FAQ

#INSURANCE #STRESSTEST #EIOPA #GEOPOLITICS

2024 INSURANCE STRESS TEST

FREQUENTLY ASKED QUESTIONS

GOAL

What is a stress test?

A stress test is an important risk management and supervisory 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. insurers, banks) and of the respective sectors as a whole to severe but plausible shocks. For example, a stress test provides an indication of the impact and potential losses upon the materialization of the risks envisaged in the scenario and help to indicate areas where further supervisory actions might be needed.

Is the EIOPA stress test a pass-fail exercise?

The EIOPA stress test exercises have never been characterised by a pass-fail nature and this also holds for the 2024 stress test. No potential weakness in the post-stress position of the participants shall automatically trigger actions aimed at strengthening the financial position of the insurers. Information collected and produced under the stress test process is used in an aggregated way to issue recommendations to the National Competent Authorities (NCAs). Individual results are only used as a basis for follow-up dialogues between EIOPA and supervisors, as well as between the supervisor and the participant.

What are the objectives of the exercise?

Given its non pass-fail nature, the 2024 exercise has the primarily microprudential objective of assessing the capability of the participants to sustain the adverse conditions depicted in the stress test scenario, both from a capital and liquidity perspective.

The post-stress individual positions are eventually aggregated to infer the overall resilience of the insurance industry.

The 2024 insurance stress test enhances the macroprudential dimension first introduced in 2021. As in the 2021 stress test, the standard fixed balance sheet approach is complemented with a constrained balance sheet approach where participants are allowed to apply reactive management actions in the calculation of their post-stress position (i.e. fixed balance sheet). For the capital component of the 2024 exercise the application of such actions are linked to the risk management framework of the participants and not only to the fulfilment of the regulatory solvency ratios. For both capital and liquidity component, the results after the reactive management actions are used to identify potential spill-over effects on other markets.

Vulnerabilities of individual positions allow supervisors to engage with the participants in a dialogue and, if needed, discuss remedial action to be taken by undertakings to improve their resilience.

The aggregated outcomes of this microprudential stress test exercise were used to assess market-wide risks. By aggregating the impact for individual entities, financial stability developments can be inferred; hence, this assessment is used for evaluating potential vulnerabilities in the insurance sector.

The macroprudential dimension enabled by the aggregation of the impacts of reactive management actions, allows for the assessment of potential spill-overs to other markets generated by the insurance sector against the prescribed scenario.

How and when will EIOPA issue potential recommendations?

If needed, public recommendations will be issued, in accordance with Article 21(2)(b) of the Regulation in order to address issues identified in the stress test and will be addressed to the relevant National Competent Authorities (NCAs) in the EU and EEA. Individual findings will be used during the regular dialogue between EIOPA and NCAs.

SCOPE

Why does this stress test focus mainly on insurance groups and not on solo undertakings?

The 2024 stress test exercise targets European insurance entities based on the following principles: the market coverage at EEA level and the inclusion of as many EEA jurisdictions as possible. Coverage of different business lines and local market coverage were considered in a second stage. Given the micro- and macroprudential layers in the 2024 exercise, groups were better placed to infer both the vulnerability of the insurance sector and the potential spill-overs to other markets.

Additionally, groups, despite their complexity, are better structured to perform complex calculations such as the assessment of their solvency position under severe but plausible scenarios.

Who selected the participants for EIOPA's stress tests?

The selection was a joint EIOPA and NCAs process. EIOPA, in line with its mandate, defined the criteria for the selection and proposed an initial list of entities to NCAs. Each NCA could propose amendments to the list based on well-grounded motivations (e.g. risk exposure, business line coverage, vulnerability to the tested scenario). Finally, the Board of Supervisors of EIOPA approved the list of entities to be included in the stress test.

What is the market coverage of the exercise?

The target sample defined by EIOPA (in cooperation with the NCAs) encompassed 48 insurance undertakings, registered in 20 European jurisdictions and operating globally. The selected sample covered 75% of the European wide market based on total assets in the Solvency II.

