EIOPA Stress Test 2014

Press Conference
Frankfurt, 1 December 2014

OBJECTIVES
OF THE STRESS TEST 2014

- To explore overall **resilience** of the insurance sector;
- To identify its major **vulnerabilities;**
- To reveal areas that require **further supervisory focus** (especially in relation with the upcoming Solvency II regime);
- To follow-up on **EIOPA’s Opinion** on Supervisory Response to the Prolonged Low Interest Rate Environment.

STRESS TEST DEFINITION

*What **is** the EIOPA stress test?*

An important **supervisory** and **risk management tool**

A set of **severe "what if" scenarios** aimed to test insurers against different macroeconomic and insurance-specific shocks

Solvency II-based estimates, excluding internal models, as a baseline

*What the EIOPA stress test **is not**?*

It is **not** a repair exercise
It is **not** a second guess of capital requirements
It is **not** a pass-or-fail exercise

PARTICIPATION IN THE STRESS TEST 2014

EIOPA fully hit the target coverage - 50% of the market share per each Member State

Core Stress	60 groups (91% of result) and 107 individual companies (9% of result)	55% of premiums at the EU level
Low Yield	225 individual companies (100% of result)	60% of technical provisions at the EU level

28 EU Member States and Norway participated fully in the exercise.

Switzerland and Iceland took part in the core stress module only.

PRE-STRESS (BASELINE) RESULTS FOR CORE MODULE

Insurance sector is in general sufficiently capitalised in Solvency II terms :

- **86%** - sufficient level of capitalization in the pre-stress situation;
- **14%** - with SCR below 100% representing **3%** of total assets
- The picture is very similar for the low yield module as well

CONCLUSIONS OF CORE MODULE

1. Under the most severe “double hit” stress scenario:

- 56% of companies would meet the SCR, compared to 73% in the less severe scenario tested
- Overall available assets would decrease by 42%

2. The insurance sector is more vulnerable to a “double hit” (i.e. asset values decrease and lower risk free rate) **scenario**

3. Smaller entities seem more exposed to the “double hit” than larger insurance groups and companies

4. Insurance specific stresses show **vulnerability to mass lapse, longevity, natural catastrophe and under-provisioning**

CONCLUSIONS
OF LOW YIELD MODULE

1. Low yield environment has most impact on:

- Countries with a significant mismatch in duration and returns between assets and liabilities (i.e. liabilities are "longer" than assets and/or guarantee rates are above the return rates of assets)

- Life insurance business with long-term guarantees

2. 24% of companies would not meet the SCR under the "Japanese-like" scenario, while 20% of companies would not meet the threshold in the "Inverse" scenario

3. A continuation of current low yield conditions could see some insurers exposed to this risk having **problems** in meeting **promises to policyholders in 8-11 years**.

EIOPA RECOMMENDATIONS TO NATIONAL SUPERVISORS

- **With regard to preparedness for Solvency II**

Engage in rigorous assessment of insurers' preparedness for Solvency II regarding the situations where capital increases and/or balance sheet management actions will be needed

Ensure NSAs are prepared for Solvency II in terms of processes and necessary resourcing

- **With regard to Core stress vulnerabilities:**

Ensure that insurers have a clear understanding of their risk exposure and corresponding vulnerabilities

Make sure that companies have the capacity to take recovery actions if those vulnerabilities materialize;

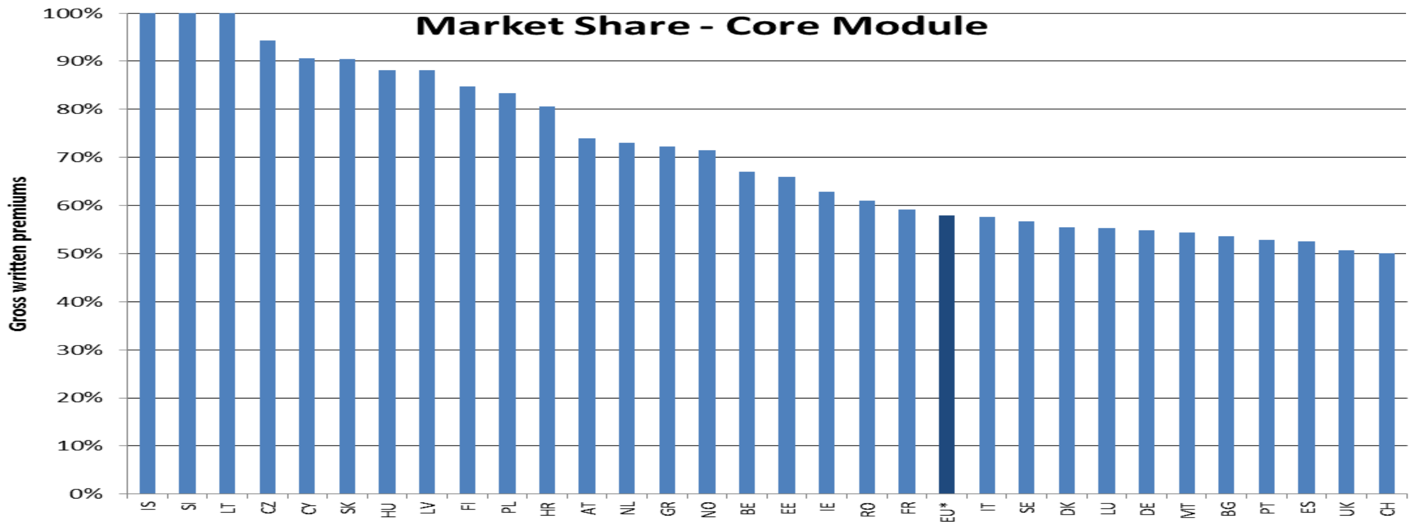
- **With regard to the Low Yield module and in particular companies with considerable mismatches**:

