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Delegations will find attached document SWD(2014) 170 final PART 2/4.

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PART 2/4

COMMISSION STAFF WORKING DOCUMENT

European Financial Stability and Integration Report 2013

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1.5 INSURANCE SECTOR

This section looks at market developments in the insurance sector in 2012 and to the extent available 2013, and also considers the challenges that insurers will face in the near future.

1.5.1 Market developments

Developments in sovereign bond markets in 2013 should have had – on balance – positive ramifications for the balance sheet of insurers. Another stabilizing factor has been the overall decrease in market volatility compared to 2012. However, the insurance industry continued to face a challenging macro environment as low economic growth and high unemployment in the EU were weighing negatively on demand for both life and non-life products. Also, the very low interest rate environment, in combination with the limited choice of asset classes that insurers can invest in[67] and the macroeconomic framework, put pressure on insurers' profitability and their capacity to offer attractive returns for existing and new products. In addition, insurers face increasing competition from banks who offer more short-term savings and investment products.[68]

Hence, major risks, (i) the prolonged low interest rate environment, (ii) the subdued disposable income of private households, and (iii) the need for further fiscal consolidation in the public sector, could also be regarded as a single compound risk to profitability. A fundamental change in this risk environment would require renewed strong and self-sustained growth triggering a new hiking cycle on behalf of monetary authorities. In addition, the low interest rate environment creates a more challenging environment especially of life insurers in central and northern European markets[69] where products tend to have long maturities and be more rigid in terms of guaranteed returns.

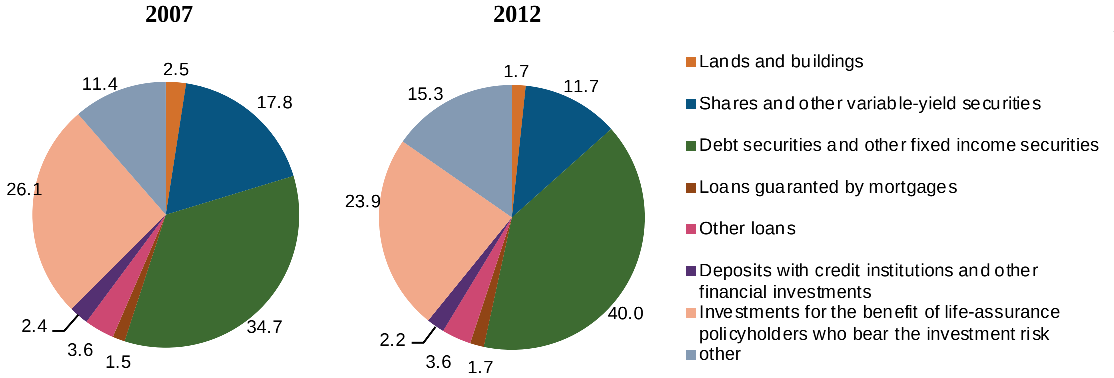
Given their prominence in the investment portfolio of large European insurers, **credit risk** is closely linked to developments in sovereign bond markets. Losses on the market value of sovereign bonds or further rating downgrades of sovereign issuers have to be watched closely in spite of rather favourable developments in 2013 (see Section 1.2).

Throughout the sovereign debt crisis, insurers have placed a rather stable share of around one quarter of their investment portfolio in sovereign debt instruments. Chart 1.5.1 shows the relative shares of types of investment of insurers in all 28 EU Member States.[70] In the run-up to the crisis, a progressive increase in investment into shares and other variable-yield securities could be observed and 2007 shows the highest share with 17.8% of total investment. This share slowly reduces over time, reaching 11.7% in 2012.

On the other hand, over the same period investment in debt securities and other fixed income securities increases by 5.3 percentage points of total investment.

[67] Up to the entry into force of Solvency II / Omnibus II in 2016.
[68] EIOPA (2013).
[69] The same survey carried out by Swiss Re also showed that interest rate sensitivity was generally lower in Southern Europe and France, as well as in the UK.
[70] Croatia is only included in the 2012 data, not in the 2007 data.

Chart 1.5.1: Average **composition of the investment portfolio** of European insurers



Source: EIOPA and own calculations.

An important step in the regulatory development of the insurance sector was to decide which institutions shall be considered Globally Systemically Important Insurers (G-SIIs). On 18 July 2013, the Financial Stability Board, after consulting the national supervisory authorities published an initial list of nine global systemically important insurers (GSIIs),[71] with five out of nine being European domiciled insurance groups (see Table 1.5.1), three being U.S.-American (MetLife, AIG, Prudential Financial) and one Chinese. The prominence of European insurers in this list partly reflects the fact that European insurance accounts for 33 per cent of market share on a global scale. The Americas account for 34 per cent (with 29 per cent U.S.) whereas Asia/Oceania/Africa account together for the remaining third.[72]

In 2012, total assets of the five systemically important insurers increased by 7.1% and accounted for roughly half of total assets in the European market of all listed insurance companies.[73] In terms of profitability, GSIIs saw an improvement in their return on equity (ROE) to 8.4 per cent in 2012, from 7.0 per cent in 2011.[74] This compared to an (unweighted) ROE for all listed European insurers of 8.2 per cent in 2012, up from 5.0 per cent in 2011. GSIIs average return on assets (ROA)[75] increased slightly to 0.65 per cent in 2012 from 0.5 per cent in 2011. Growth of gross written premium has recovered in 2012 after negative growth between 2008-2011, but growth rates continue to be much lower compared to 2007.

Table 1.5.1.: **Some key data of systemically important European insurers**, 2012

	Gross written premiums		Total assets	
	€ bn	% of total	€ bn	% of total
Total	**1,090**		**8,613.**	
Allianz SE		7.8		8.8
Assicurazioni Generali S.p.A.		6.6		8.1
Aviva plc		6.0		5.1
Axa S.A.		2.6		4.5
Prudential plc		n.a.		4.7

[71] A similar list of reinsurers was foreseen to be published in July 2014. As it is already current practice for banks, the list will be updated on an annual basis. Details on eventual needs to hold higher loss absorbing capacities are still to be developed in the case of insurers.

[72] Swiss Re (2013).

[73] Based on Standard and Poor's Capital IQ data (only listed companies).

[74] Weighted by total asset shares.

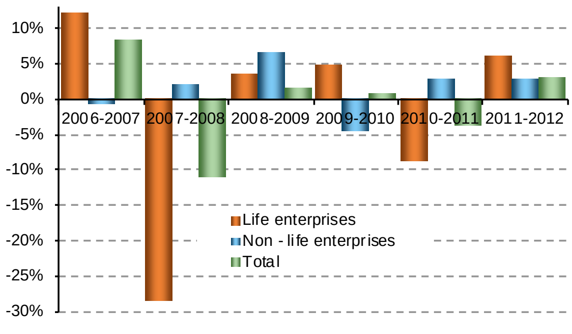
[75] Weighted by total asset shares.

Top 5	23.0	31.2

Note: The sum of shares for gross written premium excludes Prudential.
Source: S&P Capital IQ, SNL Financial, EIOPA.

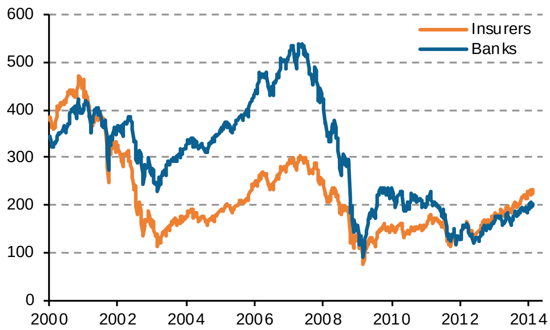
Since Omnibus II negotiations were ongoing in 2013, EIOPA's Board of Supervisors decided to postpone the regular insurance stress test until April 2014 (solvency ratios are the key output of this exercise). For the same reasons, a "Low Yield" exercise originally foreseen in 2013 was postponed as well. The aim of the exercise was to assess the potential scope, timing and scale of the risks arising in the low yield environment, paying special attention to those insurers facing greater exposure due to their product mix.

Chart 1.5.2: **Gross written premium**, annual growth rate, percentage



Source: EIOPA.

Chart 1.5.3: **Stoxx indices**, Stoxx 600, Europe



Source: Bloomberg.

Profitability, as measured by the average return on equity, improved further in 2013 (based on quarterly survey data including the third quarter of 2013) and so did solvency.[76] Chart 1.5.3 displays an interesting development that merits continued monitoring. Insurers did not benefit as banks during the pre-crisis boom as far as the value of their stock is concerned, and during the crisis when banks were bailed out, bank shares recovered more strongly from the historic trough in March 2009. However, the most recent development shows a stronger performance of European insurers.

1.5.2 Insurers and financial integration

In its recent Communication[77], the Commission stressed the potential of insurers to play the role of patient investors with a view to contributing to an efficient division of labour within the financial system. To play this role more actively, insurers should be in a position to invest in a broader class of financial assets.

