EIOPA

EUROPEAN INSURANCE
AND OCCUPATIONAL PENSIONS AUTHORITY

EIOPA Risk Dashboard
--- December 2012 ---

EIOPA-FS-12-110

Systemic risks and vulnerabilities

On the basis of observed market conditions, data gathered from undertakings, and expert judgment, EIOPA assesses the main systemic risks and vulnerabilities faced by the European insurance industry over the coming quarters to be:

- Macro risks: Recessionary pressure in a number of economies in the EU exemplify the macro-economic risks which are still at an elevated level. Although several important steps have been taken recently both at the European and national level, uncertainty remains with regard to any remaining implementation risks. In addition, the combination of austerity measures, rising unemployment and a prolonged period of subdued growth could have negative effects on insurance demand.
- Credit and market risk: The trend of decreasing CDS spreads has continued. However, this development certainly is also driven by excess liquidity, the difficult global financial investment environment and investors' risk appetite striving for an appropriate balance of yield versus risk. Recent changes in asset allocation of European insurers rather hint at a reduced risk appetite concerning credit investments. They tend to shift investments towards less riskier counterparties, reducing their European sovereign and banking exposure. This indicates a continuation of a negative outlook/perception on that credit category. Market risks are still dominated by the low-yield environment with 10-year swap rates in Western Europe having again reached new lows in the past months.
- Stabilisation in life insurance business: The declining trend in life gross written premiums has been reversed, however growth rates are still rather subdued. Lapse rates in the sample have improved from their peak in Q4-2011 and remained stable since last quarter.

Risk summary

Risk	Score	Impact	Timing	Qualification
Macro *		High	Short-term	• Political risk with regard to sovereigns and Eurozone • Weak worldwide growth outlook with a significant dispersion in outlook within Eurozone
Credit *		Very High	Short-term	• Sovereign and corporate spreads somewhat declining • Substantial banking exposures
Market *		High	Medium-term	• Low-yield environment increases re-investment risk • Equity and property markets appear robust in many EU countries, but might be driven by cheap liquidity
Liquidity/ funding *		Medium	Medium-term	• Lapse rates stabilised • Funding via cat bonds intact
Profitability/ Solvency		Medium	Structural	• Combined ratio stabilised since Q2/2011 • Solvency ratios stable, improving for life business
Interlinkages/ Imbalances		High	Medium-term	• Risk of banking crisis spillovers • Some balance sheet deleveraging in the insurance sector
Insurance *		Medium	Structural	• Uncertainty about medium-term sustainability of growth • Impact of Hurricane Sandy in the European insurance sector mainly limited to reinsurers

For more definitions see legend on slide 8.

* Expert judgment applied, see slide 4.

Use of expert judgment

Use of expert judgment after the mechanical aggregation:

- Macro risk: slightly upwards due to high heterogeneity in growth figures across EU countries and general uncertainty about the medium-term growth potential and its implications for the demand of insurance products. In addition, implementation risks around the various crisis management tools used in the sovereign debt crisis are non-negligible.
- Credit risk: slightly upwards as the observed decrease of the mechanistic score is considered too large given the uncertain macro outlook, potentially distorted bond prices as a result of excess liquidity while at the same time investors have limited alternatives to substantially reduce their credit risk exposure.
- Market risk: slightly upwards due to the severe consequences a prolonged low-yield environment could have on the profitability and solvency of the insurance sector. Improvements in other indicators, e.g. equity risk, are not considered to make up the effects of recently observed new historic lows in 10-year swap rates, given the on average small equity investments of insurers.
- Liquidity&funding: slightly downwards as the increase of the mechanistic score is solely driven by low issuance volume of cat bonds in Q3 which is seasonally driven and is already picking up substantially in October and November. Other indicators remained stable.
- Insurance risk: slightly upwards due to reduced buffers of reinsurers for catastrophe losses after Hurricane Sandy and potential price hikes in upcoming renewals, which are not reflected in Q3 figures yet. In addition, insurers' business model might be impacted in a low-yield environment when lower investment returns cannot counter-balance potential underwriting losses.