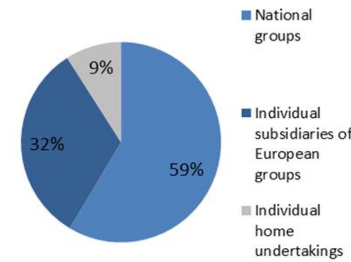
Examine Asset/Liability and Risk Management strategies and practices of insurers;

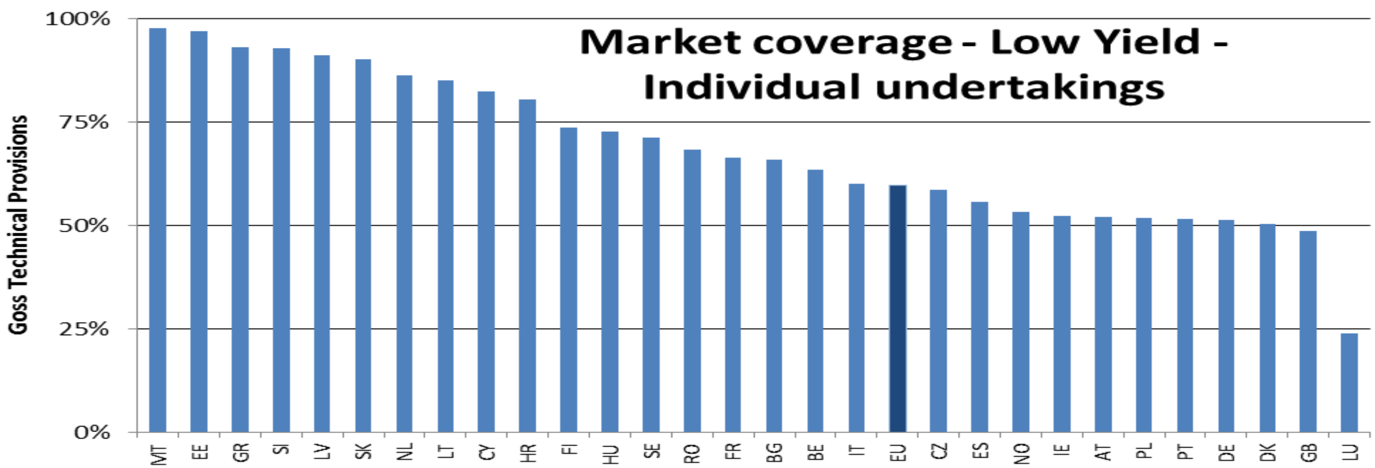
Make sure that companies properly assess the sustainability of the guaranteed rates offered