Substantial differences in the economic performance in Europe pose the risk of further market fragmentation with the impact on business models and strategies among internationally active insurance companies and occupational pension funds. The combined share of both financial and government bonds have been fairly stable over the period from 2009 to 2012, the share of the latter has increased slightly by 2 per cent (at the expense of financial bonds during this time).

[76] The solvency ratio is defined as the available solvency margin divided by the required solvency margin. See EIOPA (2013).
[77] European Commission (2014d).

Solvency II has finally been agreed, and will be fully implemented in 2016. Earlier EIOPA Financial Stability Reports highlighted the risks arising from uncertainty on the future regulatory framework of the European insurance industry in combination with the acknowledged short-comings of the current Solvency I framework. The political agreement on Omnibus II reached removed the uncertainty around implementation of Solvency II, giving both insurance undertakings and supervisory authorities clarity on the shift to the new framework from 2016.

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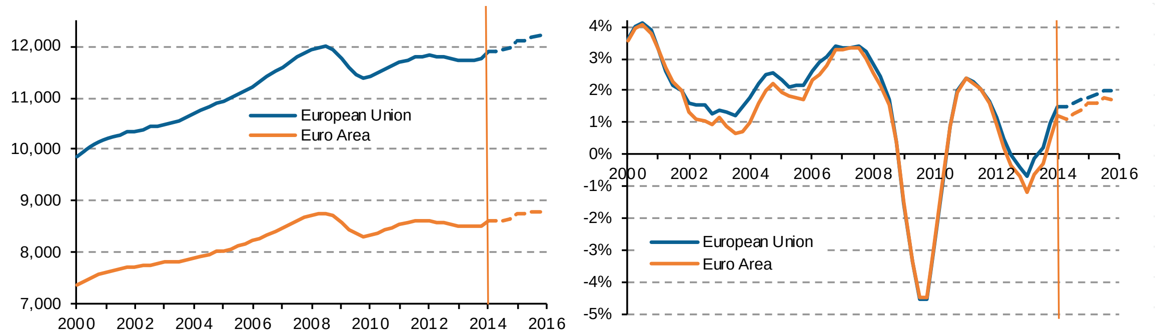
ANNEX TO CHAPTER 1: ADDITIONAL CHARTS

1.A.1 Additional charts on the general economic outlook

Chart 1.A.1: **Gross domestic product**, market prices, chain linked

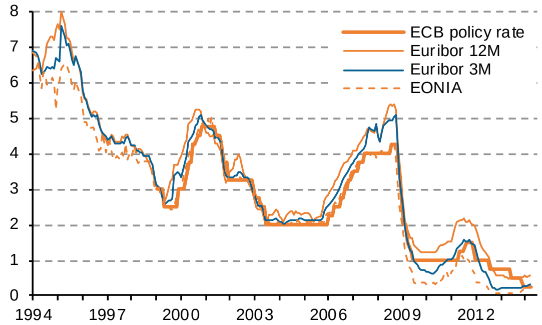
€ billion | Annual growth, percentage

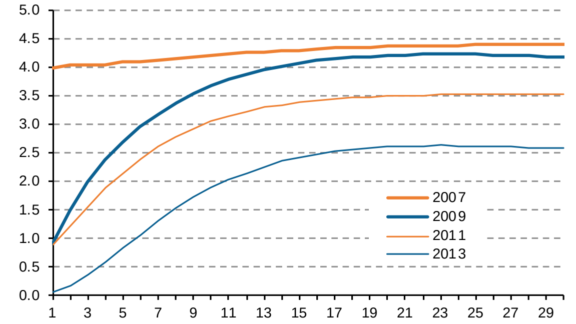


Notes: Data for 2014 and 2015 are forecast.
Source: Eurostat: National (quarterly) accounts, European Commission forecast and own calculations.

Chart 1.A.2: **Market rates and policy rate**, Euro area, percentage

Chart 1.A.3: **Yield curve**, AAA Euro area government bonds, percentage



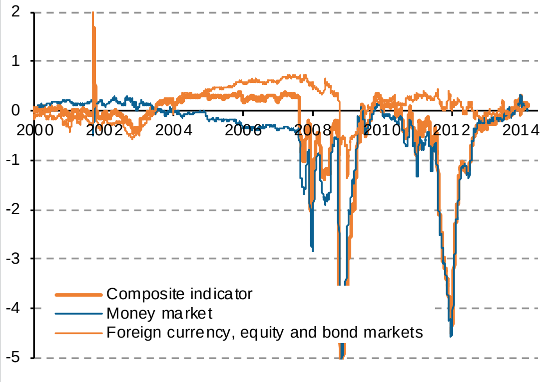


Notes: The lending and deposit rates are calculated as the composite rate (weighted by volumes) of the different type of retail loans and deposits, respectively. Retail refers to loans to and deposits from households and non-financial corporations.
Source: ECB Statistical Data Warehouse and own calculations.

This yield curve needs to be review to see what exactly corresponds to.

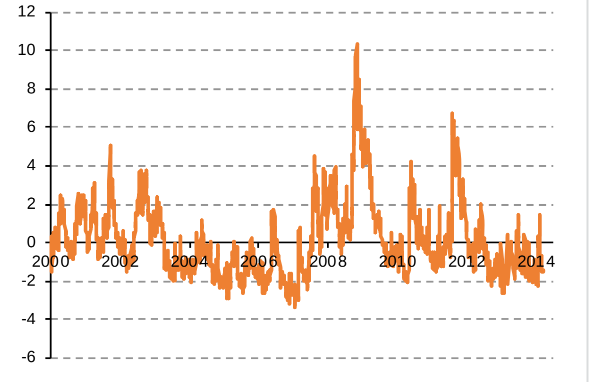
Source: Eurostat.

Chart 1.A.4: **Financial markets liquidity indicator**, Euro area



Source: ESRB Risk Dashboard.

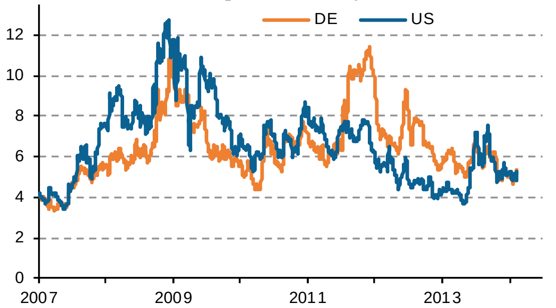
Chart 1.A.5: **Global risk aversion indicator**



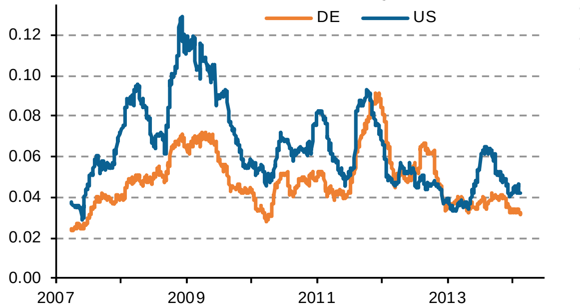
Source: ESRB Risk Dashboard.

Chart 1.A.6: **Volatility on bond markets**, market prices, chain linked

Implied volatility

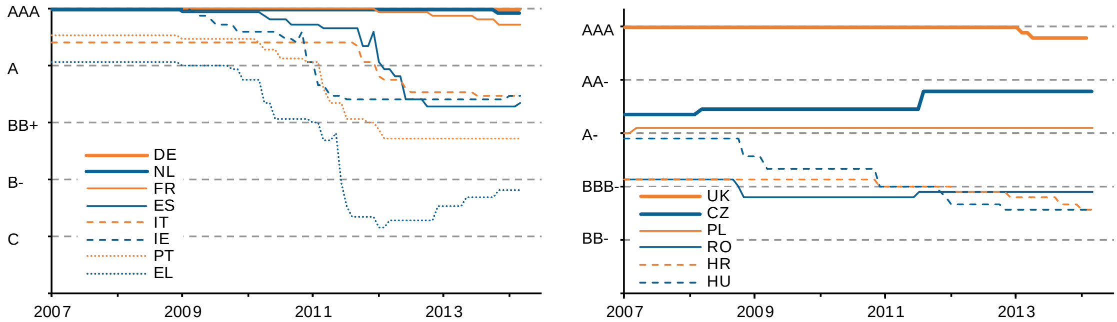


Historical volatility

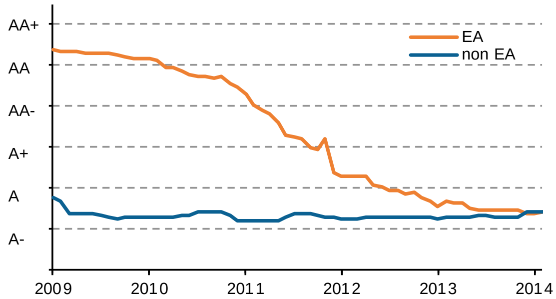


Notes: Implied volatility: three months implied volatility computed at 100% moneyness; Historical volatility: Standard deviation of daily changes.
Source: Bloomberg and Commission calculations.

