

2024 STRESS TEST EXERCISE Overview

Meeting with Stakeholders
17 January 2024

EIOPA REGULAR USE



AGENDA

Item	Topic
1	Introductory remarks Dimitris Zafeiris – Head of the Risks and Financial Stability Department
2	Introduction to the exercise: structure and timeline Matteo Sottocornola – Financial Stability Team Leader
3	Overview of the technical aspects: shocks and their applications Stelios Kotronis – Senior Expert Financial Stability
4	Templates for the data collection Eveline Turturescu – Senior Expert Financial Stability
5	Disclosure of the results Dimitris Zafeiris – Head of the Risks and Financial Stability Department



BACKGROUND

- EIOPA is requested to initiate and coordinate Union-wide assessments of the resilience of financial institutions to adverse market developments in cooperation with the European Systemic Risk Board
- In 2019 the EIOPA Board of Supervisors decided to reduce the frequency of the Union-wide insurance Stress Tests to 3 years, and given that the last exercise was the one of 2021, the next one should be in 2024
- The EIOPA BoS, in its September meeting, agreed to run a stress test in 2024 based on a high-inflation and high-yield scenario targeting large European groups and, at a second instance other entities to enhance national coverage



ECONOMIC ENVIRONMENT AND STRESS TEST SCENARIO GEOPOLITICAL TENSIONS AND HIGH FOR LONGER

The current economic conditions are characterised by a regime shift, from almost a decade of low interest rates to higher but also from heightened geopolitical tensions

- Financial markets faced a strong correction across asset classes during 2022, but in some cases, e.g., equity markets, rebounded substantially since then. It required the announcement of some extraordinary measures by ECB to tackle sovereign spread fragmentation risk during 2022. Credit spreads remained overall contained in relative terms.
- Gilt crisis and regional banks crisis in US are some examples the fragility of the economic environment when rates increase sharply and when liquidity is withdrawn
- There are three channels (among others) of how insurers are affected by this economic environment:
 - 1) claims and expense inflation
 - 2) financial market volatility
 - 3) Policyholders' behaviour
- Insurers show solid capital buffers, with solvency ratios peaking within the first quarters of 2022 (albeit with heterogenous effect for parts of the market), before closing to 2021 levels at year-end



Introduction to the exercise: structure and timeline

Matteo Sottocornola, Financial Stability Team Leader



APPROACH

BASICS

	Capital	Liquidity
Scenario	<ul style="list-style-type: none"> Renewed inflation amid high for long scenario <ul style="list-style-type: none"> Market shocks Insurance specific shocks 	
Approach	<ul style="list-style-type: none"> Instantaneous shocks / Full Solvency II framework Fixed balance sheet (no reactive management actions) Constrained balance sheet (with guided reactive management actions) 	
Metrics	<ul style="list-style-type: none"> Balance sheet based (excess of Assets over Liabilities) Solvency based (OF, SCR) 	<ul style="list-style-type: none"> Liquidity position (assets and liabilities) Net flow position over 90 days Sustainability of the net-flow position
Disclosure	<ul style="list-style-type: none"> Aggregated (stress test report) Individual: subset of balance sheet indicators, upon consent 	<ul style="list-style-type: none"> Aggregated (stress test report)

SCOPE

SUBSET OF LARGE GROUPS OF (RE)INSURERS, COMPLEMENTED BY IDENTIFIED GROUPS/SOLOS THAT ENHANCE COVERAGE

- The targeted coverage stands around the 75% at EEA ensuring sufficient coverage at national level with a balanced representation in terms of type of undertaking

Criteria

- Capital:
 - a) Large groups
 - b) Groups/solos for jurisdictions not covered in step a)

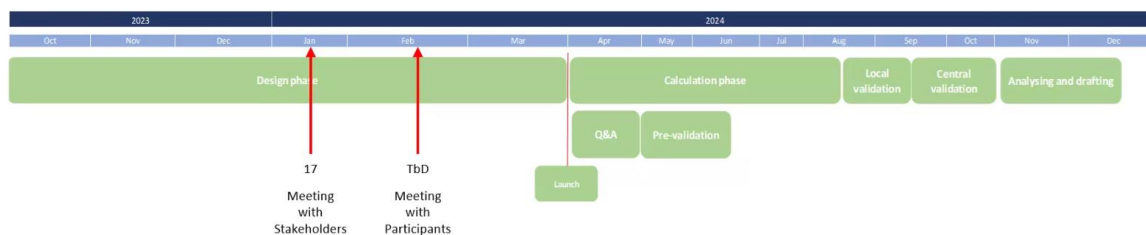
Metrics

- EEA and National market coverage
- representation of life and non-life business

