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EUROPEAN INSURANCE  
AND OCCUPATIONAL PENSIONS AUTHORITY

# Low level of interest rates and their implications for insurers and pension funds

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European Systemic Risk Board Annual Conference

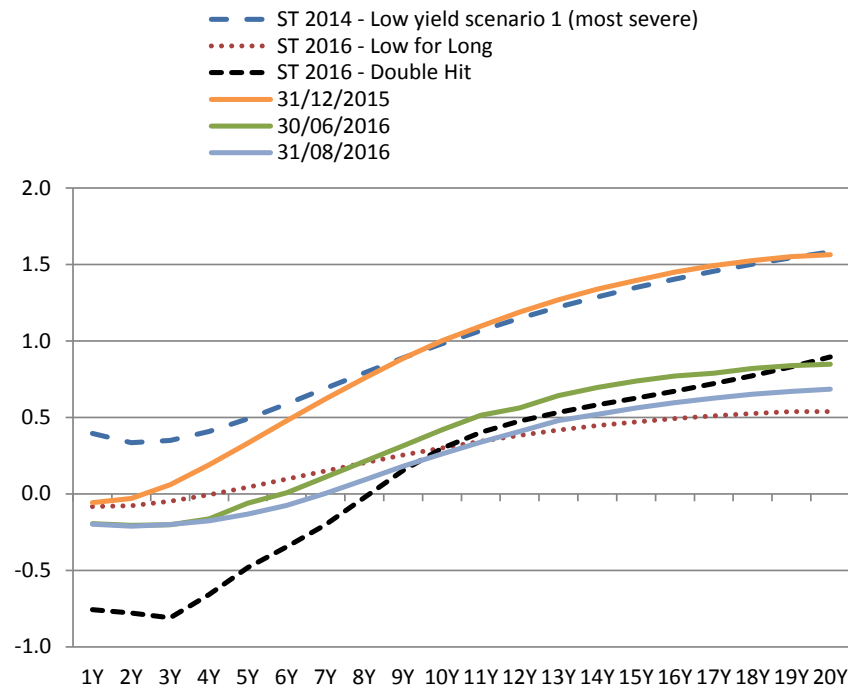
Frankfurt, 23 September 2016

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# Prolonged low interest rate environment

- The lasting low interest rate environment remains the main risk for insurance undertakings and pension funds as yield curves continue to decrease

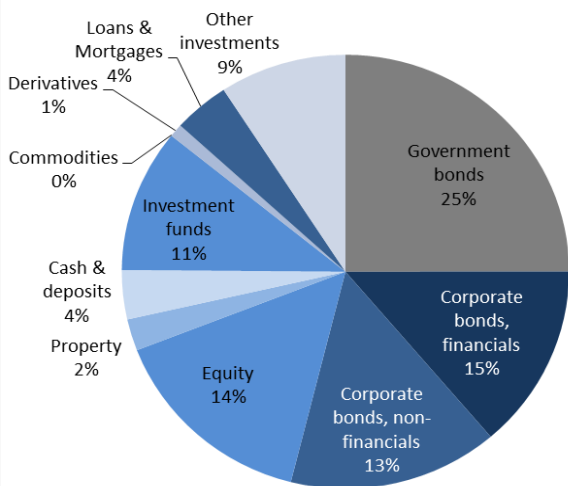
EUR swap curve (in %)



# Consequences of the low interest rate environment

- **Low yields affect both sides of the balance sheet of insurance undertakings and pension funds**

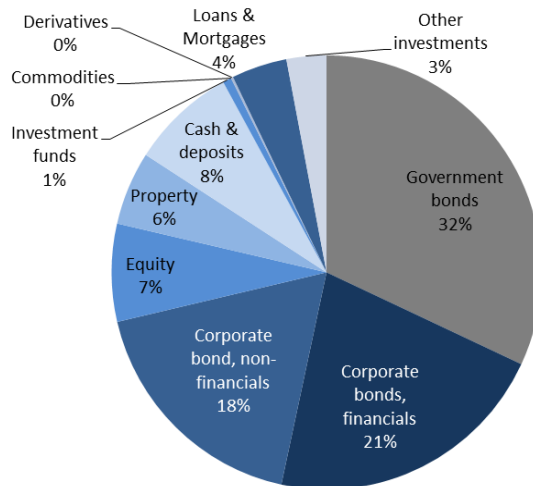
*Average composition of the investment portfolio of the Life insurance sector in EEA Q4 2015*



Source: EIOPA.

Note: The estimation for the insurance figure is based on a sample of 32 large insurers.