Chart 1.A.7: **Sovereign ratings**



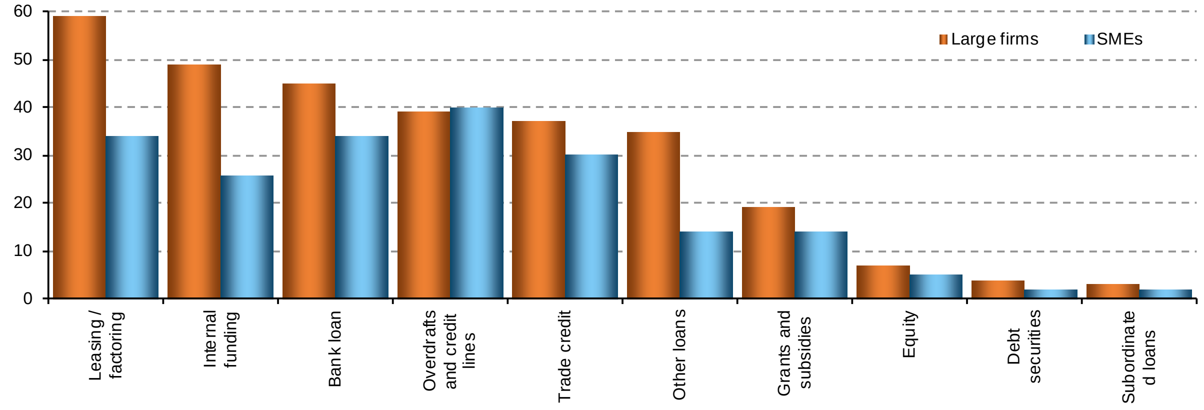
Average ratings



Notes: Ratings are calculated as the average rating provided by Standard and Poor's, Fitch and Moody's.
Source: Bloomberg and Commission calculations.

1.A.2 Additional charts and tables on financing economic sectors

Chart 1.A.8: **Source of external financing, Euro Area corporations**, % having used the source of financing, 2013 H1



Source: ECB: Survey on the access to finance of SMEs in the Euro Area.

Table 1.A.1: **Sources of financing by sector**, Outstanding amounts, Euro area, 2013 Q3, € bn

Sector	Loans	Bonds	Equity		Others	Total
			Quoted shares	Other equity		
Real economy	14,660	1,094	4,199	10,388	4,571	34,913
NFCs	8,501	1,094	4,199	10,380	3,874	28,049
Households	6,158	0	0	8	698	6,864
Government	2,278	7,581	0	4	864	10,727
Financial corporations	27,408	8,336	926	12,123	8,235	57,028
MFIs (banks)	23,024	4,875	493	2,112	1,155	31,659
ICPF	299	52	148	364	6,805	7,669
OFIs	4,086	3,409	285	9,646	275	17,701
Rest of the world	3,299	3,459	0	6,381	3,177	16,317
Total	**47,644**	**20,471**	**5,125**	**28,897**	**16,847**	**118,984**

Note: MFIs loans include interbank lending and the deposits received from other sectors. NFCs: non-financial corporations, MFIs: monetary and financial institutions, ICPF: insurance corporations and pension funds, OFIs: other financial institutions. Other financing for ICPF corresponds to insurance technical reserves. Other equity for OFIs corresponds to unquoted shares and mutual fund shares. Rest of the world refers to the financing provided by Euro area residents to residents outside the Euro area.
Source: ECB: Euro area accounts

Table 1.A.2: **Loans by counterparts granted by Euro Area banks (MFIs)**, outstanding volumes, € billion

Counterparty	2006	2007	2008	2009	2010	2011	2012	2013
Interbank loans (excluding position at ECB)	4,763	5,412	5,824	5,511	5,131	5,297	4,856	4,767
Households	4,529	4,801	4,893	4,960	5,168	5,243	5,253	5,231
Non-financial corporations	3,840	4,389	4,827	4,691	4,668	4,720	4,536	4,343
Governments	814	959	973	1,002	1,218	1,160	1,153	1,082
Other financial institutions	771	958	1,055	1,132	1,191	1,200	1,251	1,075
Total loans to Euro area residents	14,716	16,519	17,572	17,297	17,376	17,619	17,048	16,499
Loans to non-Euro area residents	2,927	3,295	3,242	2,822	2,963	3,022	2,868	2,732
Total loans provided by Euro area banks	**17,644**	**19,815**	**20,815**	**20,118**	**20,339**	**20,641**	**19,917**	**19,230**

Notes: Other financial institutions include insurance corporations and pension funds, and other financial intermediaries. Interbank loans) include also the positions of the banks at the central bank. The last rows of the table present this information; the domestic-cross border breakdown is not available.
Source: ECB: monetary statistics and own calculations.

Table 1.A.3: **Bonds issued by Euro Area residents**, outstanding volumes, € billion

Issuer	2006	2007	2008	2009	2010	2011	2012	2013
Governments	4,711	4,842	5,266	5,887	6,486	6,842	6,950	7,225
Banks (MFIs)	4,549	5,035	5,263	5,364	5,238	5,517	5,399	4,887
Other financial institutions	1,198	1,514	2,170	3,113	3,176	3,173	3,225	3,203
Non-financial corporations	592	636	695	802	852	874	993	1,071
Total	**11,050**	**12,027**	**13,394**	**15,167**	**15,752**	**16,405**	**16,568**	**16,386**

Note: Other financial institutions include insurance corporations and pension funds, and other financial intermediaries.
Source: ECB: securities statistics and own calculations.

Table 1.A.4: **Quoted shares issued by Euro Area residents**, outstanding volumes (market capitalisation), € billion

Issuer	2006	2007	2008	2009	2010	2011	2012	2013
Non-financial corporations	4,466	5,001	2,851	3,493	3,788	3,271	3,743	4,531
Banks (MFIs)	1,046	985	373	565	458	339	402	569
Other financial institutions	665	580	284	352	335	271	357	466
Total	**6,177**	**6,565**	**3,508**	**4,410**	**4,582**	**3,881**	**4,503**	**5,565**

Source: ECB: Securities statistics and own calculations.

Table 1.A.5: **Holdings of bonds Euro Area MFIs**, outstanding volumes, € billion

Issuer	2006	2007	2008	2009	2010	2011	2012	2013
Banks (MFIs)	1,637	1,740	1,976	2,080	1,886	1,852	1,851	1,704
Governments	1,278	1,197	1,245	1,482	1,524	1,396	1,627	1,745
Other financial institutions	428	767	1,150	1,280	1,358	1,353	1,267	1,244
Non-financial corporations	228	246	256	218	180	164	156	150
Total (Euro area bonds)	3,571	3,949	4,628	5,060	4,949	4,765	4,901	4,842
Non-Euro area issuers	1,109	1,234	1,227	1,148	1,052	932	873	807
Total	**4,680**	**5,183**	**5,855**	**6,207**	**6,001**	**5,697**	**5,774**	**5,649**

Source: ECB: Monetary statistics and own calculations

Table 1.A.6: **Holdings of equity Euro Area MFIs**, outstanding volumes, € billion

Issuer	2006	2007	2008	2009	2010	2011	2012	2013
Banks (MFIs)	373	424	422	435	445	484	476	458
Other financial institutions	302	375	306	340	480	444	444	451
Non-financial corporations	500	497	469	461	308	284	309	326
Total (Euro area shares)	1,173	1,295	1,197	1,236	1,233	1,212	1,228	1,233
Non-Euro area issuers	293	342	276	280	303	295	301	329
Total	**1,466**	**1,636**	**1,473**	**1,516**	**1,536**	**1,507**	**1,528**	**1,562**

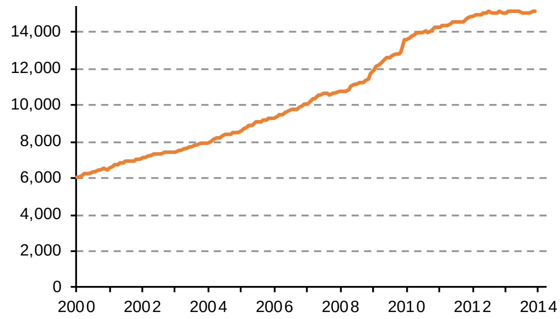
Notes: Includes all equity: quoted shares, non-negotiated shares and other types of equity. The Eurosystem is excluded from MFIs. Source: ECB: Monetary statistics and own calculations

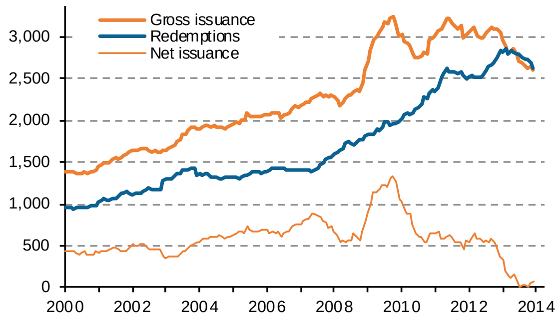
Chart 1.A.9: **Bonds issued by Euro Area residents**, € bn