Liquidity

- Liquidity component targets the same **entities identified for the capital component**
- To better reflect the in-force liquidity management practices the scope for the liquidity component will be based on **solo entities** either directly included in the scope for the capital component or identified among those belonging to the groups part of the capital component

HIGH LEVEL TIMELINE



Key Milestones

- Launch of the exercise: 2 April 2024
- Q&A: April 2024
- Pre-validation: May 2024
- Deadline for data submission: 9 August 2024
- Validation (resubmissions): till end-October 2024
- Publication of the report and individual results (upon consent): mid-December 2024

HIGH LEVEL TIMELINE

FOCUS ON Q&A AND PRE-VALIDATION PROCESSES

Q&A

- **Aim:** ensure a clear and shared understanding on the application of the shocks and of the reporting requirements
- **Deliverable:** list of Q&A, revised package (public)
- **Operational aspects:**
 - 4 weeks: 8 April to 3 May
 - Publication of the Q&A on the EIOPA website on a weekly basis
 - Final Stress test package published by mid-May

Pre-validation

- **Aim:** ensure a proper and homogeneous approach to the exercise (level playing field) in terms of simplifications / approximations / reactive management actions
- **Deliverable:** pre-validation note (internal)
- **Operational aspects:**
 - 5 weeks: 29 April to 31 May
 - Each participants will be allocated to a slot
 - Discussion based on the pre-validation questionnaire (under finalization) to be filled and submitted before the call and covering scope of application of the shocks, simplification and approximations, approach to SCR recalculation, envisaged management actions

Overview of key technical aspects: shocks and their applications

Stelios Kotronis, Senior Expert Financial Stability



TECHNICAL SPECIFICATIONS

GENERAL APPROACH

Main principles followed

- ▶ Ensure consistency with the Methodological principles for stress testing drafted, consulted and published over the past years
- ▶ Ensure stability of the framework with previous exercises, but also:
 - ▶ enhance aspects of the 2021 stress test
 - ▶ reflect the main elements of the narrative in the shocks and their application
- ▶ the “stress test package” to incorporate the feedbacks and Q&As received in previous editions
 - ▶ technical specifications, templates



TECHNICAL SPECIFICATIONS

STABILITY OF THE FRAMEWORK

▶ Similar set of market shocks

Shock
swap rates (nominal and inflation linked)
sovereign bond spreads
corporate bond and covered bond spreads
equity prices
real estate prices (residential and office & commercial)
residential mortgage-backed securities yields (RMBS)
other assets prices (private equity, hedge funds, real estate investment trusts (REITs), commodities)
investments in infrastructure

▶ Similar set of insurance specific shocks

Shock	Life	Non-life
Mass lapse	$X_{C,L}$	
Cost of claims		$X_{C,L}$
Expenses	$X_{C,L}$	$X_{C,L}$
Reinsurance recoverables/receivables	X_L	X_L
Reduction in written premia	X_L	X_L

TECHNICAL SPECIFICATIONS

REACTIVE MANAGEMENT ACTIONS

- ▶ **Decision on the application of RMA remains in the capacity of the participants but shall be considered in the light of the post stress position:** if a participant considers that reactive management actions are not necessary, the exercise can be limited to the fixed-balance sheet assumption
- ▶ However, to ensure homogeneity in the approach (missed in 2021) some guidelines are specified:
 - ▶ if the company's SCR ratio falls below the **target solvency ratio explicitly linked or derived from risk management framework of the participant** (e.g., risk appetite), it is expected that reactive management actions will be implemented to possibly restore the situation
 - ▶ addition to the qualitative information to be requested
- ▶ This applies also to the liquidity component:
 - ▶ For the latter, RMA are expected to be implemented in case of **breach of any metric / level specifically defined in the risk management framework, e.g., liquidity management plan, contingency funding plan**. It should be noted that the RMAs can differ in the capital and liquidity component

TECHNICAL SPECIFICATIONS

Questions

To grant homogeneity in the application of the reactive management actions, do you have suggestions on how to more clearly identify metrics/thresholds to trigger RMAs?

Based on the common practices, can you suggest more precise location (e.g. risk management plan) where these metrics can be found?

