

## **EIOPA's Insurance Stress Test 2016**

### **Frequently asked Questions & Answers**

#### **1. What is a stress test?**

A stress test is an important risk management tool. It is used by financial institutions, micro-prudential and macro-prudential supervisors to explore vulnerabilities and assess the resilience of financial institutions (e.g. banks, insurers) and whole systems (e.g. the banking sector, the insurance sector) to severe but plausible external shocks. Stress tests assess adverse outcomes under a variety of risks. They provide an indication of the impact and potential losses on materialization of these risks, and help to indicate areas where further supervisory actions are needed.

#### **2. Why does this test focus on solo undertakings and not on insurance groups as it was done previously?**

The main focus of the current stress test is the low interest rates environment. The effects of this environment differ from country to country and also depend on the type of guarantees offered. Approaching solo undertakings primarily running long term business allows a better delimitation of the vulnerabilities at country level. EIOPA made this choice conscious of the fact that individual subsidiaries may, at consolidated basis, find support from well diversified groups and will take these aspects into account when analysing the results. However, in the first year in which Solvency II is legally enforceable, EIOPA wanted to avoid the extra burden that a double request of information (as it was done in the 2014 exercise) would imply for the insurance industry if groups were also included.

#### **3. What is the reference date for the Stress Test 2016?**

1 January 2016.

**4. Who selects the participants for EIOPA's Stress Tests?**

It is the National Competent Authorities (NCAs) that identify and contact prospective participants in the stress test, based on the criteria and target market share agreed at the level of EIOPA.

**5. Will the Stress Test not become a burden for the small- and medium sized companies?**

No, EIOPA applies the principle of proportionality and ensures that only relevant companies participate in the EU-wide stress test, even if the target participation rate is increased compared to 2014 exercise.

For this purpose, EIOPA has foreseen the possibility for a reduction of the target market share coverage from the 75% to 50% in cases where NCAs would have to add companies representing less than 1% of the national market share or in cases where companies with gross life technical provisions (excluding health and index-linked and unit-linked) below EUR 50 Million (at year-end 2015) would need to be added, to reach the 75% threshold.

**6. Will EIOPA disclose individual results of the companies?**

EIOPA will publish the list of participating companies. However, the results of the stress test will be disclosed in an anonymized and/or aggregated way.

Again EIOPA's stress tests are not pass-or-fail exercises. They aim to identify the risks and vulnerabilities of the European insurance sector.

In line with the Solvency II requirements as of 2017 insurance companies will publicly disclose data related to their solvency positions. Therefore, this time EIOPA prefers not to publish individual stress test results with companies' names.

Currently, EIOPA in cooperation with the NCAs is investigating the legal basis for possible enhancement of the disclosure of stress test results for the upcoming exercises.

**7. To what extent is the Stress Test based on the Solvency II harmonised reporting requirements?**

The stress test templates reproduce to the extent possible the Solvency II day-1 templates used for the supervisory reporting purposes. The stress test templates and specifications explicitly identify the additional information that is required for the stress test. Information which is required for the supervisory reporting purposes, but is either simplified or not required for the stress test, is also identified.

**8. Why do the Stress Test technical specifications - with regard to the reconstruction of the balance sheets after the stresses – not exactly reproduce the Solvency II framework?**

EIOPA Stress Test 2016 is not a pass-or-fail exercise. Its main focus is on assessing vulnerabilities and the potential systemic impact of shocks to the financial and economic environment. As such, there are no requirements for recalculating solvency position post stress and some scenarios may include elements not prescribed in the regulatory framework.

**9. How exactly did the European Systemic Risk Board (ESRB) contribute to the EIOPA Insurance Stress Test 2016?**

EIOPA discussed with the ESRB potential stress scenarios for the insurance sector based on their risk outlook. As a result, the current “double hit” scenario was agreed. The scenario has been calibrated using the European Central Bank’s (ECB) financial shock simulator and consists of a set of prices’ shocks for a large spectrum of assets triggered by two simultaneous events: a shock in government bond prices and a drop in the risk free rate curve. The scenario is accompanied by a qualitative questionnaire, which investigates the second round effects.

**10. Are there any differences between the input from the ESRB published on the ESRB’s Website and the scenarios employed by EIOPA in the Stress Test?**

Yes. First of all, the stress test package includes a separate scenario (the “low-for-long” scenario) developed exclusively by EIOPA to assess the impact of a prolonged period of low yields.

Second, in order to ensure that the overall stress test package was complete and that the technical specifications were consistent, some

adjustments and additions were required to operationalise the input. In particular, the shocks provided in the “double-hit” scenario were extended to other currencies and countries where necessary.