Long term bonds

Outstanding amounts

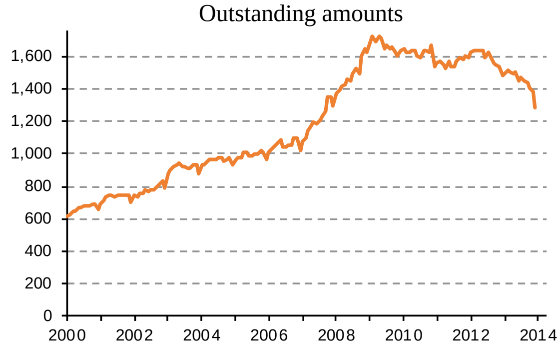
Net flows (year to date)



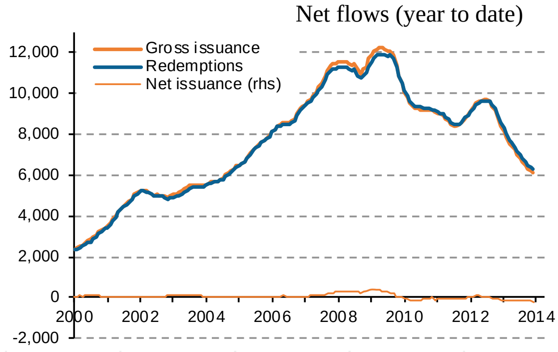


Short term bonds

Outstanding amounts



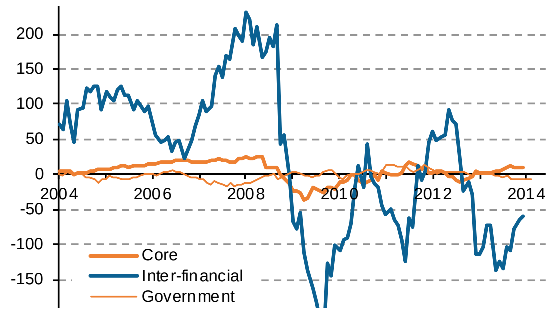
Net flows (year to date)

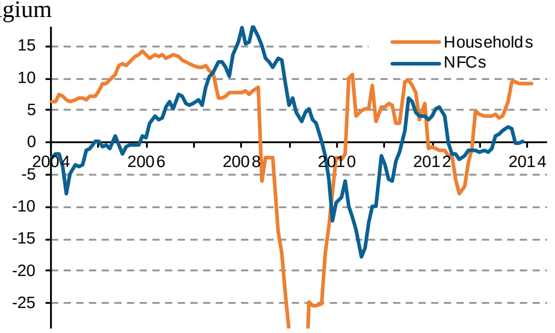


Source: ECB: securities statistics and own calculations.

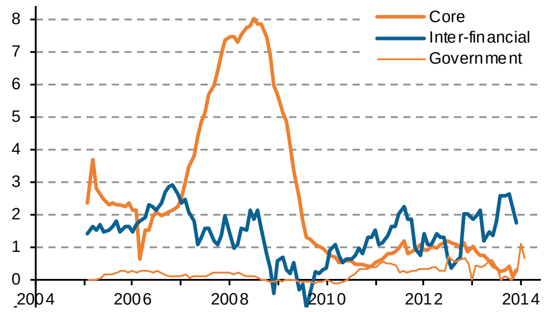
Chart 1.A.10: **Provision of credit by banks from selected countries**, net flows, year to date, € billion

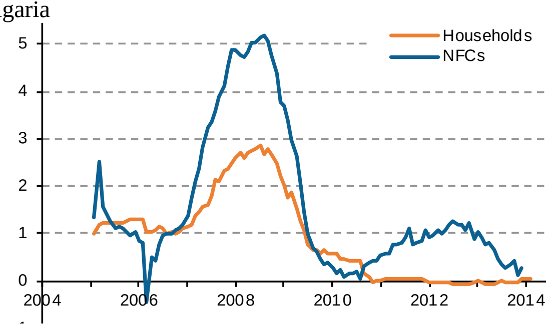
Belgium



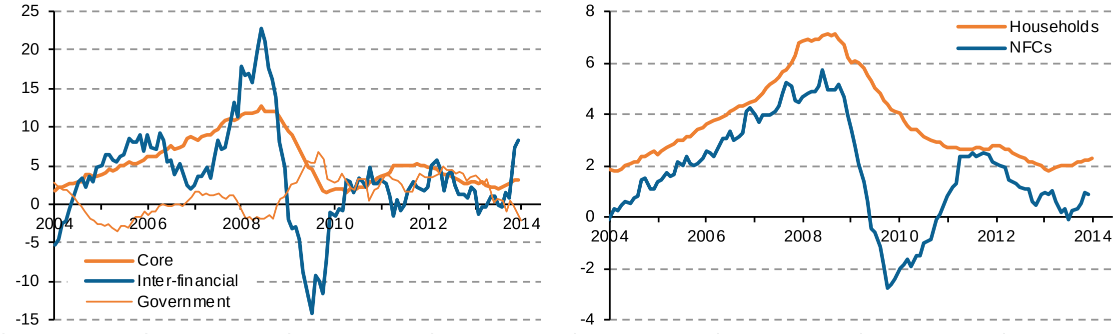


Bulgaria

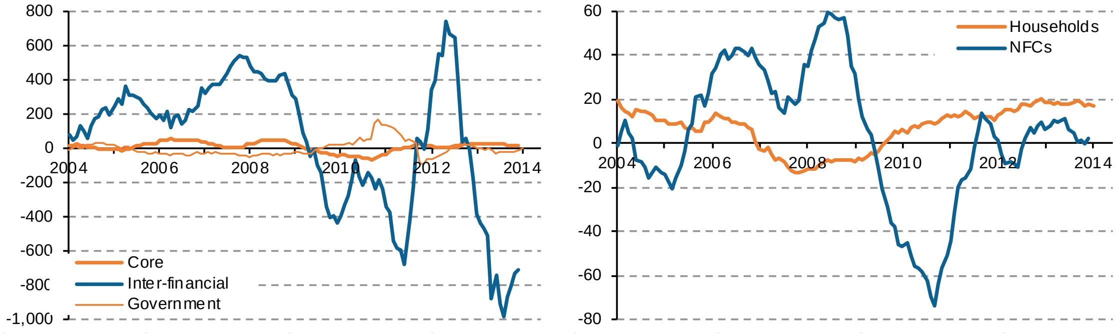




Czech Republic



Germany



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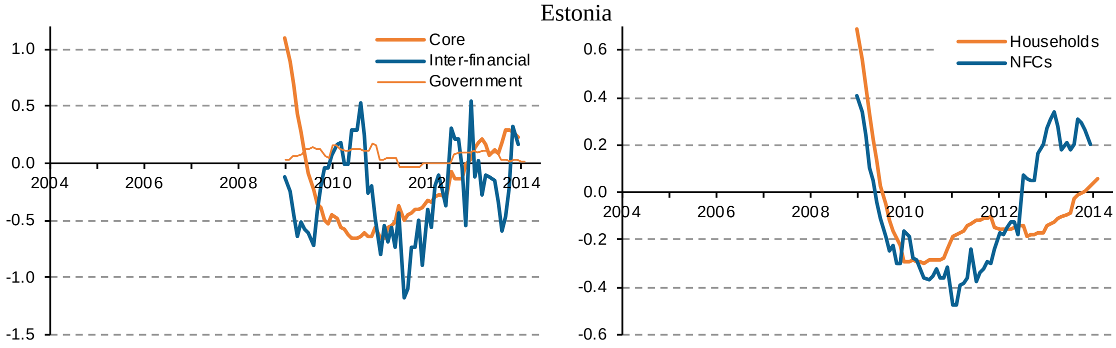

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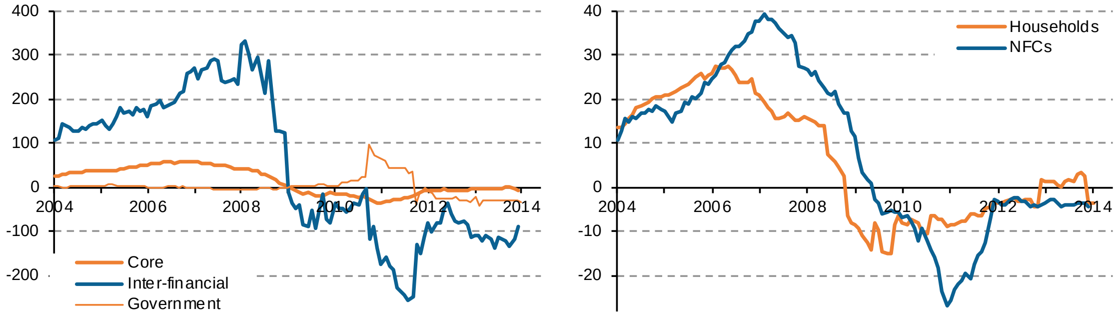

