

To: Solvency II WG
From: Prudential Team
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Subject: High-level summary of EIOPA's Financial Stability Report December 2024

Summary

Members will find hereafter the main take aways from EIOPA's Financial Stability Report December 2024 ([here](#)), published on 12 December. The report provides an overview of significant developments and risks within Europe's insurance and occupational pensions sectors.

Key developments

- Escalating global tensions and shifting dynamics due to elections in key economies pose risks to international cooperation and financial systems. The war in Ukraine remains a critical factor, particularly with its cyber implications and potential for broader geopolitical escalation.
- Inflationary pressures have eased but remain volatile due to unexpected bottlenecks, especially in energy prices. The Euro area's economic growth showed slight improvements in Q2 and Q3 of 2024, but forward-looking indicators point to weakening momentum.
- Consumption has not been impressive despite rising real wages. Households are opting for precautionary savings, reducing their spending contributions to economic growth.
- Central banks, including the ECB, have initiated rate cuts to counter slowing growth, but future rate paths remain uncertain due to inflation and labour market conditions. The dynamic flattening or steepening of the Euro swap rate curve presents mixed implications for short- and long-duration assets.
- Equity markets recovered quickly from minor corrections, demonstrating resilience, but remain vulnerable to unexpected shocks or geopolitical developments.
- Regarding the insurance companies' capital, the median SCR ratios slightly reduced in Q2 2024. However, insurers are still well capitalised above the 100% SCR. More specifically:
 - Life sector – 239.2% (243% in Q4 2023)
 - Composites – 218.8% (225% in Q4 2023)
 - Non-life sector – 212.6% (215% in Q4 2023)

1. EEA Insurers' and IORPS' real estate related investments

Trends

- Insurers and IORPs hold approximately 10% of their portfolios (excluding unit-linked business) in real estate-related assets:
 - Life Insurers: Focus on mortgages (43.3%) and funds (24.2%).
 - Non-Life Insurers: Prefer funds (34.6%) and direct property holdings (27.1%).

Vulnerabilities

A sensitivity analysis revealed that a significant real estate market shock (e.g. 20%) would modestly affect aggregate excess assets over liabilities, although some insurers with concentrated exposure might see more material impacts.

Conclusions

While real estate investments are integral to insurers' and IORPs' portfolios, the overall financial stability risks are limited under normal conditions. The sector's resilience is bolstered by diversified investment strategies, long-term perspectives and adequate solvency buffers. Nevertheless, supervisors are encouraged to maintain vigilance, particularly for markets with concentrated exposures and during periods of economic instability.

2. Asset intensive (or funded) reinsurance

Asset-intensive reinsurance (AIR) has gained attention due to its potential implications for financial stability, particularly given its association with alternative investments and cross-border transactions. Less than 1% of life insurance business in the EU/EEA is reinsured with entities outside the region, primarily in the UK and Bermuda. Cross-border asset-intensive reinsurance is limited to a few European insurers in specific Member States. While current financial stability concerns are minimal, the concentration of this activity among a small group of reinsurers in offshore jurisdictions with alternative business models requires supervisory oversight.

- Cedants recognise the reinsurance asset backed by collateral. AIR transactions are categorised into "funds withheld" (assets remain on the cedant's balance sheet) and "funds transferred" (assets are managed by the reinsurer).
- AIR provides reserving and capital efficiency, investment flexibility, and sometimes tax advantages. It has been particularly attractive during periods of low interest rates.
- Different jurisdictions, such as Bermuda, offer lower capital requirements, making them favourable destinations for reinsurance.
- Credit risk (partially mitigated by collateral), legal/operational risks and potential solvency challenges in stressed scenarios.
- Dominance of private equity-linked reinsurers raises conflict-of-interest concerns and increases use of risky, leveraged assets.
- Supervisors, including EIOPA, are closely monitoring AIR activities. Concerns over transparency, risk management practices, and the implications of these transactions on financial stability have prompted supervisory reviews.

3. Assessment of systemic risk in the EEA insurance sector

The European Systemic Risk Assessment Framework (SRAF) assesses systemic risk in the European Economic Area (EEA) based on supervisory data, primarily from Solvency II QRTs. It includes 73 key risk indicators and 24 ancillary indicators across 10 categories. The risk level for each category is determined by analysing these indicators, without aggregating their individual risk levels.

Overview of the latest results of the SRAF for the EEA aggregate

(The results are based on 2023 year-end Solvency II data and macroeconomic and financial market data up to end-July 2024)

- **Economic environment:** The global economy showed signs of recovery from the COVID-19 pandemic and geopolitical tensions in 2023, with slightly improved prospects for GDP growth and inflation in 2024. However, financial market conditions remain uncertain.

- **Macroeconomic exposure:** Most indicators in 2023 were classified as low or medium-low risk. On the negative side, there has been an increase in the selling of credit default swaps in the EEA. On the positive side, the spread between guaranteed rates and investment returns for life business declined.
- **Counterparty exposure:** Risk levels remained mostly stable, with a slight decline in exposure to below-investment-grade assets. However, risks increased in areas like derivatives exposure and rating downgrades.
- **Asset liquidation and policyholder behaviour:** Risk indicators remained stable, but the lapse ratio, which measures surrender rates for life insurance, increased slightly.
- **Substitutability:** Risk levels in this category remained stable, with most sectors/LoBs being either highly competitive or unconcentrated.
- **Underwriting and solvency:** Underwriting and solvency risks improved in 2023 due to premium growth and better investment returns. However, underwriting profitability worsened slightly, especially in non-life insurance, and solvency indicators remained strong and in the low to medium-low risk buckets across the EEA.
- **Emerging risks – ESG:** Exposures to ESG risks remained stable. Moreover, the share of insurers' investments in green bonds in the total corporate bond portfolio has steadily increased over the last years. Natural disasters affecting Europe, caused insured losses of EUR 7.2 billion for windstorms in 2023.
- **Emerging risks – digitalisation and cyber risks:** Cyber risks were generally at medium-low to medium-high levels, with a decline in the frequency of cyber incidents in 2023.

The results of this assessment show a still challenging but slightly improved economic environment in 2024 compared to the previous year, with better prospects for GDP growth and inflation.