ACTUARIAL ASSOCIATION OF EUROPE

Low Interest Rates Working Group

Results of the Survey

JOINT COMMITTEE IC-RMC-PC

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Agenda items

1) **Context**
2) **Life/Pension**
3) **P&C insurance**

Context – Survey

Objectives and limitations

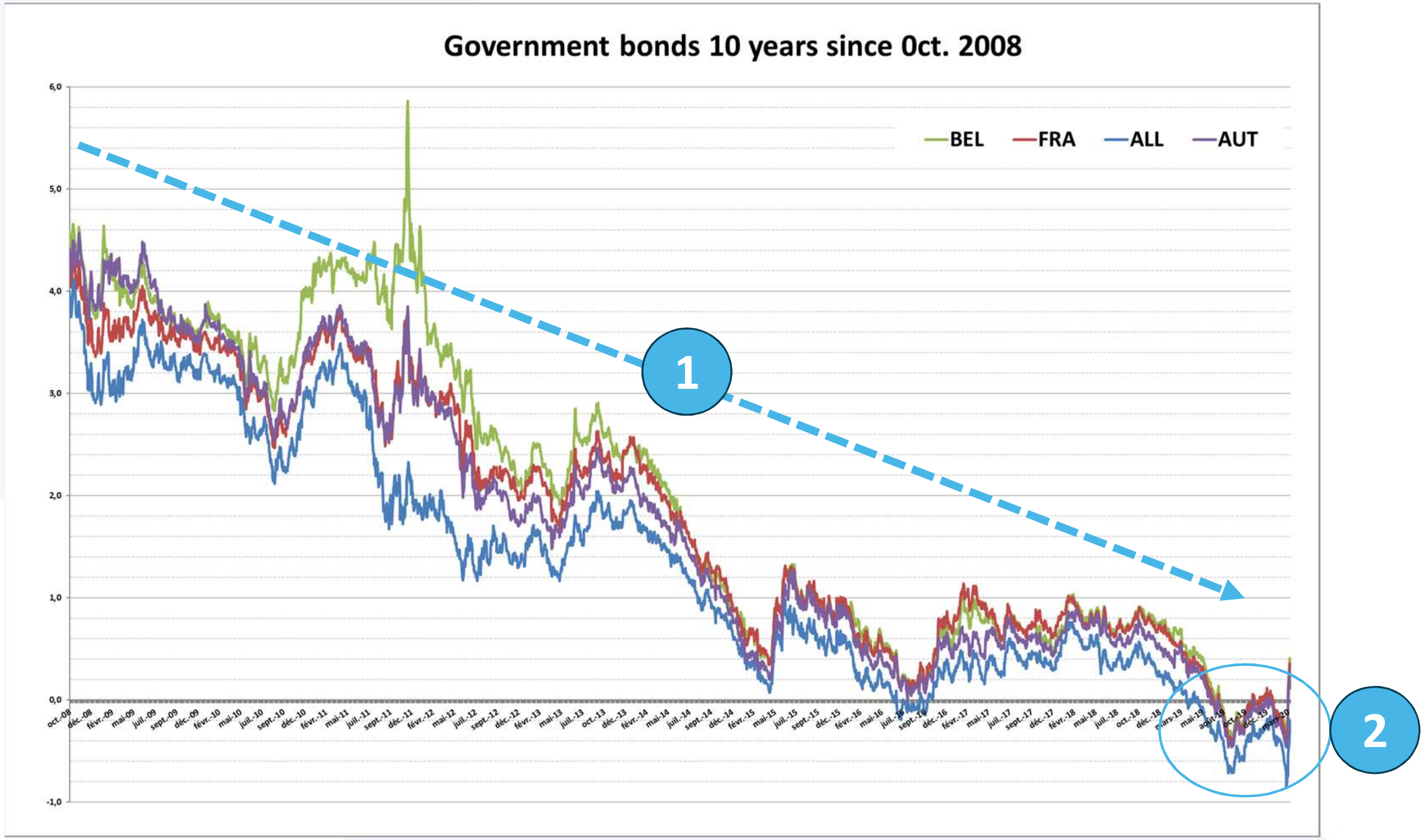
- In 2016, the AAE published a paper on its conclusion of the consequences of low interest rate environment in Life Insurance across Europe.
- In January 2020, the LIRWG launched a new survey
- Aiming to assess how low-yield period known since 2015, have affected the strategy of Life, Pensions and P&C insurers across Europe
- 10 member states participated in Survey

Thank you for your participation !

