Executive Summary

In 2016 the macroeconomic environment has continued to be weak. Although the ECB still pursued its path of monetary stimulus, low crude oil prices put further downwards pressure on inflation expectations implying a continuation of the current low yield environment in the short to medium-run. This poses increasing reinvestment risk for the European insurers and pension funds. Additionally, geopolitical risks, the situation in emerging markets as well as Greece or a potential outcome of the EU Referendum in the United Kingdom contribute to further uncertainties. In this environment where government bonds yields remain very low and economic growth in Europe is fragile and heterogeneous, a double-hit scenario (decreasing assets' value and sustaining value of liabilities) cannot be ruled out. Moreover, as technological innovation progresses in a fast pace, the insurance sector increasingly faces higher competition. The industry is still lagging behind in the digital consumer experience while innovative business models based on technology - commonly known as InsurTech - emerge. This development also implies that companies are more and more exposed to cyber-attacks as well as new market opportunities to provide insurance protection against these new risks.

On average EU gross written premium growth (GWPs) has persisted through 2015, although growth was higher for non-life insurers than for life insurers. In the life sector the developments in the national markets were clearly challenging and not uniform: some countries were clearly growing, whilst others reported premium declines. Increasingly new products are on offer with for example reduced average guaranteed rates to make sure that yields promised are more aligned with yields that are obtained in the market. Declining profitability indicators such as the investment return or the return on equity (ROE) show how insurers are already affected by the low interest rate environment. Although Solvency I ratios have dropped in many countries in 2015, in preparation of Solvency II, some companies have taken measures to underpin their capital position.

The reinsurance market continues to suffer from an oversupply of capacity owing to the absence of large losses and alternative capital inflow. The price decline slowed down in 2015, but prices have not yet found their floor. On average, reinsurers maintained a strong level of capital through the end of 2015 and into 2016, helped by the lack of significant catastrophe activity in recent years and the availability of substantial capital market capacity.

The ongoing low interest rate environment continues to generate challenges to the European occupational pension fund sector as well. Cover ratios, based on preliminary data, seem to have dropped among the reporting countries for 2015 creating additional pressure to the sector. EIOPA's IORPs (Institutions for Occupational Retirement Provision) stress test in 2015 revealed that the sector is vulnerable to a persisting low yield environment, especially if it is complemented with sharp increases in risk premiums. However, EIOPA recognises that in many instances these risks would only materialise over a number of years. The recent exercise further underscored that current heterogeneous national prudential regimes are often not entirely sensitive to market price changes. This might lead to an underestimation of risks and makes it difficult to assess the impact on schemes across countries on a consistent basis.

The EIOPA risk assessment further confirms the low interest rate environment as a main concern among national supervisors. Unsurprisingly, the key risks and challenges classified as the most imminent in terms of their probability and the potential impact remain broadly unchanged, both for the insurance and pension sector. The investment portfolio remains focused on fixed-income instruments although some minor shifts towards other asset classes can be seen. These changes could signal the beginning of a changed portfolio composition that might evolve over time as a response to the low yield environment and also reveals a potential for excessive "search for yield" behaviour. Hence, national supervisors need to closely monitor this development to ensure that all risks are properly managed. It applies especially to life insurers with their long-term liabilities towards policyholders that are particularly affected by low yields and need to find assets providing returns corresponding to their commitments towards policyholders.

The report consists of two parts – the standard part and the thematic article section. The standard part is structured as in previous versions of the EIOPA Financial Stability Report. The first chapter discusses the key risks identified for insurance and occupational pension sectors. The second, third and fourth chapter elaborates on these risks covering all sectors (insurance, reinsurance and pension). The fifth chapter provides the final qualitative and quantitative assessment of the risks identified. This assessment is done in terms of the scope as well as the probability of their materialization using econometric techniques and qualitative questionnaires. Finally, the thematic article elaborates on the impact of mergers and acquisitions on European insurers using data on equity prices.