The liquidity component targeted 132 solo EEA undertakings within the perimeter of the groups. The selected solo undertakings covered a relevant part of the total assets of insurance EEA solo undertakings belonging to each group (approximately 80%).

DISCLOSURE

Which results of the stress test are disclosed?

The results that are published are based on consolidated data that contain aggregate results of the capital and liquidity assessment. The aggregation of the data and their presentation ensures the anonymity of the information in such a way that the position of individual participants cannot be discerned.

Additionally, participants were requested to disclose individual results based on a subset of individual balance sheet-based indicators. The provision to publish individual stress test results is not part of the in-force Solvency II directive and of the EIOPA regulation. The decision to publish the individual results lays with each participant. Therefore, EIOPA has only published the individual results where participant explicitly provided their consent to the disclosure.

Which results are the participating groups asked to disclose individually?

The individual disclosure is limited to a set of Solvency II balance sheet-based indicators up to the excess of assets over liabilities under both fixed and constrained balance sheet approaches. No disclosure of the solvency capital requirement is requested. Also, no disclosure of the pre- and post-stress liquidity positions is requested.

Is the disclosure of the stress test results at individual participant level compulsory?

The current regulatory framework does not grant EIOPA the power to publish stress test results at individual level. To enhance the transparency of the exercise, EIOPA pursued the publication of individual results in 2018 and 2021, requesting to each participant the consent to the disclosure of their individual information. The limited number of insurance undertakings that agreed to the publication of individual results forced EIOPA to formally ask for the powers to disclose the individual results of stress test through the issuance of an Opinion on the subject on 12 April 2022. The Opinion was reflected in the recently approved Solvency II review where a specific provision was included. Pending the entry into force of the reviewed Solvency II Directive, the new provisions could not be applied in the context of this stress test.

DESIGN OF THE EXERCISE

What was the role of the European Systemic Risk Board (ESRB) in EIOPA's Insurance Stress Test 2024?

EIOPA designed the narrative, scenario and market shocks in cooperation with the ESRB. The market shocks are complemented by a set of relevant insurance specific shocks given the context of the scenario, designed by EIOPA.

What's the probability of the market scenarios?

The overall probability of materialisation of the market risk shocks depends on several factors, including the probabilities of the triggering events and their level of correlation. The market risk scenario has been calibrated on triggering events whereby the one-year euro swap rate and the euro swap curve slope shocks are assumed to reach given thresholds (168 bps and 122 bps, respectively). These thresholds have been set so that the marginal probability for each trigger (the probability that each trigger in isolation takes a value at least as large the threshold considered) is 8% and 5% respectively. Based on the individual probabilities of the triggering events, and considering their sample correlation, the likelihood of a joint materialisation of the triggers is estimated at 4.5%. The overall likelihood of the scenario for affected variables can be gauged by the probabilities of the shocks simulated for each response variable jointly with the historical (sample dependent) probability of the trigger events. These joint probabilities vary across the different categories of financial assets, ranging between 0.03% and 0.5%.

Why does the EIOPA exercise test a scenario based on an increase in interest rates and increasing inflation?

The re-intensification or prolongation of geopolitical tensions generates supply chain disruptions and leads to lower growth and higher inflation, further exacerbated by second round effects stemming from a wage-price spiral. Concerns about the persistent effects of severe adverse shocks are reflected in a larger increase in expected market rates at the short end of the yield curve than at the long end. This contributes to a further inversion of the yield curve. Despite expectations of decreasing inflationary pressures over time, growth will continue to be adversely affected. Based on this, the economic and market reactions are temporary and concentrated in the short-run, while long term inflation and interest rates are not diverging materially from the foreseen projections.

How are the reactions of the participants treated in the stress test?

The shock profiles of the adverse scenario are one-off instantaneous shifts in asset prices relative to their end-2023 levels without further evolution over the one-year horizon. EIOPA asked participants to calculate their post stress position under a fixed balance sheet assumption which implies that only the so-called embedded management actions are allowed. An example of such embedded actions is the automatic movement in assets and liabilities fully incorporated in the models and algorithms the participants are using under normal periods.

