

APPENDIX

Level of risk		Very high
		High
		Medium
		Low

Trend	⇧	Large increase
	⬀	Increase
	⇨	Constant
	⬂	Decrease
	⇩	Large decrease

Description of risk categories

Macro risks

Macro risk is an overarching category affecting the whole economy. EIOPA's contribution focuses on factors such as economic growth, state of the monetary policies, consumer price indices and fiscal balances which directly impact the insurance industry. The indicators are developed encompassing information on the main jurisdictions where European insurers are exposed to both in terms of investments and product portfolios.

Credit risks

The category measures the vulnerability of the European insurance industry to credit risk. To achieve this aim, credit-relevant asset class exposures of the (re)insurers are combined with the relevant risk metrics applicable to these asset classes. For instance, the holdings of government securities are combined with the credit spreads on European sovereigns.

Market risks

Market risk is, for most asset classes, assessed by analysing both the investment exposure of the insurance sector and an underlying risk metric. The exposures give a picture of the vulnerability of the sector to adverse developments; the risk metric, usually the volatility of the yields of the associated indices, gives a picture of the current level of riskiness. The risk category is complemented by an indicator which captures the difference between guaranteed interest rates and investment returns.

Liquidity and funding risks

This category aims at assessing the vulnerability of the European insurance industry to liquidity shocks. The set of indicators encompasses the lapse rate of the life insurance sector with high lapse rate signalling a potential risk, holdings of cash & cash equivalents as a measure of the liquidity buffer available, and the issuance of catastrophe bonds, where a very low volume of issuance and/or high spreads signals a reduction in demand which could form a risk.

Profitability and solvency

The category scrutinises the level of solvency and profitability of the European insurance industry. Both dimensions are analysed for the overall industry (using group data) and include a breakdown for the life and non-life companies (using solo data). In detail, the solvency level is measured via solvency ratios and quality of own funds. Standard profitability measures for the whole industry are complemented by indicators such as the combined ratio and the return on investments specifically applied to the non-life and life industry respectively.

Interlinkages and imbalances

Under this section various kinds of interlinkages are assessed, both within the insurance sector, namely between primary insurers and reinsurers, between the insurance sector and the banking sector, as well as interlinkages created via derivative holdings. Exposure towards domestic sovereign debt is included as well.

Insurance (underwriting) risks

As indicators for insurance risks gross written premiums of both life and non-life business are an important input. Both significant expansion and contraction are taken as indicators of risks in the sector; the former due to concerns over sustainability and the latter as an indicator of widespread contraction of insurance markets. Information on claims and insurance losses due to natural catastrophes also contribute to this risk category.

Market perception

This category encompasses the financial markets' perception of the healthiness and profitability of the European insurance sector. For this purpose, relative stock market performances of European insurance indices against the total market are assessed, as well as fundamental valuations of insurance stocks (price/earnings ratio), CDS spreads and external ratings/rating outlooks.

Abbreviations

AFG	Annual Financial Stability Reporting for Groups
ARS	Annual Prudential Reporting for Solo Entities
QFG	Quarterly Financial Stability Reporting for Groups
QRS	Quarterly Prudential Reporting for Solo Entities
QFT	Quarterly Fast Track Reporting (pre-Solvency II, for around 32 large insurance groups on a best effort basis)

Notes

- Sample size for the different indicators may vary according to availability and consistency of the reported information.

- Vertical dashed lines where displayed in the graphs signals the structural change in the series driven by the transition from Solvency I to Solvency II reporting.

EIOPA Risk Dashboard April 2017

This report provides an interim risk-update, updating previous Risk Dashboards. Legal basis of this report is Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), and in particular Article 32 (Assessment of market developments) thereof.