Moreover, shocks were added to commercial real estate prices in the “double-hit” scenario. The path for commercial property prices was separately provided by ECB staff and is consistent with the “double-hit” scenario.

Finally, some adjustments were necessary to the qualitative questionnaire published by the ESRB for the “double-hit” scenario, in particular to reflect the fact that EIOPA is not requiring the recalculation of the SCR and MCR post stress. All of these adjustments and operationalisations were carried out in cooperation with the ESRB and ECB.

#### **11. What is the time horizon of the “low-for-long” scenario?**

It covers until the end of the life on current insurance portfolios. Consistently with the forward looking valuation prescribed by Solvency II and the instantaneous shocks approach applied in the stress test, the assumptions implying very low risk free rates will affect the valuation of balance sheet until the very end of the insurer’s liabilities. Given the focus of the exercise on those insurers providing long term guarantees the life of the obligations will vary but it may go beyond 60 years in many cases.

#### **12. What is the likely-hood of the “double-hit” scenario?**

While developing the scenario EIOPA created the situation when the rapid increase of all the EU sovereign bond yields and a drop in a risk free rate are happening simultaneously. Such a situation has not been observed so far. The severe character of this scenario was designed as a response to the challenging macroeconomic environment we are currently observing. Such a scenario is a low probability event, at the same time its likely-hood cannot be fully ruled out. The solely purpose of this scenario is to obtain a better picture of the most critical vulnerabilities of the sector. Given this purpose the severity of the “double-hit” scenario goes beyond the Solvency II capital requirements. Further technical information can be found on EIOPA’s and ESRB’s Website – see link: <https://goo.gl/OXCSxr>

**13. Why does the Stress Test require information on the impact of long-term guarantee (LTG) measures from participants?**

The LTG measures are relevant for assessing the impact of the scenarios of the stress test.

In addition, and as a part of the mandatory review of the long-term guarantees (LTG) measures and measures on equity risk to be performed by EIOPA in accordance with Article 77f of the Solvency II Directive, EIOPA is obliged to produce yearly reports on the impact of the LTG measures. The first report of this kind should be produced in 2016.

In order to reduce the burden on industry, EIOPA decided to collect the relevant information simultaneously with the stress test and not in a separate exercise. This additional information is conveniently identified in the technical specifications of the stress test.

**14. Does the Stress Test fully reproduce the Solvency II framework?**

The starting balance sheet of the stress test reproduces the Solvency II balance sheet in the pre-stress situation. Participants are requested to re-compute the initial balance sheet under the assumptions of two hypothetical adverse scenarios according to the specifications of the stress test. In particular, it is considered more appropriate in assessing potential vulnerabilities at the European level to use a different assumption for the ultimate forward rate (UFR) in the low for long scenario and a particular application of the transitionals. Consequently, the balance sheet after the scenarios which is relevant from a financial stability perspective would not be fully appropriate to assess the compliance with the legally enforceable capital requirements under Solvency II. Therefore the recalculation of the minimum and solvency capital requirements (MCR and SCR respectively) is not requested after the scenario. This is also fully in line with the non pass-or-fail nature of the exercise.

**15. Did EIOPA consult external stakeholders in the process of designing the Stress Test 2016? To what extent were any suggestions taken into account?**

On March 2016, EIOPA invited the main EU stakeholders associations (Insurance Europe, CRO Forum, AMICE, Actuarial Association of Europe, CFO Forum) to participate in a workshop for the 2016 Insurance Stress Test. The objective of this informal consultation was to enhance the transparency on the approach towards the planned exercise and improve

the understanding of the stress test design and requirements. Stakeholders provided useful comments both during as well as after the meeting which EIOPA considered and took into account to the extent possible.

**16. Is there any connection of the extreme severity of the low yield scenario with the currently ongoing consultation on the methodology to derive the UFR and its implementation?**

In order to assess the potential systemic impact of adverse scenarios, EIOPA assumes a lower UFR in the prolonged low yields scenario as one of the possible consequences if yields were to remain low for a considerable amount of time. There is no direct or indirect link with the ongoing consultation on the methodology to derive the UFR. To underline this absence of link, the probability of the scenario is not assessed.

The low yield scenario is considered extreme and severe enough to assess the vulnerabilities of the life insurance sector, but avoids questioning the implications in the capital requirements of a change in the UFR as it does not require a quantification of the legally enforceable requirements after the shock.

**17. When will EIOPA disclose the stress test results?**

Publication of the results is envisaged at the end of 2016.