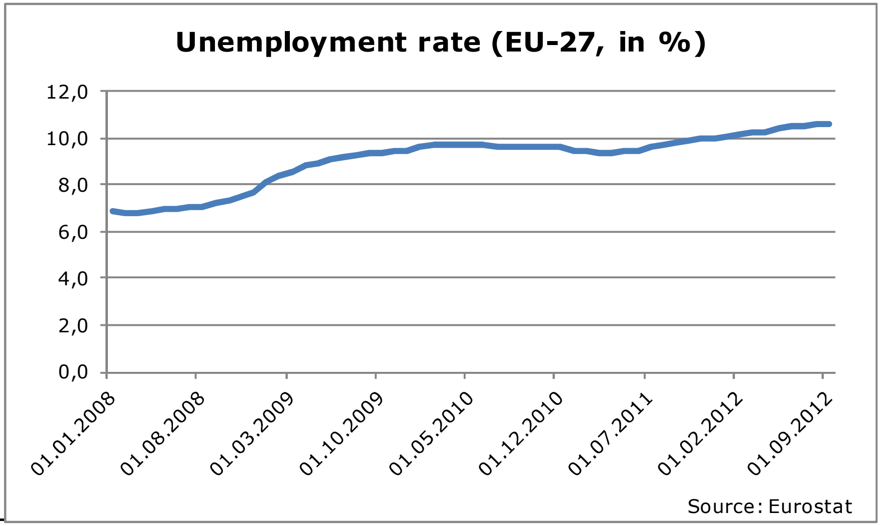
Detailed assessment: Macro risk

Although the downward trend has not worsened further, macro risks are still at an elevated level given the large uncertainty about the sustainability of sovereign debt levels, the implementation of crisis management tools and the effects of austerity measures on the real economy.

- Although recent policy measures helped to ease market pressure, the underlying risks however remain in existence.
- Unemployment rates in the EU are further increasing with rising discrepancies among different countries. This could negatively affect the demand for insurance products, particularly for, but not limited to, life insurance products.
- Uncertainties in the macro outlook are not limited to the EU, but a global concern, e.g. a failing agreement on the avoidance of the "fiscal cliff" in the US could affect the business of EU insurers' subsidiaries.

GDP growth forecasts for ... as of ...	Q3-2012	Q4-2012	Q1-2013	Q2-2013	Q3-2013	Q4-2013
Eurozone						
30.05.2012	-0,6	-0,2	0,4	1,0		
31.08.2012		-0,5	-0,2	0,3	0,9	
27.11.2012			-0,6	-0,3	0,2	0,7
United States						
30.05.2012	2,4	2,5	2,2	2,5		
31.08.2012		2,1	1,9	2,4	2,6	
27.11.2012			1,7	2,2	2,5	2,8
United Kingdom						
30.05.2012	0,3	0,9	1,2	n.a.		
31.08.2012		0,0	0,7	2,0	1,3	
27.11.2012			1,0	1,7	1,0	1,1

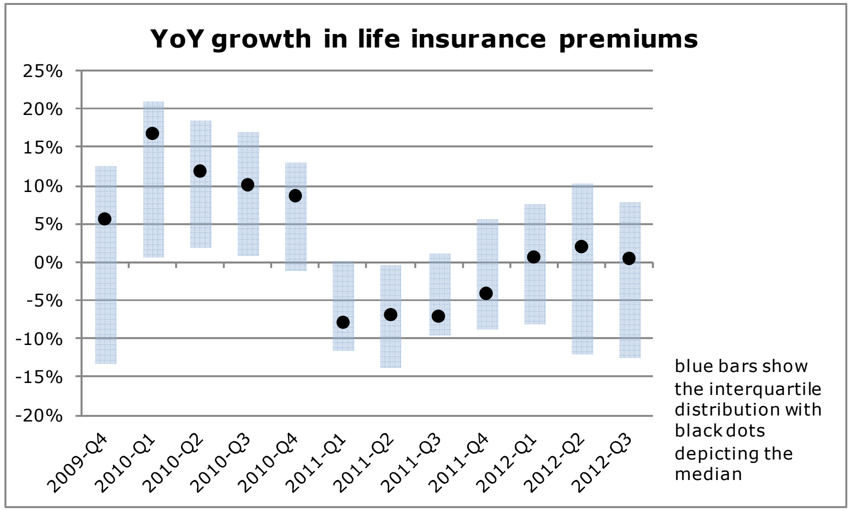
Source: Bloomberg



Detailed assessment: Insurance risk

Insurance risk is currently characterised by positive premium growth (though higher for non-life than for life) and the occurrence of the first big natural catastrophe of 2012.

- Non-life premiums continued their steady growth trend in Q3-2012. In life insurance, the median growth in the sample was slightly positive – overall the trend of declining life premiums which was observed in 2011 seems to have reverted.
- Hurricane Sandy left the insurance sector with an insured loss of potentially more than 20 bn USD. Primary insurers in Europe are less affected as most of the loss is borne by reinsurers and US insurers. European reinsurers had built up adequate buffers over the last quarters so the event will materialise foremost in the profits and less in the solvency margin. Currently the impact of the event on the pricing of reinsurance protection in upcoming renewals is hard to predict.