Participants could also include in the calculation of the post-stress position reactive management actions. The aim is to obtain a more realistic picture of their post-stress situation and to infer potential macroprudential implications. Hence, under the so-called constrained balance sheet assumption, participants were allowed to apply actions that are appropriate and plausible in the context of the scenario, building on (and improving) the fixed balance sheet positions.

What is the reference date for the 2024 stress test?

The baseline of the exercise is the position at 31 December 2023.

CONSISTENCY WITH SOLVENCY II

Does the stress test fully reproduce the Solvency II framework?

Yes, for the capital component, it does. Participants were required to calculate their balance sheet and solvency position under the Solvency II regime. The exercise in its capital component fully adhered to the Solvency II framework and participants were invited to compute their post stress position relying on the models used for the regular annual Solvency II reporting. Simplifications and approximation were allowed upon agreement with the national supervisors and EIOPA before calculating the post stress positions.

The Solvency II framework does not contain specific reporting or metrics to assess the liquidity position of insurance undertakings, hence the 2024 exercise followed the metrics and approaches based on the EIOPA liquidity monitoring assessment and the experience of the 2021 stress test.

Is the Ultimate Forward Rate (UFR) kept unchanged?

Participants were asked to estimate their post stress liabilities using the same UFR they are using in 2024 for their regular reporting (e.g., 3.30% for Euro).

Why did the stress test require information on the impact of long-term guarantee (LTG) and transitional measures from participants?

The stress test methodology is fully consistent with Solvency II framework; hence, it includes the LTG and transitional package. The LTG and transitional measures were introduced in the Solvency II framework for different purposes: the former was included to absorb the unintended effects of a mark to market valuation of assets and liabilities on a long-term insurance business, while the purpose of the latter was to smooth the transition from Solvency I to Solvency II.

The information on LTG and transitional measures was important in this this stress test exercise as it allowed EIOPA to assess how the LTG package reacts under extreme but plausible conditions. It also helped to assess its capability to absorb part of the impact to the insurers stemming from the market shocks. Additionally, given the temporary nature of the transitional measures, the contribution of transitional to the post-stress position of participants provides valuable information about the vulnerability of one segment of the industry that is still relying on them.

To what extent is the stress test based on the Solvency II harmonised reporting requirements?

The stress test templates for capital reproduced (to the extent possible) the Solvency II regular templates used for the supervisory reporting purposes. The stress test templates and specifications explicitly identified where the information diverges from the standard templates with specific reference to: i) additional data not contained in the regular reporting but required for analysis and validation in the context of the stress test; ii) data regularly collected by EIOPA in the standard reporting but requested in different granularity, iii) qualitative information not reported within the Solvency II framework.

CONSULTATION WITH STAKEHOLDERS

Did EIOPA consult stakeholders in the process of designing the 2024 insurance stress test? To what extent were any suggestions taken into account?

Relevant stakeholders, representing the stress test participants and the actuarial profession, have been consulted during the preparation of the stress test package. EIOPA engaged with the stakeholders at an early stage, especially focusing on aspects on technical specifications and key elements on the individual disclosure of results.

An overview of the consultation process can be seen in the section "Preparatory phase" on the dedicated website Insurance stress test 2024 - EIOPA.

Is there public information on the methodological approach applied by EIOPA in its bottom-up stress test exercises?

The specific approach for each exercise is described in the technical specifications that are part of the package published at its launch.

The technical specifications are based on a set of methodological papers on stress test published by EIOPA from 2019 onward.

Discussion papers went through a public consultation and benefitted from stakeholders views, including insurance associations and undertakings that were reflected in the final version of the papers:

- Methodological principle of insurance stress testing (available here) published on 4 December 2019
- Methodological principles of insurance stress testing - Liquidity component (available here) published on 31 January 2021
- Methodological principles of insurance stress testing – Climate change component (available here) published on 27 January 2022
- Methodological principles of insurance stress testing - Cyber component (available here) published on 11 July 2023

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