Technical Background Slides

PARTICIPATION IN THE STRESS TEST 2014





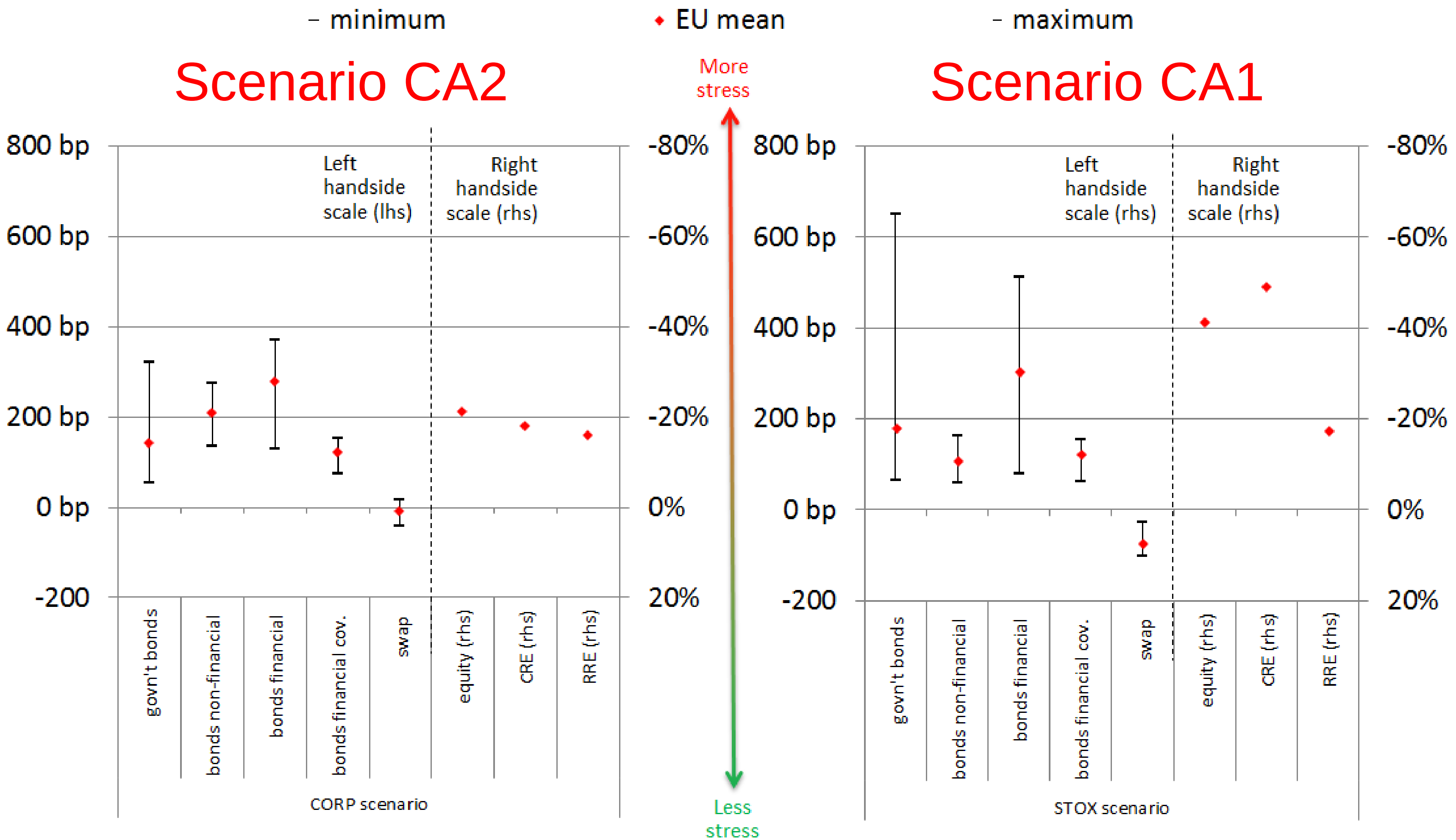


STRESS TEST 2014 FRAMEWORK

Module	Elements
Core Stress (mainly groups and few solos)	an asset market shock scenario originating in the equity market (CA1)
	an asset market shock scenario originating in the non-financial corporate bond market (CA2)
	a qualitative analysis of how undertakings would respond to Scenario CA2
	a set of single factor insurance stresses (7 NatCat, 2 non-life, 4 life (2 longevity, 2 mortality) 2 lapse events
Low Yield (purely solos)	a "Japanese-like scenario" embodying a persistent low interest rate environment (LYA)
	an "Inverse scenario" with an atypical change (raise) in the shape of the yield curve (LYB)

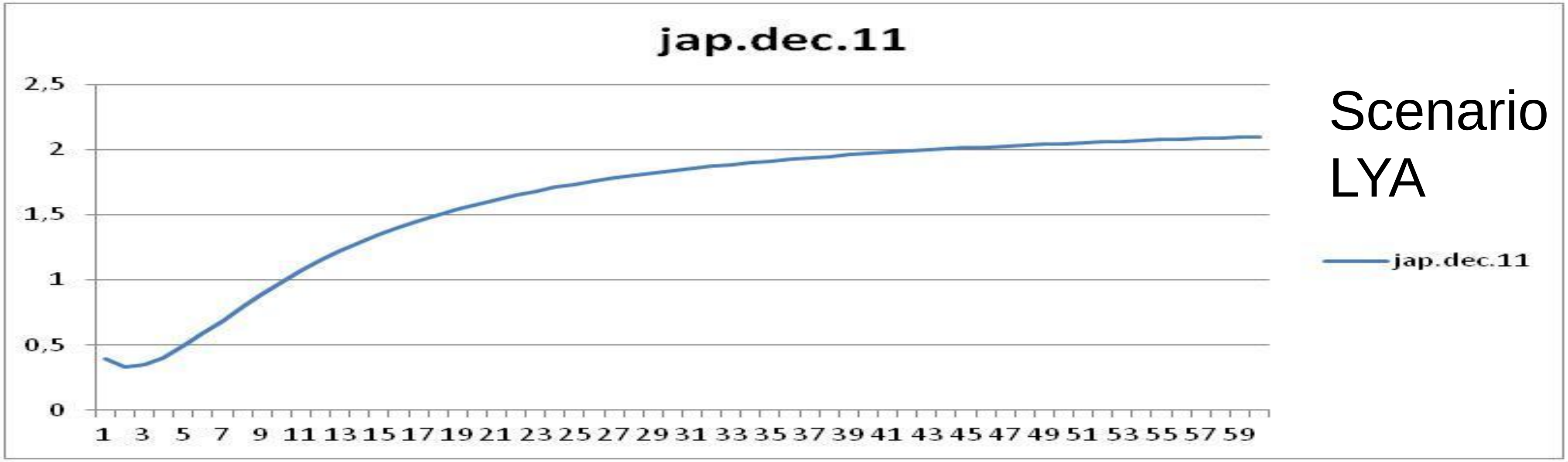
Summary Market scenarios tested in the core module

