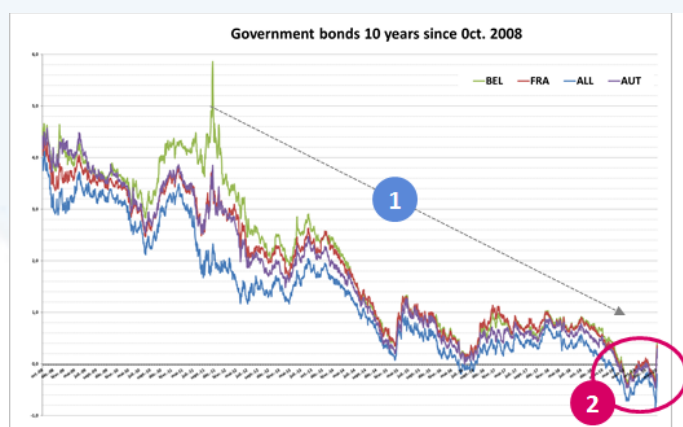


## LOW INTEREST RATES WORKING GROUP: KEY FINDINGS OF THE SURVEY

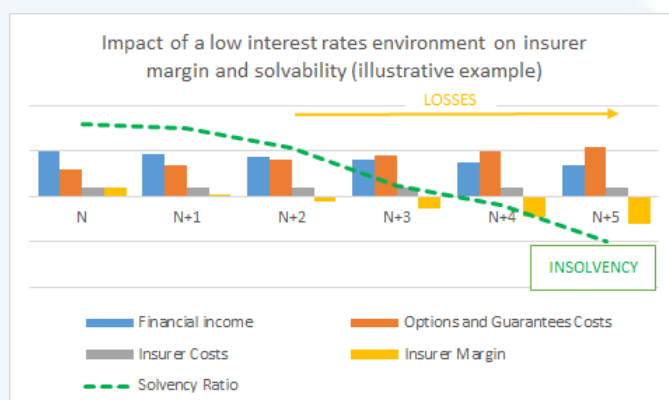
### INTRODUCTION

In the current financial environment, one of the major concerns for the insurance industry is the low level of interest rates:



<sup>1</sup> Since 2008, insurers faced a decrease of governments bonds yields from around 4% in 2008 to 0% in 2019.

<sup>2</sup> In 2019, the graph shows that the **average government bond rate (10Y) is around 0%**. At the same time, the results of the survey shows that the **average guaranteed interest rate is around 1%** for more than 4 000 billions € reserves.



A low yield environment implies that the cost of options and guarantees increases. At the same time, the financial income decreases, which can lead to a negative result.

Most of solvency ratio calculations rely on market-consistent stochastic simulations. It implies that the lower the rates, the more adverse scenarios are numerous. In the end, it could lead to insolvency.

In the beginning of 2020, AAE performed a survey aiming at identifying how low-yield periods known since 2015, have affected the strategy of insurers across Europe. We received a response from 10 different member associations. It should be noted that this survey was performed before the lockdown and does not include consequences of COVID-19 Crisis<sup>1</sup>.

This document aims at putting together the main results of the survey and our key findings.

### STRUCTURE OF BUSINESS IN EUROPEAN MARKET

#### Life/Pension Insurance: insurers tend to reduce the financial guarantees offered to their policyholders

Many countries still show high rate commitments that may be difficult to sustain in a protracted low rates scenario. However, in most of the countries surveyed, new business offers less and less guarantee on interest rates, which

<sup>1</sup> For more details on COVID-19 crises first effects, see [https://www.eiopa.europa.eu/content/impact-ultra-low-yields-insurance-sector-including-first-effects-covid-19-crisis\\_en](https://www.eiopa.europa.eu/content/impact-ultra-low-yields-insurance-sector-including-first-effects-covid-19-crisis_en)

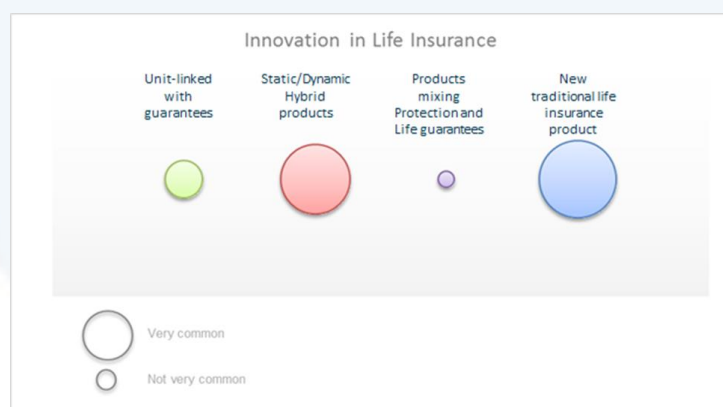
suggests that the average guaranteed interest rate will decrease over the next few years. However, it is highly likely that in most countries where the life insurance market is "mature", the stock inertia will cause significant sensitivity to interest rate risk over the next few years.