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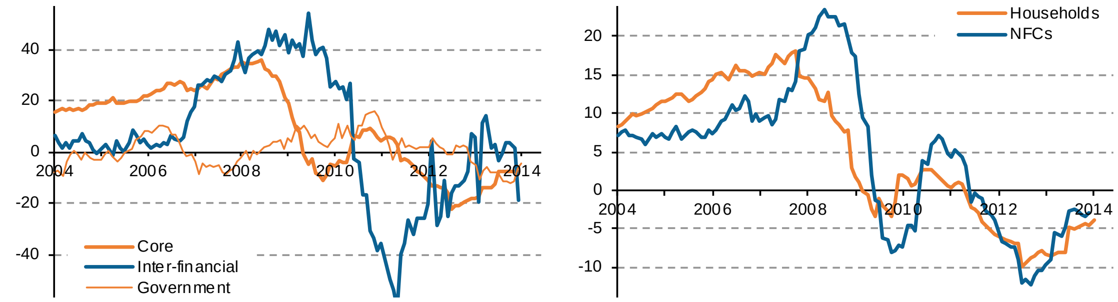

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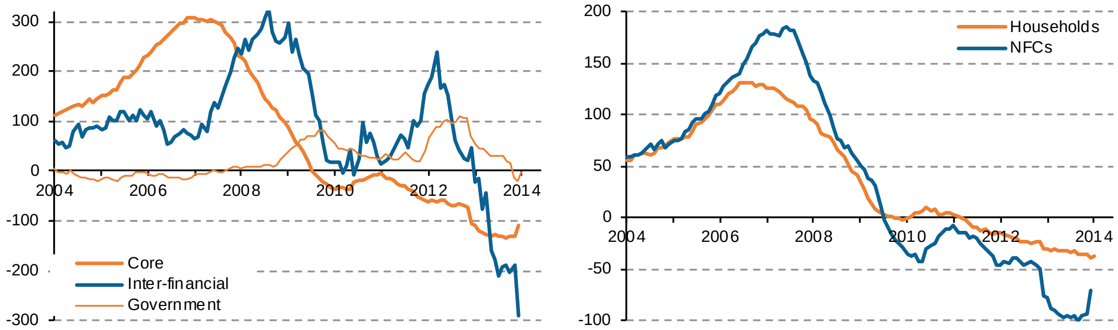

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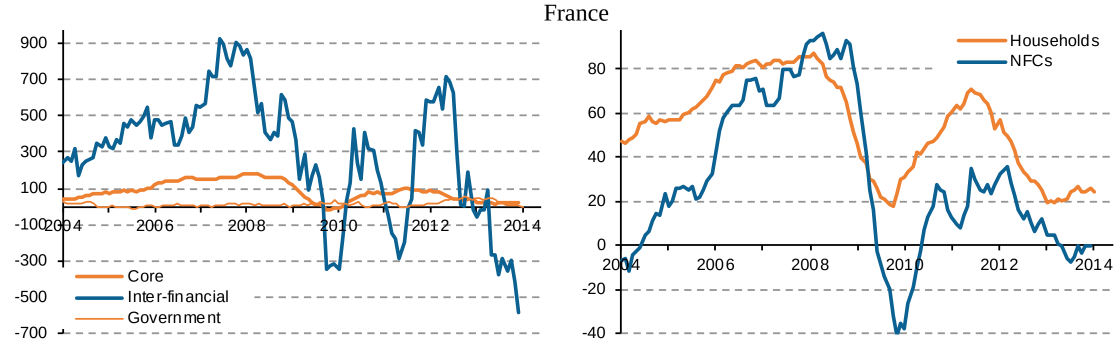

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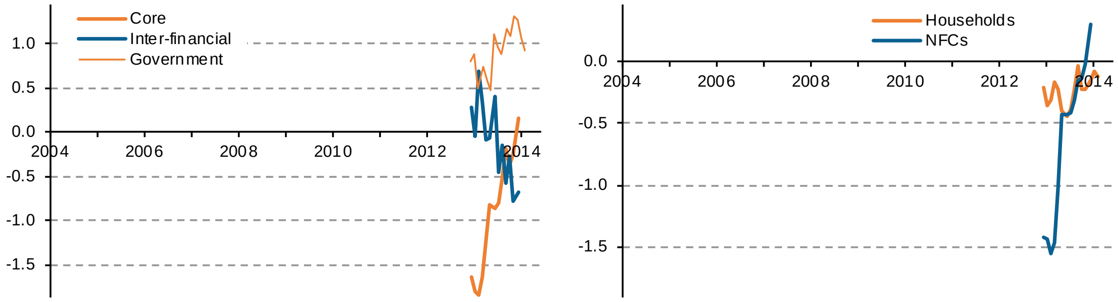

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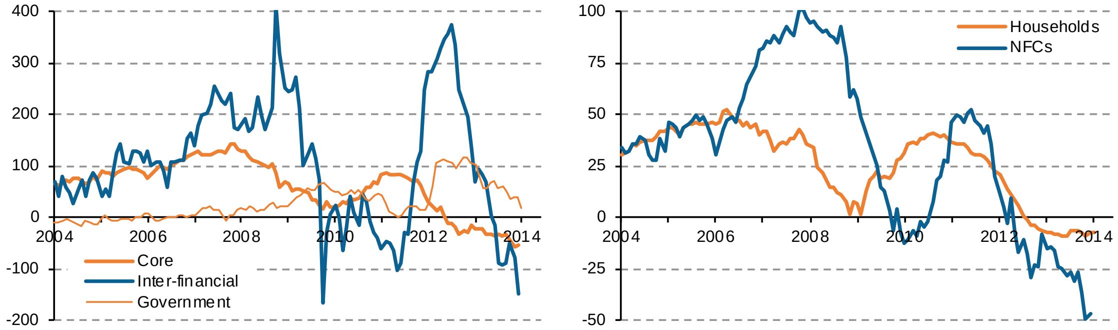

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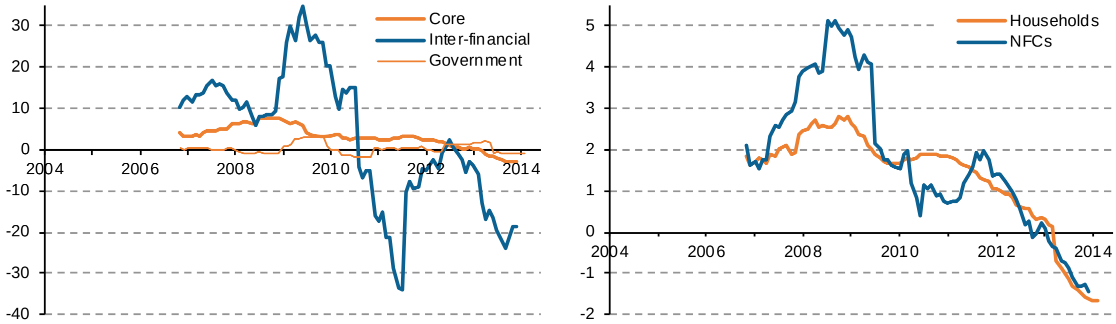

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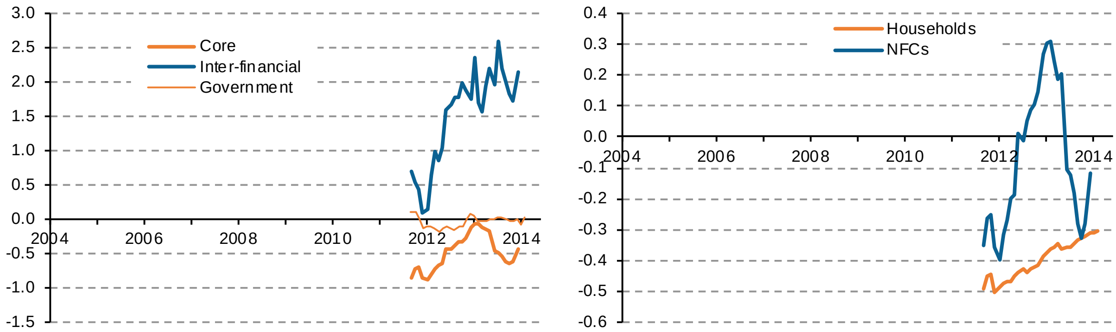