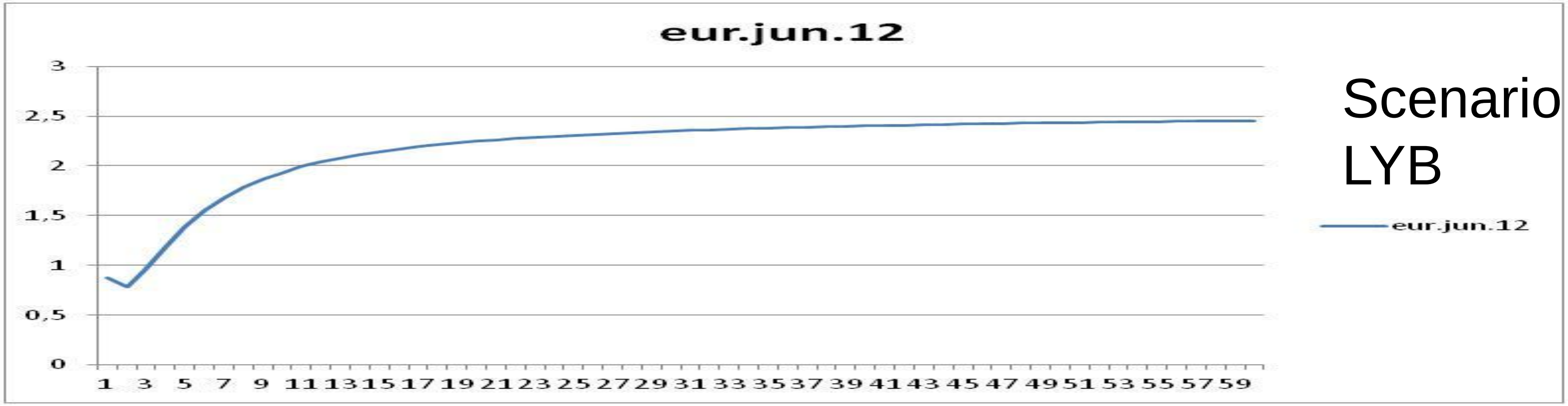
Developed in cooperation with ESRB



- CRE stands for commercial real estate
- RRE stands for residential real estate

(Target) Risk Free Rate Curves tested in the Low Yield Module.





Showed for the Euro. For other EEA currencies + USD + JPY + CHF): "proportional" shifts were provided.

PRE-STRESS (BASELINE) RESULTS*

	Core Module	Low Yield Module
Solvency capital requirement ratio above 200%	**25%**	**44%**
Solvency capital requirement ratio below 100%	**14%** (3% of total assets)	**16%** (7% of total assets)
Minimum capital requirement ratio below 100%	**8%**	**6%**