While the existence of a surrender option seems widespread across Europe, the possibility of converting a savings contract into annuities seems more specific to each market. Nevertheless, we noted a decrease of options and guarantees provided for new business.

### P&C and health insurance: a good resilience to low yield environment

Most of contracts in P&C and health insurance have short term maturity with an ability for the insurer to reprice the risk. However, low interest rate environment should have an impact on business related to long term guarantees, such as annuity payments, but could also have a significant impact on liability and other long tail insurance (MTPL, GTPL, Accident...).

## INNOVATION IN LIFE INSURANCE



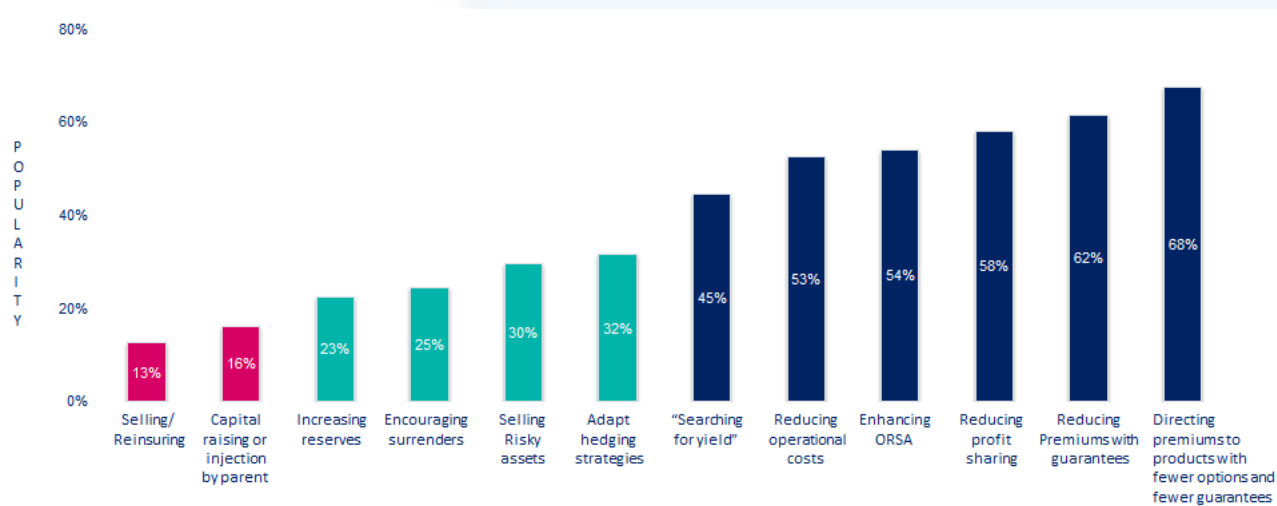
To cope with a lower and lower interest rates, insurers proposed new products to their policyholders, often with financial incentives.

However, in most countries, insurance contracts with guaranteed interest rate remain globally attractive and widely offered.

We also noted that sometimes, tax incentives have showed high efficiency to support the launch of these new products. Moreover, we noted that despite Solvency 2 LTG measures, this prudential regime is considered as the main obstacle to product innovation.

## ALM STRATEGIES AND RISK MONITORING

Insurers mainly focus on strategies aiming at limiting rate guarantees on New Business, either by limiting premiums on the euro fund or by encouraging payments to less risky products. On the asset allocation side, two antagonistic strategies can be observed (buying risk free assets/searching for yield with eventual hedges) to manage both solvency and financial positions.:



Concerning risk monitoring, Stress tests (ORSA) and long-term solvency projections eventually with early indicators give the best results in managing low interest rate periods.

## CONCLUSION AND NEXT STEPS

The life insurance sector has been in transformation for several years in order to be more resilient to an environment of protracted low interest rates: fewer options and guarantees for new business, product innovation, ALM strategies, additional reserve for low interest rates, smoothing effect of the profit sharing mechanism. However, many questions are still open: what is the future insurance business model? What is the impact of new regulation?

In that way, the Low Interest Rates Working Group:

- Supports EIOPA's working plan on:
  - Monitoring and supervising insurers that are greatly exposed to low interest rates environment
  - Engaging in a dialogue to explore actions to improve financial resilience
  - Identifying missing tools and powers in the current toolkit
- Encourages the European authorities to focus its work on promoting product innovation in life insurance
- Supports the enhancement of the ORSA

In addition, the Low Interest Rates Working Group identified the following next steps:

- Exploring the impact of low interest rates on the book of existing business with guarantees, in particular by answering the following questions:
  - How do the actions being taken relate to new and existing business?
  - What are the actions now being taken on in force business and what other actions could be taken?
  - How resilient is the industry given the level of existing business guarantees?
  - How does this vary by country?
- Getting in touch with the Consumer Protection Working Group in order to identify to what extent this work can be used, in particular in our discussions with EIOPA.