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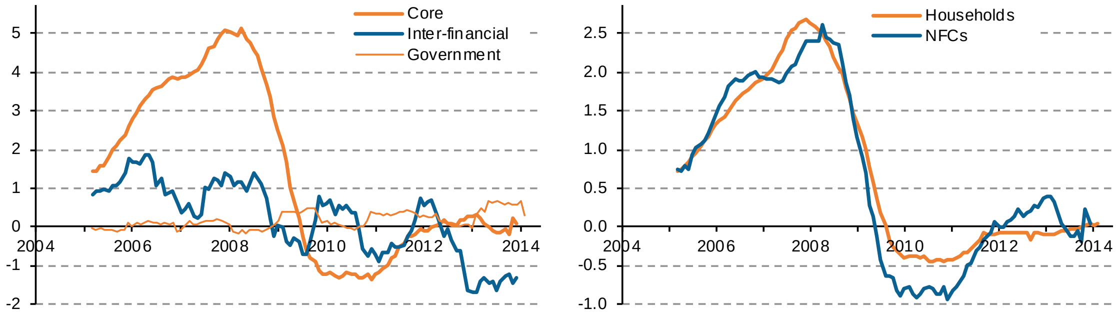

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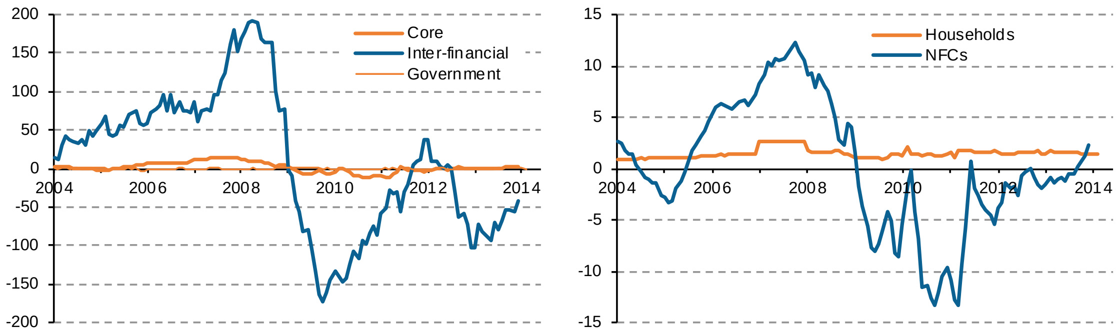

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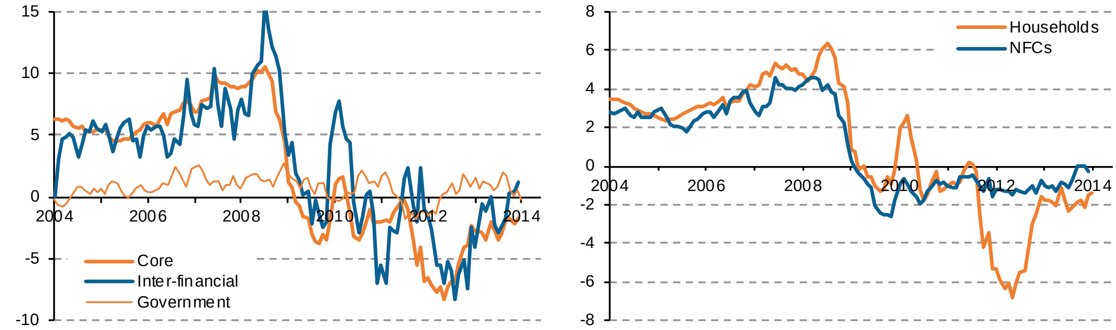

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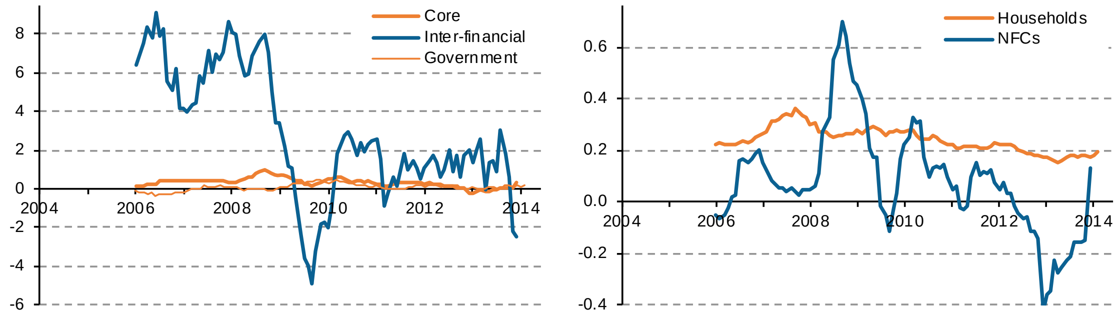

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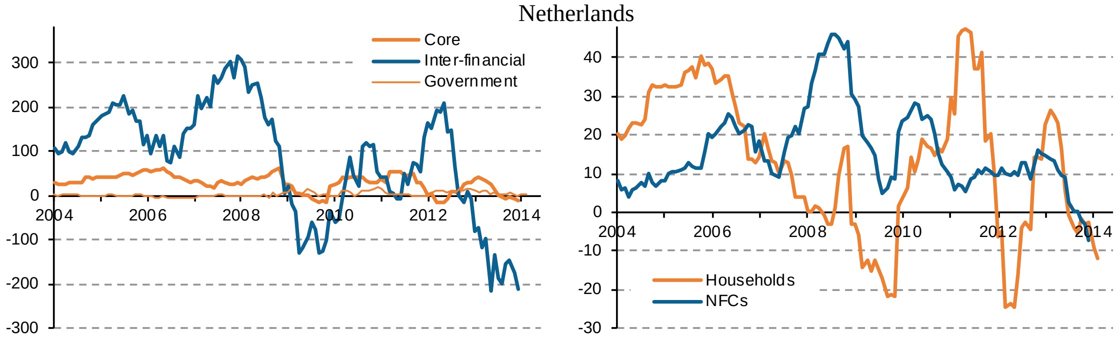

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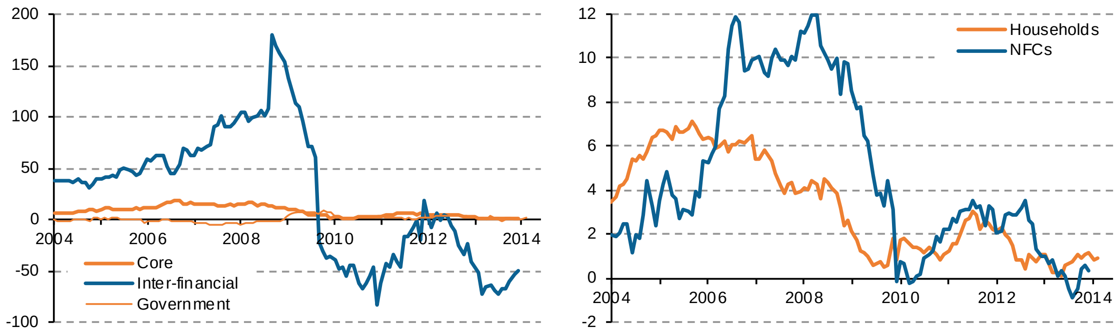

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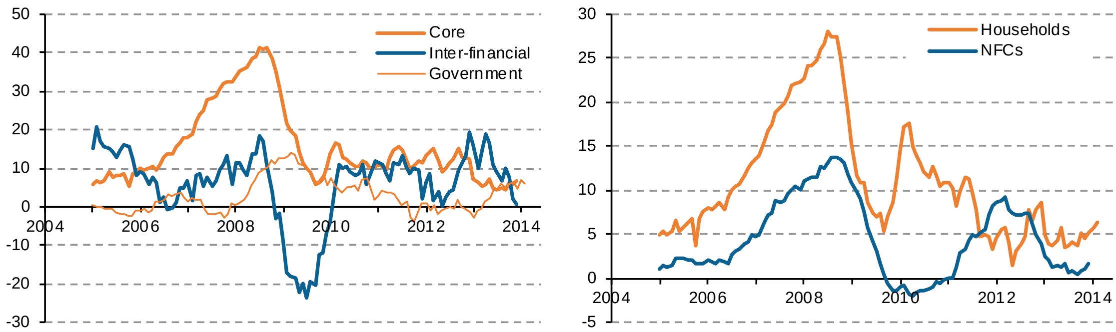

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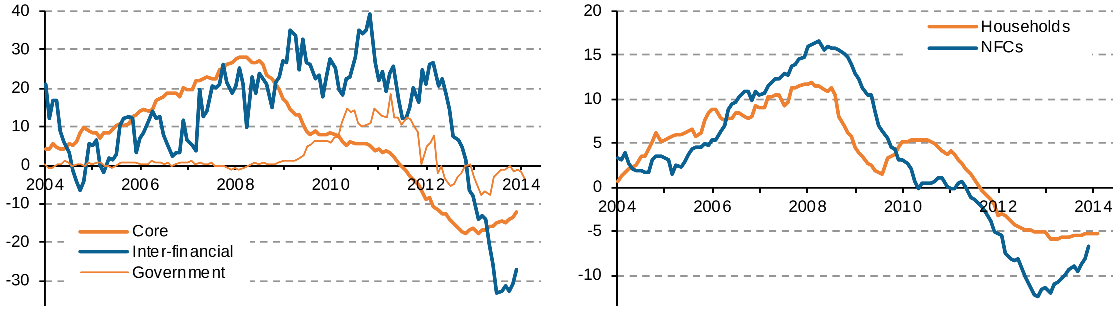

