Executive Summary

The euro area economy continues to remain in a recovery path despite global and domestic uncertainties. Fragilities in the financial market became evident after equity corrections occurred in the beginning of the year. Although the impact on European markets was relatively limited, the combination of a persistent low yield environment and high uncertainties – such as the ongoing negotiations on Brexit, the rising tendencies towards protectionism across the globe and several elections in Europe - still contributes to the risk of a sudden yield spike scenario. In addition, climate related risks are becoming more pronounced for the financial sector. Weather-related disasters are not only becoming more severe but are also occurring more frequently. The emerging climate risks pose threats in particular for the insurance industry, as insurers act simultaneously as investors and underwriters. However, they also present business opportunities as demand for weather hedging is growing, while technological advances bring better risk modelling techniques and improved data quality to assess the underlying risk. Several initiatives launched at both the European and global level on greening the financial sector should stimulate the trend towards sustainable insurance further.

The insurance industry faces similar challenges on technological developments. On the one hand, the digital transformation makes insurers themselves increasingly susceptible to cyber attacks, with significant operational and reputational risk. On the other hand, the rise of InsurTech also creates opportunities for insurers and new entrants, through improved customer interaction, risk modelling, streamlining of information systems and/or more efficient claims handling. Over time, this could lead to a more fragmented insurance sector, where specialized players increasingly take up a part of the insurance value chain.

Overall, solvency positions of insurance companies continued to improve in 2017, while gross written premiums remained stable as a share of GDP and the share of unit-linked business increased further over 2017. All results show significant disparities across undertakings and countries. Lapses also remained low, albeit a sharp increase in yields combined with lower economic welfare of households could potentially lead to a sudden increase. Profitability figures did not deteriorate yet, despite the ongoing low yield environment. With interest rates only slowly rising again, especially countries with high guaranteed insurance contracts and limited cash-flow matching are still facing material risks in the long-term.

In 2017, the global insurance industry catastrophe losses were considerably higher than the long-term average. According to estimates, natural catastrophes caused losses at an all-time high. Nevertheless, the bulk of the reinsurance companies generally closed the financial year 2017 with a profit, partly due to the ability to release reserves from previous years and very high solvency ratios. However, the impact of the large insured losses on future prices in the reinsurance sector is uncertain. While price increases are typically expected following significant reinsurance losses, so far the first round of renewals in 2018 saw only moderate ones, mostly for the regions affected by the 2017 hurricanes. This is partly due to the excess capacity and the continued inflow of capital into the reinsurance sector, which dampens price increases.

In the European occupational pension fund sector, total assets increased for both the European economic area and the euro area in 2017 based on the preliminary data received. In addition, the investment allocation as well as the average cover ratios for defined benefit schemes remained broadly unchanged since the previous year. In terms of performance the weighted average rate of return slightly decreased in 2017.

The EIOPA qualitative Spring 2018 Survey further confirms that low interest rates, albeit declining, remain the main risk for both the insurance and pension sector. In detail, the solvency position of solo undertakings improved in 2017 and remains high on average. Insurance companies have traditionally high exposure to fixed income assets, in particular to government and corporate bonds. However, recent data suggests that insurers are addressing low-yields by slightly shifting their portfolios from government bonds to other asset categories, indicating potential search for yield behaviour. Analysing insurers' portfolios at country level, however, shows significant differences across countries. For insurers relying heavily on government bonds, home biased investment behaviour can be observed. This behaviour can also be seen in the case of equity investments. Total investments in infrastructure are small overall and consist of about only one quarter of qualifying infrastructure. The insurance sector is broadly exposed towards the banking sector, and the interconnectedness between insurers and banks has relevant implications for financial stability, as it may lead to spillover effects in times of stress on financial markets. A potential transmission channel could be through investments; from a financial stability perspective, a high exposure towards one sector might increase the risk of contagion in case of distress in the financial markets.

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 the insurance and occupational pension sector. 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 likelihood as well as the impact of their materialization using also qualitative questionnaires. Finally, one thematic article on potential drivers of insurers' equity investments will be presented.