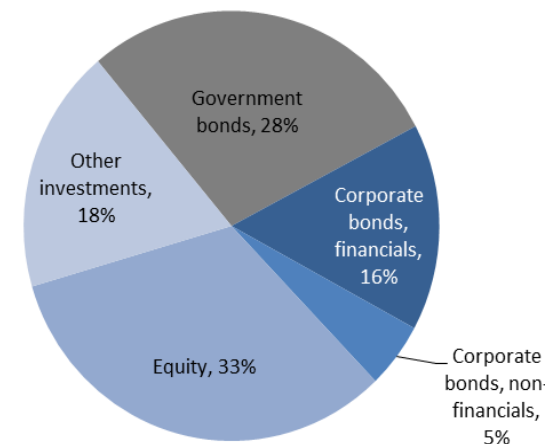
*Average composition of the investment portfolio of the Non-Life insurance sector in EEA Q4 2015*



Source: EIOPA

Note: Data is preliminary and subject to revisions. Data on NL include DB schemes and for the UK DB and HY schemes only.

*Average composition of the investment portfolio of IORPs in EEA Q4 2015*

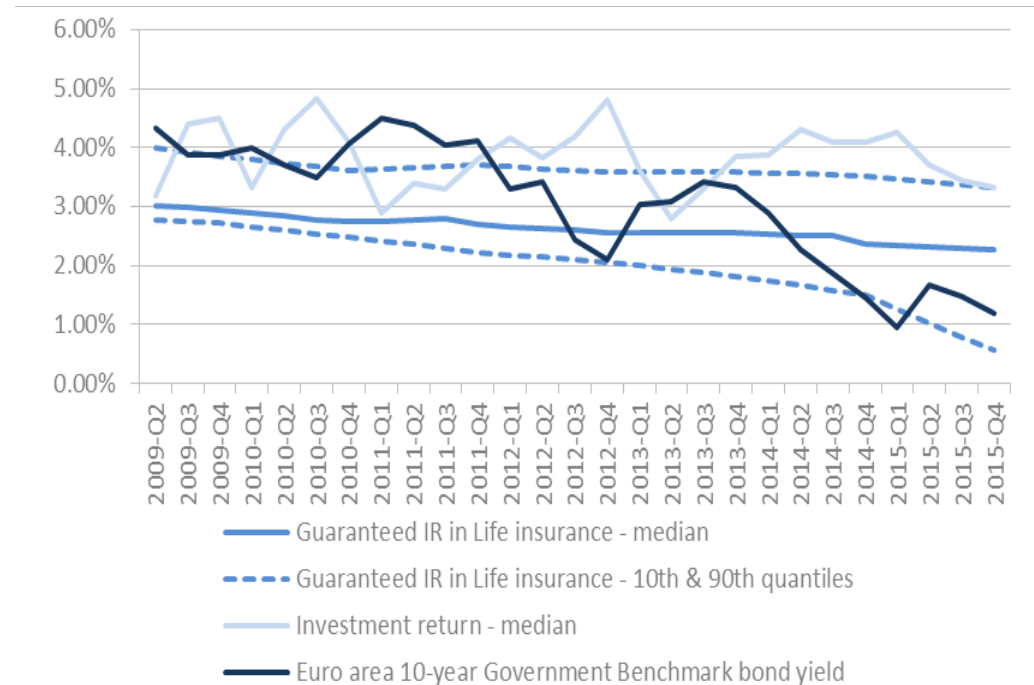


- **Potential reallocation of portfolios towards more risky assets**

# Consequences of low interest rate environment

- **Increasing reinvestment risk for the European insurers and pension funds**
- **Negative impact is higher for life insurers and pension funds with more pronounced duration mismatch between assets and liabilities**