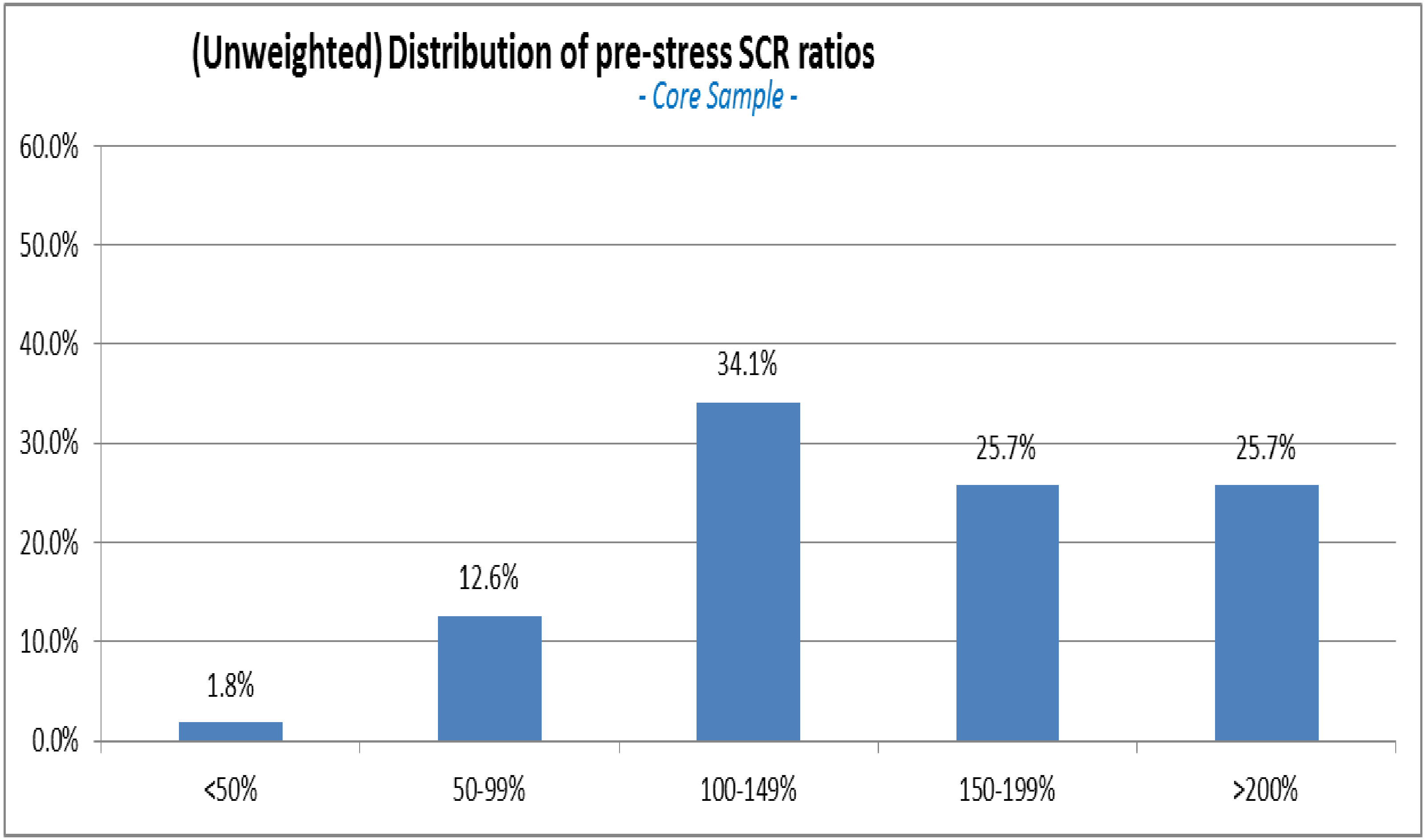
***Figures are based on the standard formula of the upcoming Solvency II regime, without the use of USP. Use of LTG measures was done on a voluntary basis.