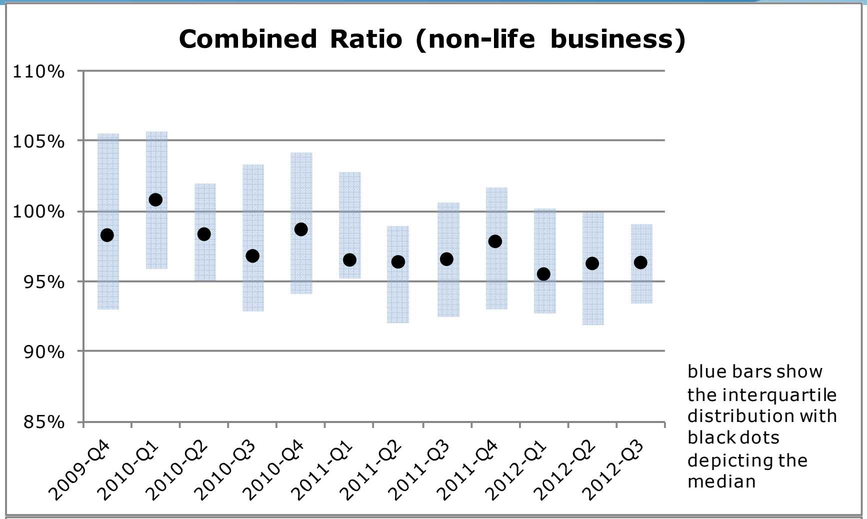


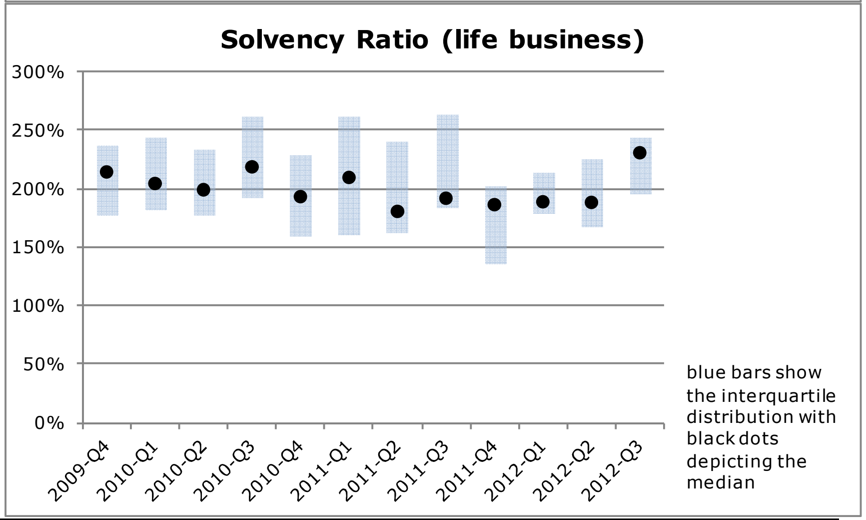
Loss estimates for Hurricane Sandy			
Risk modelling firm	**Insured losses (bn USD)**	**Economic losses (bn USD)**	**Estimate as of**
AIR Worldwide	16 - 22	n.a.	26.11.2012
EQECAT	10 - 20	30 - 50	01.11.2012
PCS	11	n.a.	22.11.2012
RMS	20 - 25	n.a.	14.11.2012

Detailed assessment: Profitability and solvency

Profitability and solvency currently signal some resilience of the insurance sector.

- Non-life underwriting performance remained positive in Q3-2012 despite competitive pressure as this was offset by fewer catastrophic events. The impact of Hurricane Sandy on EU insurers will likely be limited to the reinsurance sector only which had built up substantial buffers before the event.
- Solvency ratios (though not risk-based under Solvency I) in life are improving with declining sovereign bond spreads and less volatile capital markets being supportive factors. However, the current macroeconomic situation may have effects on future solvency margins. Non-life solvency margins remain strong due to continued underwriting profitability and lower susceptibility to the macro-economic environment.





Explanatory notes

Score	Provides an assessment of the relevance of the particular risk, and is as such, akin to a traditional risk score	●	Very high
		●	High
		●	Medium
		●	Low
Change	Indicates the change of the risk assessment over the last three months; comparison is made with last quarter's assessment	⇧	Substantial increase
		⇗	Increase
		⇨	Unchanged
		⇘	Decrease
		⇩	Substantial decrease
Impact	Provides an assessment of the effect that the materialisation of the given risk will have on the insurance industry	Very high	Severe impact (most undertakings affected or very sizeable exposure amount of the sector)
		High	Serious impact (large number of undertakings affected or sizeable exposure amount of the sector)
		Medium	Medium impact
		Low	Low or negligible impact (limited number of undertakings affected or limited exposure amount of the sector)
Timing	Indicates over which future period the risk is seen as most likely to materialise	Short-term	Materialisation possible within the next months
		Medium-term	Relevance over the medium-term; partly dependent on possible materialisation of short-term risks
		Structural	No immediate concern, but closer monitoring may be warranted