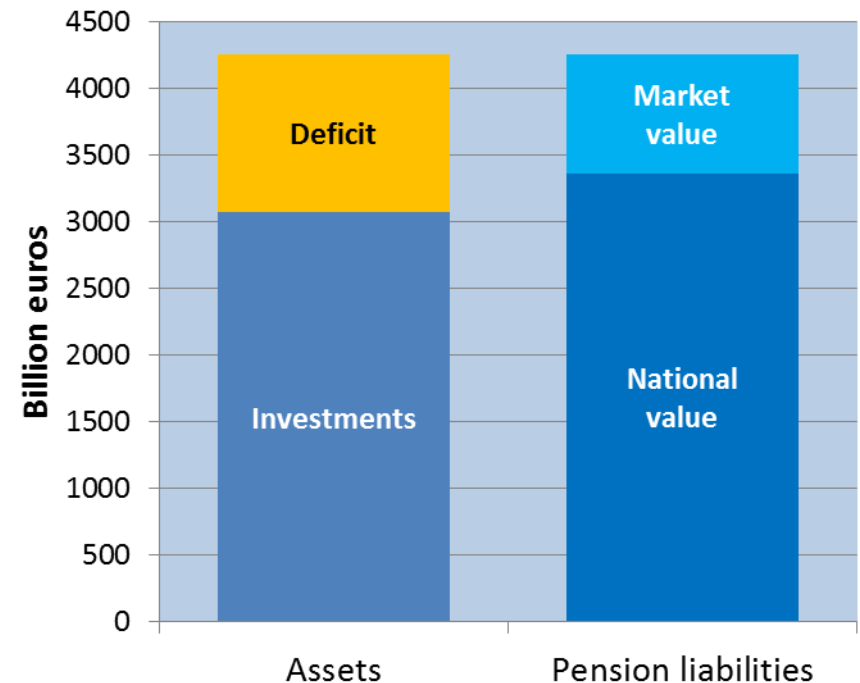
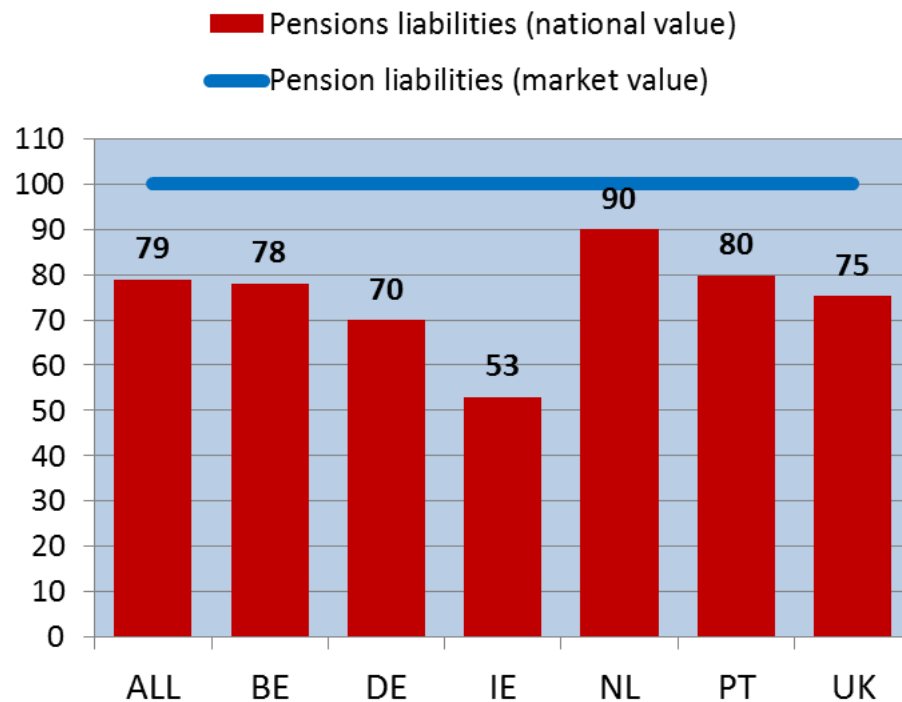
Guaranteed interest rate in life insurance vs. investment return, Euro area 10-year government bond



Source: EIOPA (sample based on 32 large insurance groups in EU and Switzerland) and ECB  
Note: The figures represent guaranteed rates for businesses where such guarantees are applied.

# Consequences of low interest rate environment

- National regimes value pension liabilities 20% lower than a market adjusted value



- **Business models**

- Life insurance long-term guarantees and Defined Benefit pension plans sustainability is **severely questioned**
- Lower investment returns challenge the technical equilibrium in non-life insurance and **puts pressure on raising premiums**
- **Acceleration of the move** towards pure Unit-linked products and Defined Contribution plans
- Risk transfer to policyholders and pension plan members puts **extra pressure on transparency and selling practices**

- **EIOPA Opinion 2013:** Supervisory Response to a Prolonged Low Interest Rate Environment (recommendations on enhanced supervision and promotion of industry actions)
- **Insurance Stress Test 2014:** Low Yield module, general recommendations and follow up (focus on sustainability of business models)
- **IORPs Stress Test 2015:** Testing the resilience of DB IORPs to the long lasting low interest rate environment
- **EIOPA methodology to derive ultimate forward rate (UFR) under Solvency II**
- **Monitoring Solvency II implementation:** Impact of long-term guarantee measures and transitional provisions
- **Insurance Stress Test 2016:** Assessing the impact of the prolonged low interest rate environment on insurers long-term guaranteed business (results to be published end 2016)

- **Solvency II review to address macro-prudential framework**
  - Need to assess existing tools (Solvency II) in order to evaluate if the following operative objectives are sufficiently addressed:
    - Ensuring sufficient reserving and loss absorption capacity
    - Avoiding negative interconnections and excessive concentrations
    - Avoiding excessive involvement in activities that may pose systemic risk
    - Limiting procyclicality
    - Avoiding moral hazard
  - Need to ensure a common basis to address individual, system-wide and systemic risks
- **Develop a EU framework for recovery and resolution**
  - Minimum harmonization of tools and powers
  - Avoid emergency of inconsistent national solutions
  - Coherence between policyholder protection and financial stability
  - EIOPA work on rationale and key building blocks (Consultation before end 2016)



- **Implementation of the EIOPA Opinion on a Pillar II “Common framework for risk assessment and transparency”**
  - Use of common pre-defined stress scenarios
  - Better understanding of vulnerabilities and risks
  - Trigger a proper dialogue on the long-term sustainability of occupational pension promises
  - Encourage timely adjustments
  - Fair distribution of shortfalls between generations
  
- **EIOPA Pension Funds Stress Test 2017**
  - How prolonged low interest rates will affect the sponsors’ behaviour
  - Analyse possible negative consequences for financial stability and the real economy



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**Thank you for your attention!**

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