**

USE OF SOLVENCY II LTG MEASURES

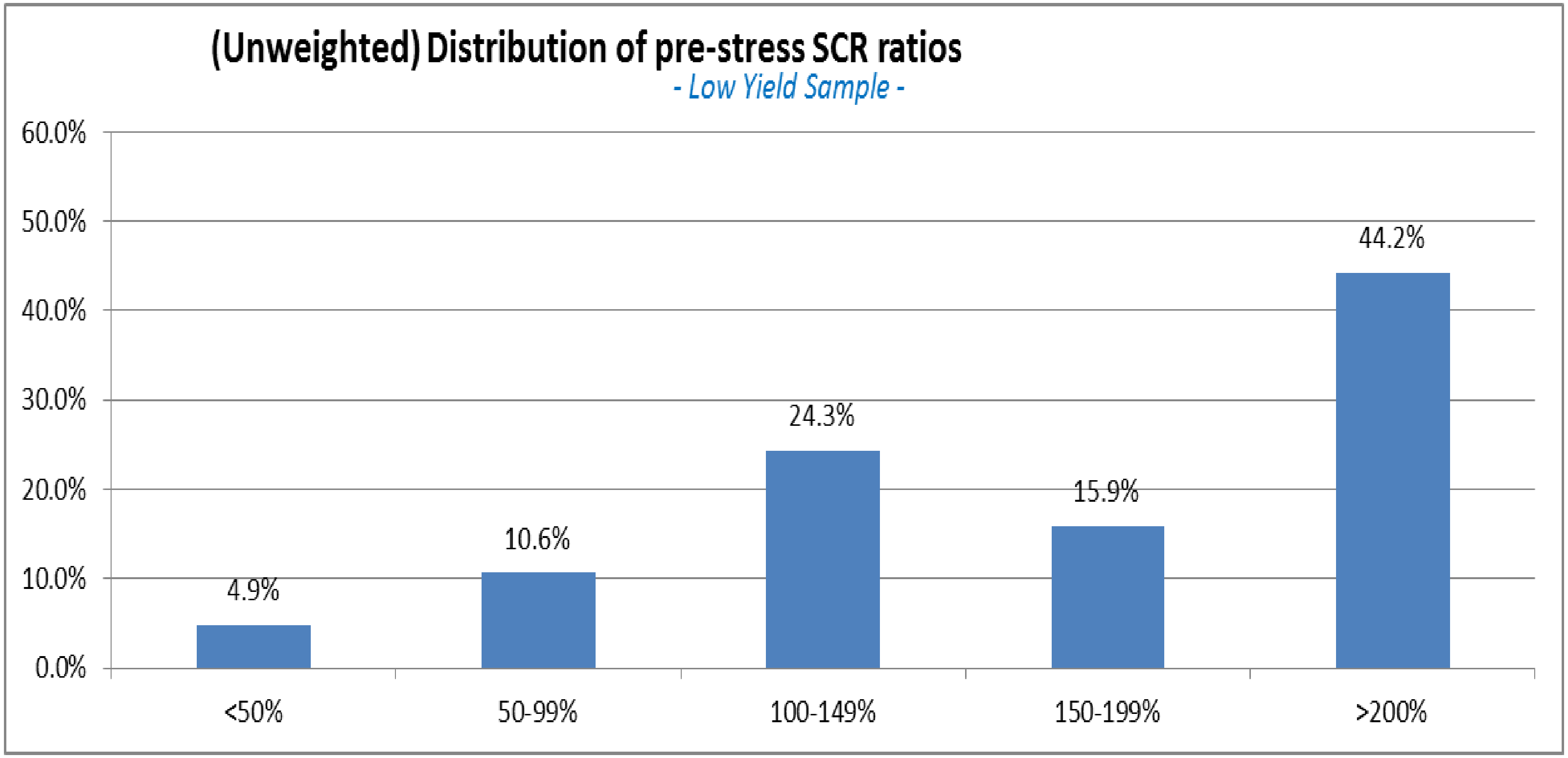
- Use of Long Term Guarantee (LTG) measures has an expected positive effect on the Solvency Capital Requirement (SCR) ratio