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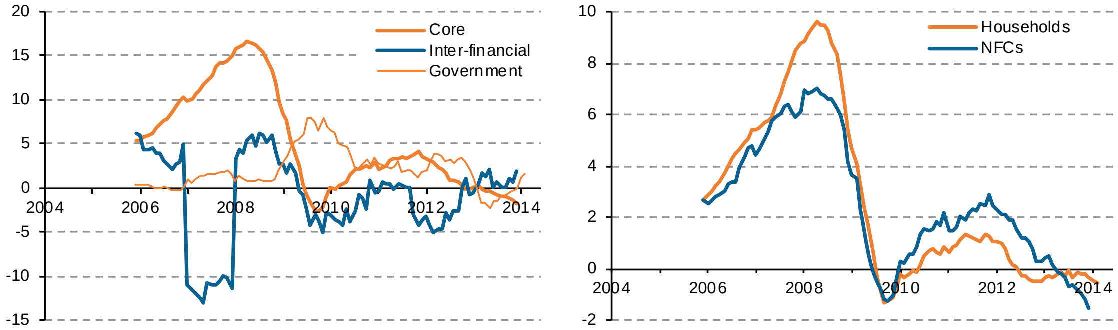
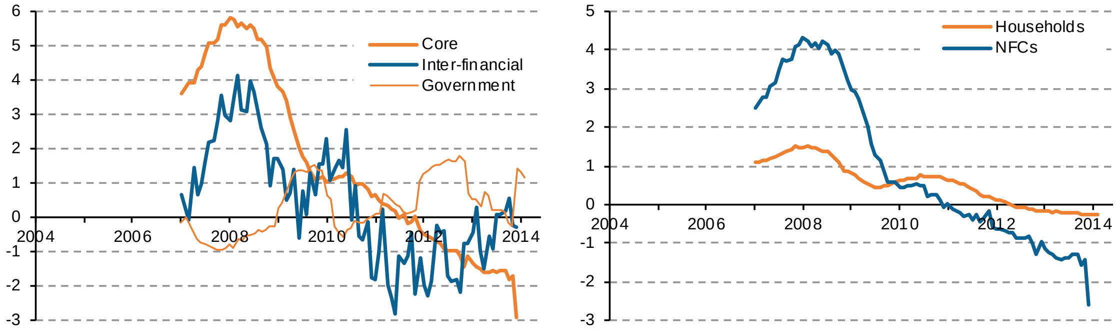
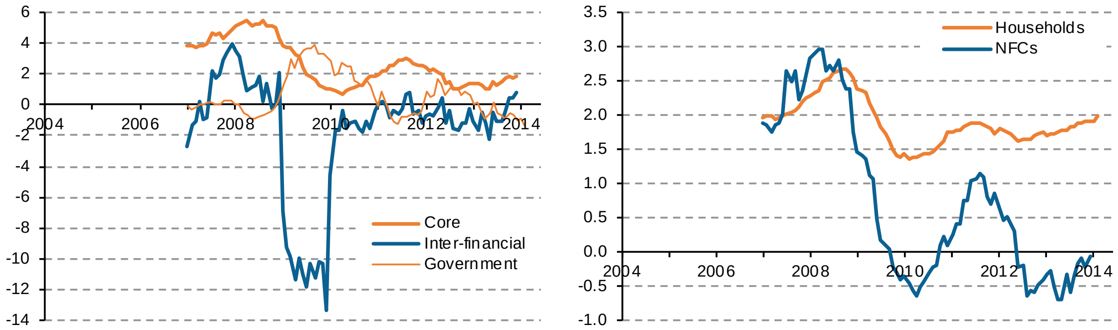


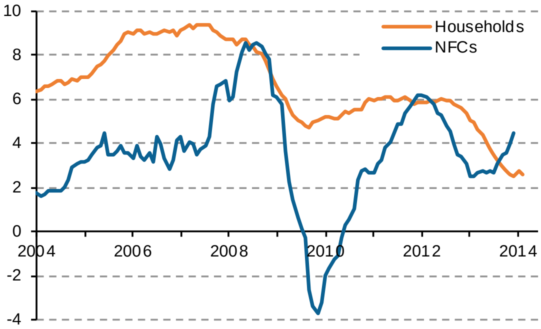
Slovenia



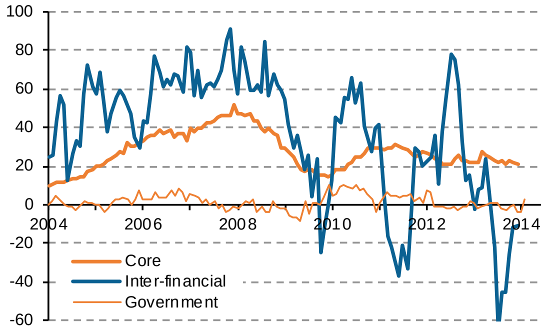
Slovakia

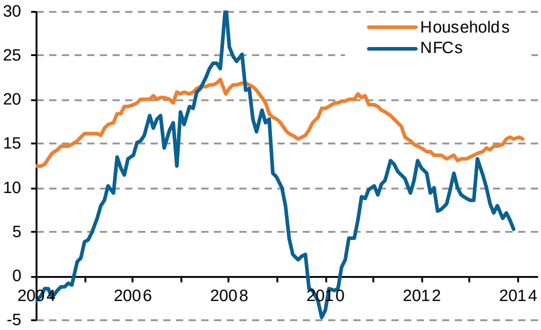


Finland

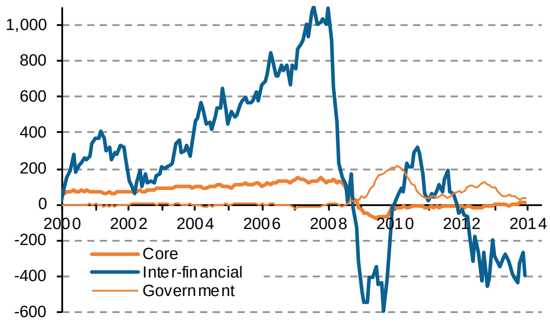


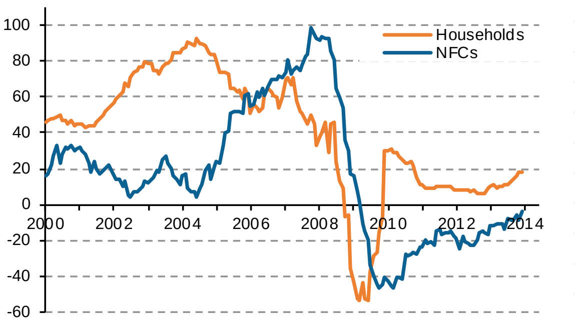
Sweden





United Kingdom

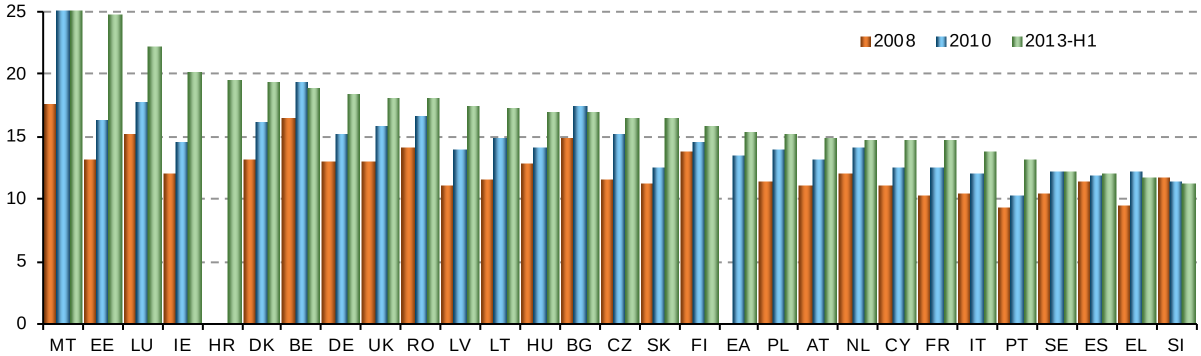




Notes: Credit comprises loans and purchase of securities (equity, debt securities and derivatives). Core assets: credit provided to households and non-financial corporations. Inter-financial assets are computed by subtracting government and core assets to total assets. Inter-financial assets include the positions of banks in the Central Bank (current accounts, deposit facility and fixed term deposits). Data for UK are in £ billion and were extracted from the Bank of England. Data for Denmark are not available.
Source: ECB: Monetary statistics and own calculations.

