

To: Solvency II WG
From: prudential team
cc:
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Subject: EIOPA Stress Test Report Summary

Comments

The secretariat has prepared a summary of the [EIOPA 2021 Stress test report](#), published on 16 December 2021.

Summary

General

- EIOPA conducted its 5th Stress Test in cooperation with the ESRB, it included the following new aspects:
 - Inclusion of liquidity risk assessment and
 - Allowing respondents to reflect reactive managements actions.
- EIOPA notes that the insurance sector has shown resilience during the pandemic crisis and entered the ST with a strong 217.9% SCR ratio.

Scenario

- adverse double-hit scenario (prolonged COVID-19 scenario):
 - Lowering of long-term risk-free interest rates.
 - Material increase of the risk premia on sovereign bonds amid weakening domestic demands and concerns regarding sustainability of public debts (Increase of 28 bps in ten-year sovereign bond across EU).
 - Increased insolvency risk of non-financial companies, a further undermining of corporate profitability leads to increased corporate bonds yields. (Between 71 and 269 bps in EU).
 - Abrupt stock price decline of 45% in the EU.
 - A decline in EU residential and commercial real estate prices (respectively 8.4% and 17.4% decline).

The market shocks were complemented by a set of insurance specific shocks affecting all the lines of business that are more exposed to the effects of the pandemic outbreak.

Scope

- 44 participants (43 groups and 1 solo), representing 75% of the EEA insurance market based on total assets.
 - 27 Standard formula users, 15 PIM users and 2 full IM users.
 - 34 participants use LTG measures (incl. 3 MA users)
 - 19 transitional measure (TM) users (incl. 1 using the transitional measure on the interest rates)

Overview of results

1. Capital component

- EIOPA highlights that the 2021 ST exercise enhances the macroprudential dimension of the framework complementing the **standard fixed balance sheet (FBS) approach** with a **constrained balance sheet (CBS)** approach where participants were allowed to apply reactive management actions in the

calculation of their post-stress position. However, only 19 participants applied reactive management actions.

Impact on 'Solvency ratio', 'Solvency ratio without TM' and 'Solvency ratio without TM and LTG'

	Baseline Value	FBS	CBS
Solvency Ratio	217.9%	125.7%	139.3%
Solvency ratio without TM	204.6%	111.0%	123.8%
Solvency ratio without TM and LTG	173.3%	47.2%	55.1%

- The impact of removing LTG is important and doubles in the adverse scenario. The impact of removing transitional measures is consistent but considerably lower than the impact of removing the LTG measures. When removing both LTG and TM, 31 undertakings show a Solvency Ratio below 100% in the FBS scenario, and 27 in the CBS.

Impact on SCR

	Baseline Value	FBS	CBS
SCR	291.1bn	311.6bn	300.0bn

- Standard formula users show an increase in SCR of 9.3% in the FBS and 1.4% in the CBS, while partial and full internal model users report an increase in SCR of 5.5% and 4.3%, respectively.
- Removing TM does not materially affect SCR, while removing both TM and LTG, or LTG alone consistently increases the SCR.

Impact on Eligible Own Funds (EOF)

	Baseline Value	FBS	CBS
Eligible Own Funds	634.1bn	391.8bn	417.9bn

- Aggregate EOF decrease by 38.2% in the FBS and by 32.1% in CBS, mainly driven by changes in Basic Own Funds, it is noted that reactive management actions are important in mitigating the reduction caused by the shock.
- While Tier 1 EOF still represents around ¾ of total EOF, the increased contribution of Tier 2 and Tier 3 signals a deterioration in the quality of capital to cover the SCR.
- The decrease caused by removing TM and/or LTG is substantial.

Impact on 'Assets over Liability ratio' and 'excess of Assets over Liabilities (eAoL)'

	Baseline Value	FBS	CBS
Asset Over Liability Ratio	110.0%	105.9%	106.2%
Excess of Assets over Liabilities (eAoL)	590.2bn	325.8bn	340.8bn

- None of the participants falls under 100% of the ratio both under the FBS and CBS approaches. This indicates that the sector, even under a severe scenario, is able to meet its promises to policyholders.
- The aggregate eAoL almost halves in the FBS (-44.8%). Under the FBS, the reduction of the eAoL is driven by the larger decrease in the assets (EUR 659.3 bn/ -10.1%) partly offset by a contained decrease of liabilities (EUR 394.9 bn/ - 6.7%). Under the CBS, the reactive management actions contribute mostly to contain the impact on the assets rather than the liabilities.

2. Liquidity

The following table shows the impact of the adverse scenario on the liquidity indicators

	Baseline Value	FBS	CBS
Net liquidity position (cash + net-flows)	81.1bn	-10.1bn	11.4bn
Sustainability (net flows + cash + liquid assets)	2.8tr	2.2tr	2.2tr

Net liquidity position

- Net cash flows position decreased substantially and, in the FBS case, turned negative from approximately EUR 6.0 bn in the baseline to EUR -78.9 bn and to EUR -57.4 bn in the CBS, but for the CBS the net liquidity position turns positive following the reactive management actions.
- Overall, the important presence of liquid asset positions (EUR 2.8 tr in the baseline which drops by EUR -538.7 bn in the FBS approach and EUR -525.8 bn in the CBS approach) constitutes a strong buffer for the participants.

Sustainability

- All participants can balance the negative net cash-flows with other liquid assets in the baseline as well as in the FBS and CBS. The decrease in cash flows is also initially compensated by reactive management actions.

3. Conclusions

- The sector displays a sufficient level of assets backing the liabilities of policyholders, also under the adverse scenario.
- The application of the reactive management actions improves the aggregate solvency ratio by 13.6%.
- Based on the capital component, it is seen that the main risks are stemming from the decoupling of risk-free rate and risk premia. Though this can be addressed by means of reactive actions.
- The ST shows the relevance of the LTG package. A part of the insurance market is still relying on transitional measures that will be phased out in 2032 and
- Insurers have a large amount of liquid assets that allow to cover liquidity needs.
- Regarding the macroprudential aspect, a visible shift from corporate bonds holding and equities to government bond holdings in aggregate terms. In case a large number of insurers would adopt similar behaviour, this could potentially lead to an impact on the fixed income market

4. Next Steps

- EIOPA will continue analysing the data collected to get a deeper understanding of the sector's risks and vulnerabilities.
- EIOPA will assess the need to issue further recommendations based on the evidence collected during the test.