- Big groups (79% of top 30 entities) use the LTG measures much more extensively than smaller entities (28% of non-top 30 entities)

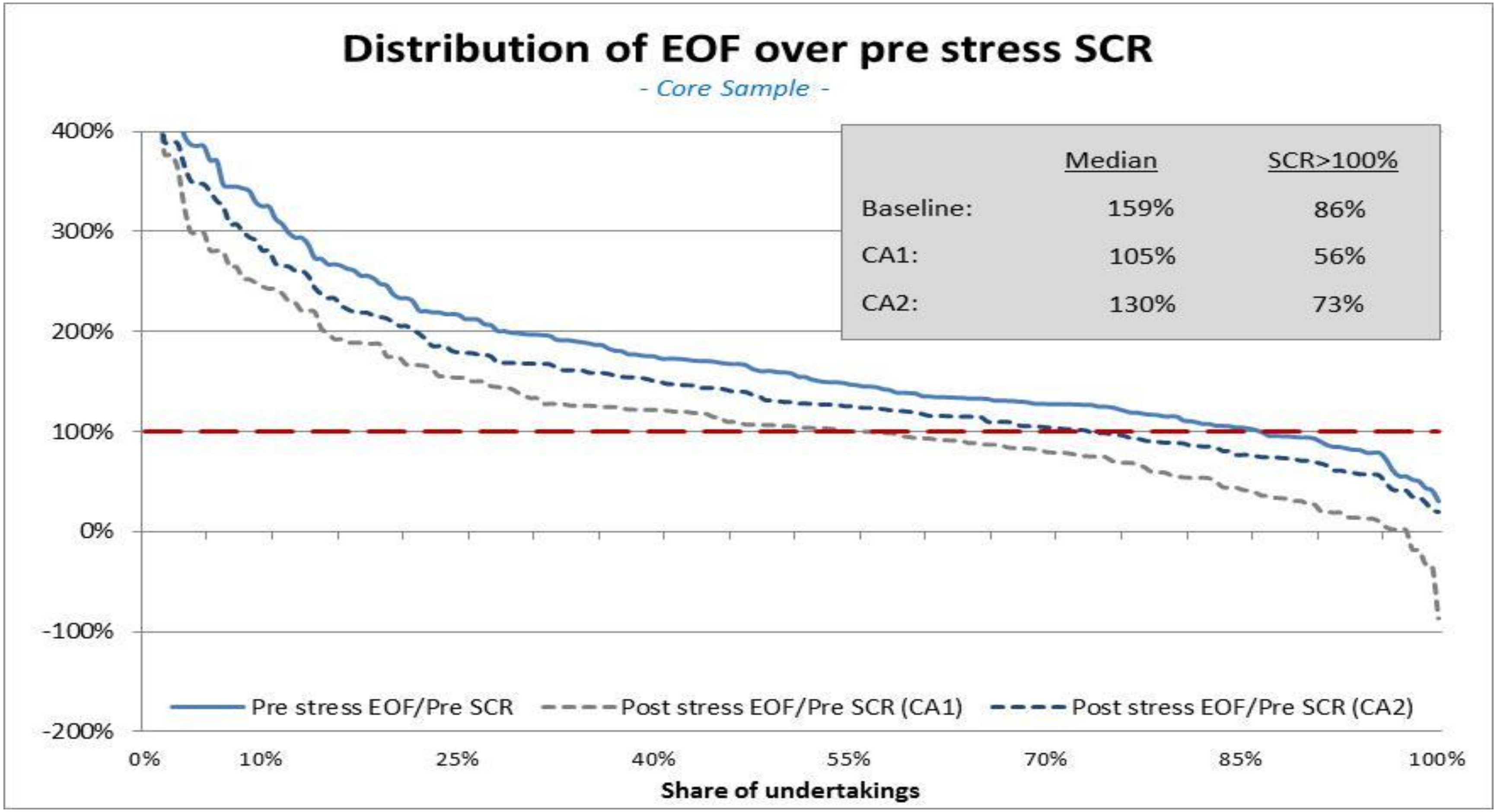
Baseline – Core Module



Baseline – Low Yield Module



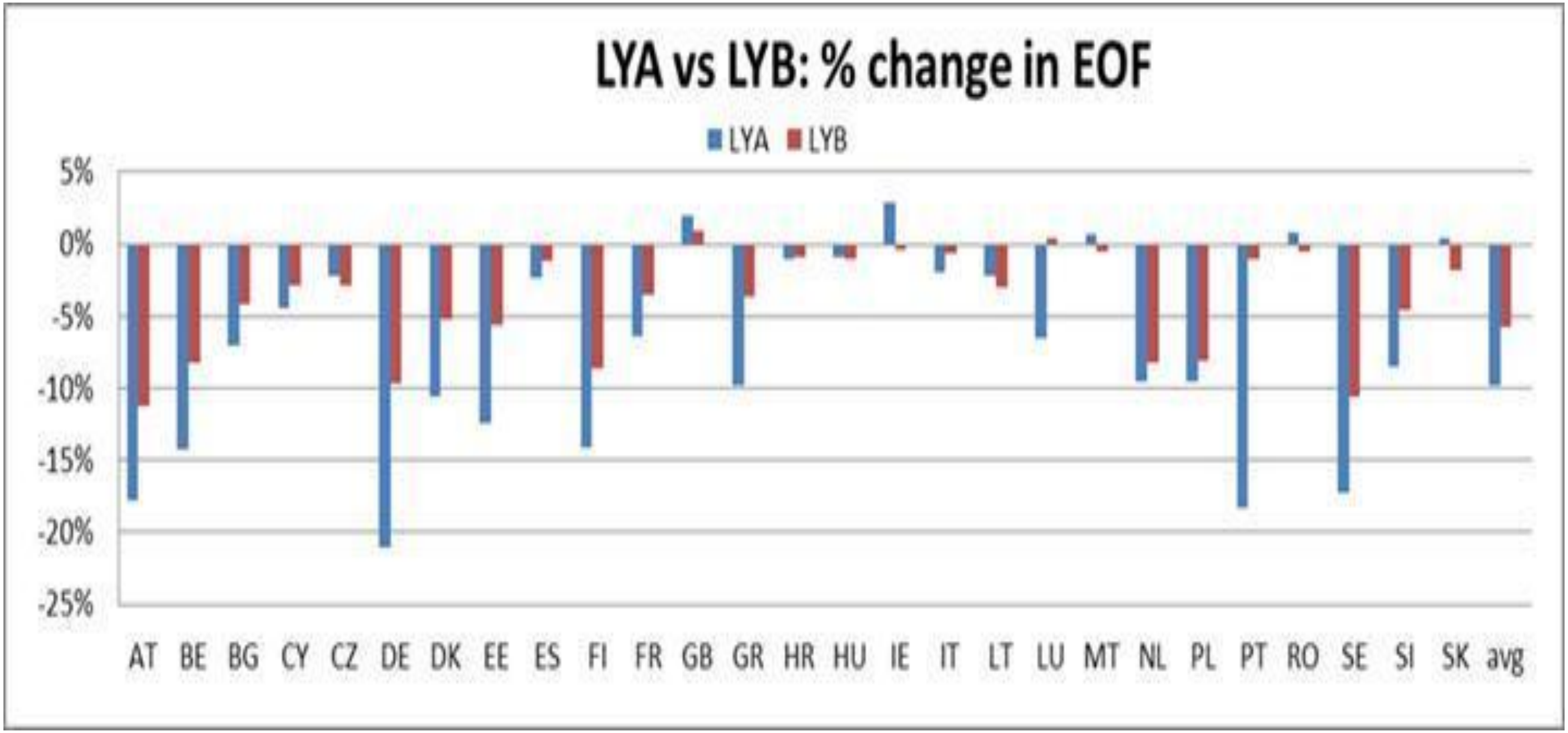
Stress Scenarios – Core Test



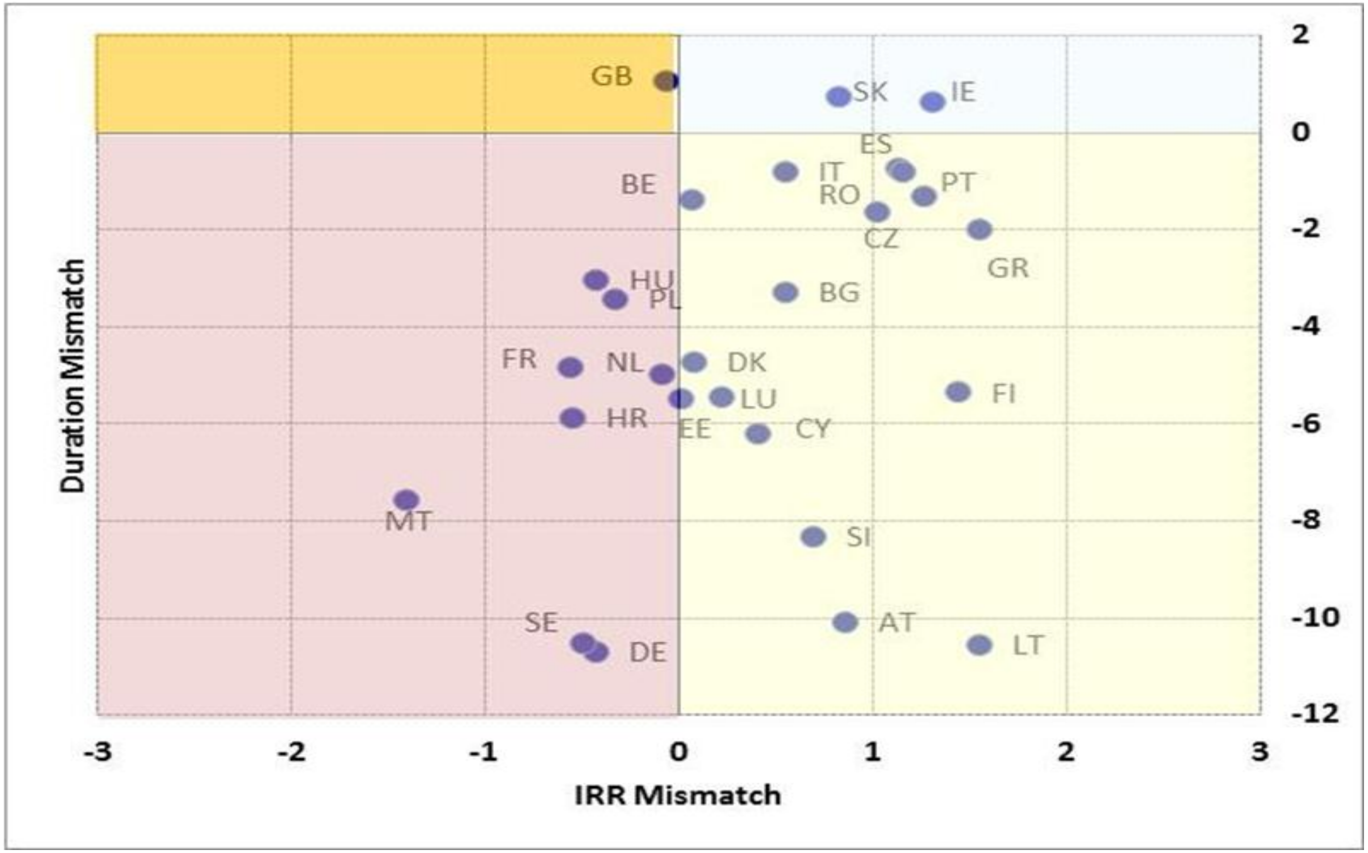
Insurance Specific Stresses

Scenario	Loss as % EOF (gross)	Loss as % EOF (net of RI)	Loss as % EOF (net of RI & LAC)	Reinsurance rate	Initial sample size
Non-Life stress scenarios					
Nat Cat event (1-in-200)	10.9%	4.3%	3.7%	60%	105
Provision deficiency (+3%)	13.4%	10.0%	9.0%	25%	107
Life stress scenarios					
Longevity (18% uplift)	12.3%	11.4%	9.4%	8%	96
Mass Lapse (35%)	15.9%	15.9%	6.7%	0%	103

Low Yield Module - Results



Low Yield Module - Results



Joint mismatch of Internal Rate Return (IRR) and Duration. [Assets minus liabilities]
Baseline (i.e. pre-stress situation)

Low Yield Module Results