TECHNICAL SPECIFICATIONS

IN LINE WITH PREVIOUS EXERCISES AND METHODOLOGICAL PRINCIPLES WITH SOME EVOLUTIONS (UNDER DISCUSSION)

- **Treatment of participations in credit institutions** (Follow-up to remarks received in 2021 and to ensure level playing field)
 - Shock to equity prices used as a reference (as in 2021), with the following explicit specification:
 - Impact on BS and OF fully captured
 - Impact on SCR scaled to neutralise the effect of such participations on the Solvency Ratio on the participants
 - because: e.g., the fully fledged recalculation of the capital requirement of banks not obviously feasible within the context of the EIOPA stress test (also to be checked with participants)
- **Investment in infrastructures** (Follow-up to remarks received in 2021)
 - Specific set of shocks provided by the ESRB
 - To be used to treat securities (all types) related to infrastructure investments
- **Mass lapse** (In line with the narrative and to capture the observed trends)
 - Focus to financial products
 - Shocks tailored to the distribution channel (Direct distribution vs. Credit institutions or insurance distributors other than credit institutions)
- **Impact of inflation** (Improvement of the consistency of the scenario)
 - Improved calibration of the shock based on inflation linked swaps provided by the ESRB
 - Cost of claims (non-life) and Expenses (all business lines)
 - Non-life claims inflation shall be carried out by inflating the projected baseline claims-related cash flows with a given yearly shock, pursuing the methodology exposed on EIOPA's last report on inflation (source EIOPA-BoS-23-360)
 - Expenses cash-flows could have a different, lower shock reflecting a higher sensitivity to inflation on the claims side

TECHNICAL SPECIFICATIONS

Questions

Do you think that allowing a fully-fledged estimation according to the sectorial rules e.g., for banking participations, would be a feasible in the context of EIOPA stress test? If yes, which additional information would be needed to run the fully-fledged estimation?

Based on your experience, is there alternative proxy to use for claims / expense inflation, consistent with allowing a level playing field and prevailing the comparability of the exercise?

Templates for the data collection

Eveline Turturescu – Senior Expert Financial Stability



BASIC PRINCIPLES

- Ensure a comprehensive overview of the impact of the shocks
- Ensure a consistent application of the shocks
- Limit the burden for participants in all the phases of the exercise

Collect all and only the needed information (for analysis and / or validation purposes)

- Maintain consistency with the regular SII reporting (where possible)
- Maintain stability with the previous exercises (where possible)
- Improve the usability

Enhancements only where needed to align with SII reporting, better capture / validate shocks, reduce the mistakes

CAPITAL

MAIN ENHANCEMENTS UNDER DISCUSSION

Technical	<ul style="list-style-type: none">▪ Switch to the new Solvency II taxonomy (2.8)▪ Indicators automatically calculated▪ 1st level validation checks included directly in the template
Content	<ul style="list-style-type: none">▪ Qualitative information directly embedded in the templates for the data collection (no more separate word document)▪ Qualitative information on the applied reactive management actions (if any)▪ Simplification of the non SII based information to be collected▪ Assets: additional details on the impacts to CIUs (look through)▪ Liabilities: modified duration of the non-life TP by business line▪ Sensitivity of Assets and liabilities to market movements (baseline)
Question <p>The validation impact of the shock to non-life cost of claims will require the collection of the baseline duration of the technical provisions of the non-life portfolios of liabilities by business line. A better estimation of the impacts can be done through the assessment of the baseline and stressed cash flows per liability portfolio. CF shall be submitted at least for a representative subsample of solo entities belonging to the group. What is your view on the 2 options?</p>	

LIQUIDITY

MAIN ENHANCEMENTS UNDER DISCUSSION

Technical	<ul style="list-style-type: none">▪ 1st level validation checks included directly in the template
Content	<ul style="list-style-type: none">▪ Collection of qualitative information more structured and better embedded in the templates▪ Qualitative information on the applied reactive management actions (if any)▪ Stocks:<ul style="list-style-type: none">▪ no more split between assets backing life and non-life portfolios▪ Alignment with IAIS latest publication on haircuts▪ Flows: collection trading activities under baseline and adverse scenarios split between general and UL/IL portfolios


Disclosure of the results


Dimitris Zafeiris – Head of the Risks and Financial Stability Department



PUBLICATION OF THE RESULTS PENDING FINAL DRAFT OF THE SOLVENCY II REVIEW

In line with the more recent exercises and following the recommendation of the European Court of Auditors Audit on stress test initiatives, the communication of the outcome of the 2024 ST exercise will be twofold

1. Publication of a report based on aggregated data covering both the capital and the liquidity component 
 - comprehensive set of capital indicators (e.g., balance sheet and solvency) and of liquidity indicators based on the collected information
 - Aggregated data, ensuring that figures from individual participants cannot be inferred or recalculated

2. Publication (upon consent of the participants) of a subset of capital based indicators at individual level 
 - based on a subset of pre-defined indicators limited to the pre- and post-stress group balance sheet with and without the application of reactive management actions
 - No disclosure of the solvency position (OF and SCR) pre- and post-stress
 - No disclosure of the liquidity position pre- and post-stress

The process to collect the consent for the individual disclosure from the participants will replicate what done in 2021

- Indicators to be published communicated at the launch of the exercise
 - Interactions with participants once results are validated
 - Collection of consent in written
-