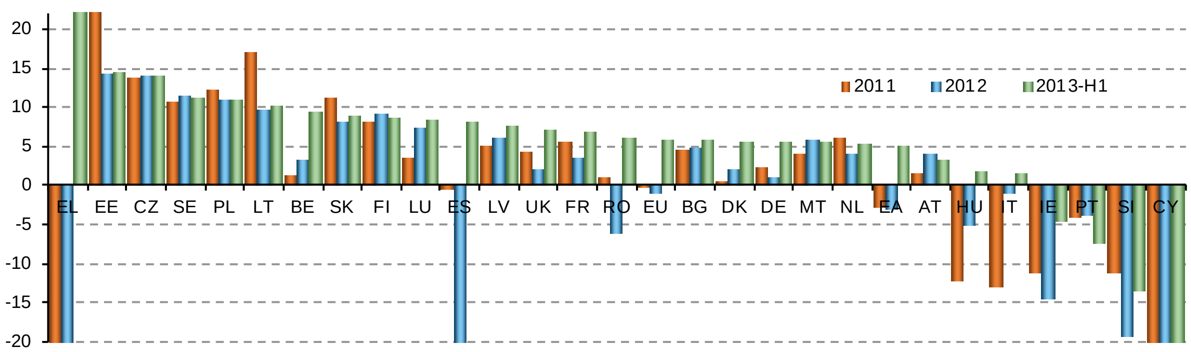
1.A.3 Additional charts on the banking sector

Chart 1.A.11: **Overall capital (solvency) ratio**, percentage of risk-weighted assets



Notes: Definitions of capital and risk-weighted assets may differ across countries and banks. Comparisons of semi-annual data with annual data should be taken with caution. Malta: 2010 = 52.0; 2013-H1 = 55.5; Source: ECB: Consolidated banking data.

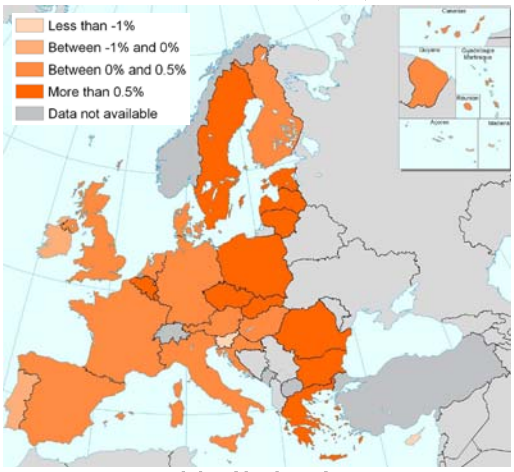
Chart 1.A.12: **Return on equity (RoE) of banks**, percentage



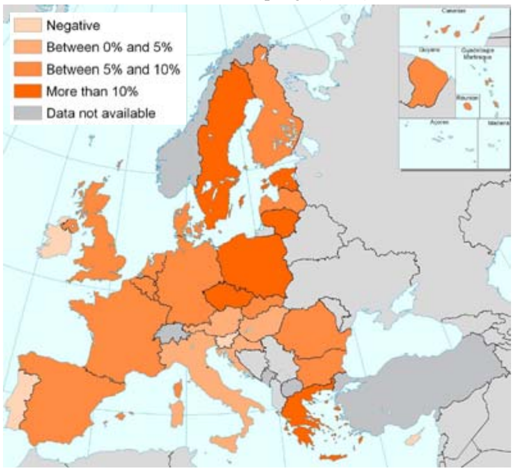
Notes: EL: 2011 = -43.5%; 2012 = -76.8%; 2013(H1) = 42.0%; EE: 2011 = 25.5%; ES: 2012 = -24.7%; CY: 2011 = -86.0%, 2012 = -90.3%, 2013(H1) = -44.3%. Comparisons of semi-annual data with annual data should be taken with caution
Source: ECB: Consolidated banking data.

Chart 1.A.13: **Profitability of banks**, percentage, 2013-H1

Return on Assets (RoA)

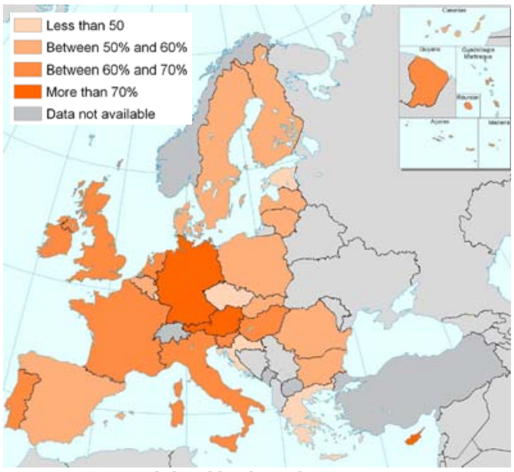


Return on Equity (RoE)



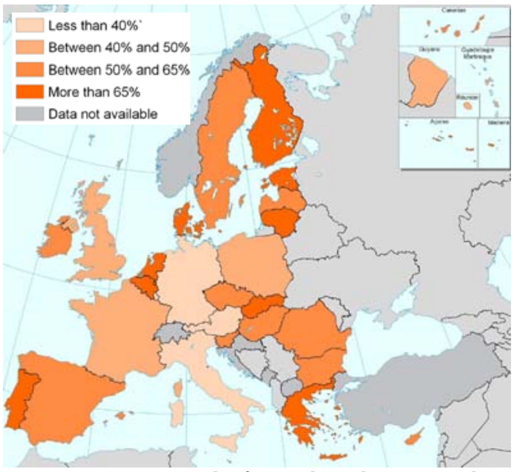
Source: ECB: Consolidated banking data.

Chart 1.A.14: **Cost-to-income ratio of banks**, percentage, 2013-H1



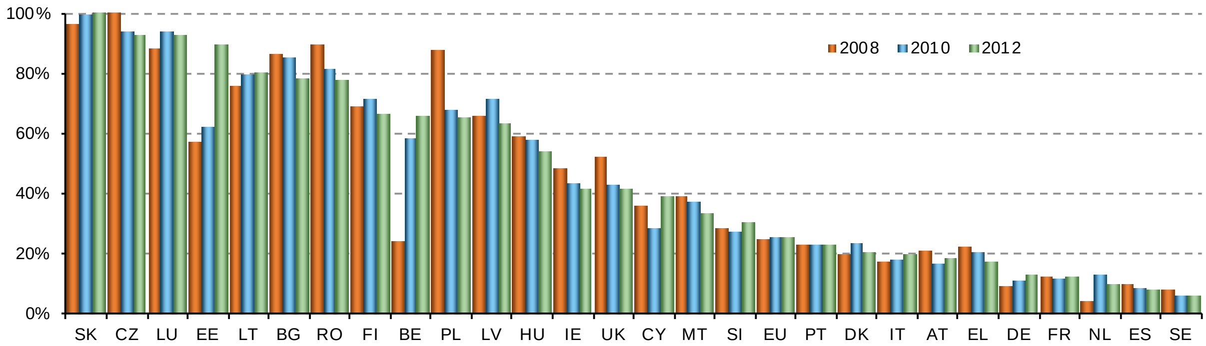
Source: ECB: Consolidated banking data.

Chart 1.A.15: **Concentration**, share of total assets by five largest credit institutions, percentage, 2012



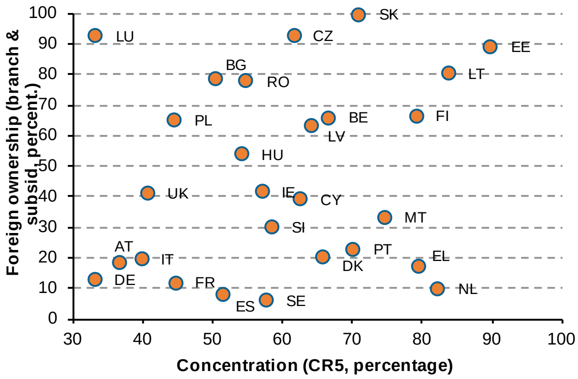
Source: ECB: Structural financial indicators and own calculations.

Chart 1.A.16: **Assets under foreign control**, percentage of total assets, consolidated basis



Source: ECB: Structural financial indicators and own calculations

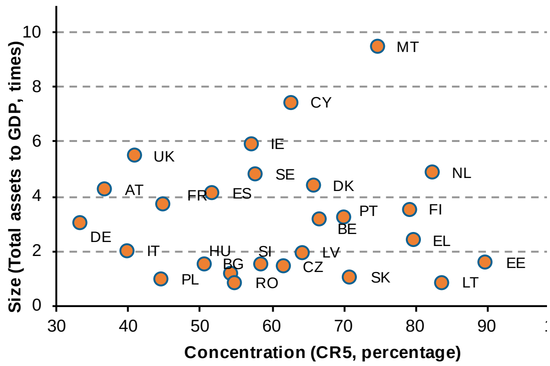
Chart 1.A.17: **Assets under foreign control vs. concentration**, 2012



Note: LU: size = 21.9 times, concentration = 33.1 per cent

Source: ECB: Structural financial indicators and own calculations

Chart 1.A.18: **Size vs. concentration**, 2012



Source: ECB: Structural financial indicators and own calculations