- <u>Limitations:</u>
  - ✓ No consideration of a sudden rise in interest rates
  - ✓ Survey performed before the COVID-19 crisis in Europe

Context

Breakdown of government bonds yields

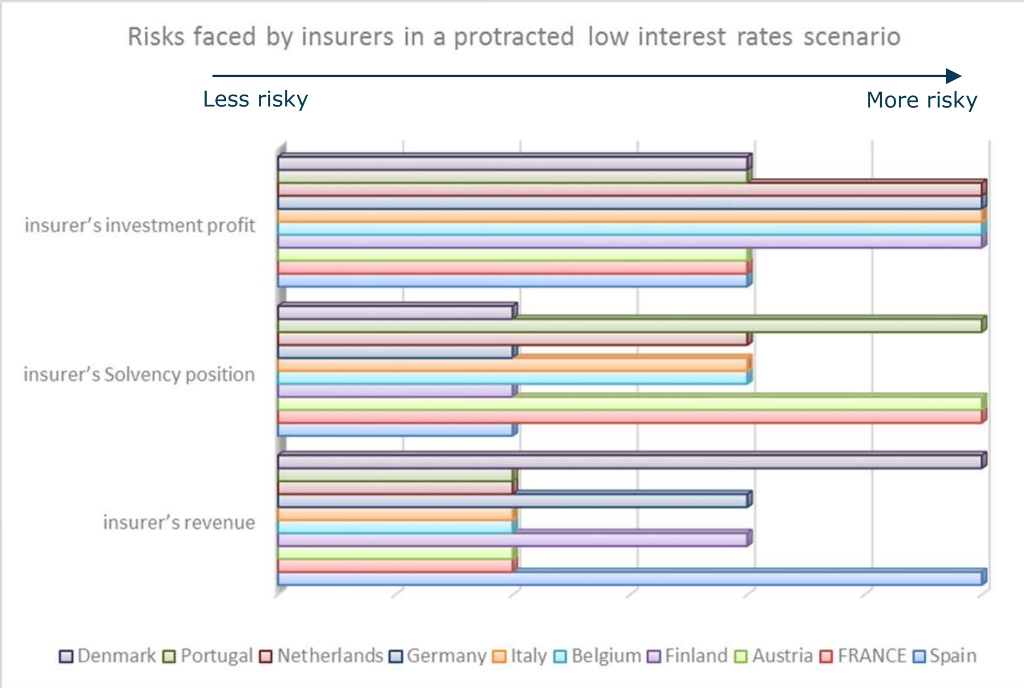


1 Since 2012, insurers faced a decrease of governments bonds yields from around 4% en 2008 to 0% in 2019. During this period, some countries also faced a spread increase.

2 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.

Context – Survey

Common issues



The decrease of fixed income returns seems to be the main risk highlighted by the respondents

Could the observed differences be explained by a difference in the use of the transitional measures?

Could the observed differences be explained by a difference in tax regulation?

Key findings and messages

- Life insurance : Insurers will have to face lower margins due to lower assets return -> focus on products with less or no guarantee (beyond one year) -> may lead to reputational risk.
- Pension : issues concerning guarantees linked to price inflation
- Health insurance : mainly short term with repricing -> premium increase for customers / cuts in management costs.
- P&C insurance : similar answers to health insurance, except for life time annuity stream where asset and liability mismatch issue arises.
- Main challenges noted by the respondents are : consumer behavior, insurance business model and actuarial valuation with negative interest rates.

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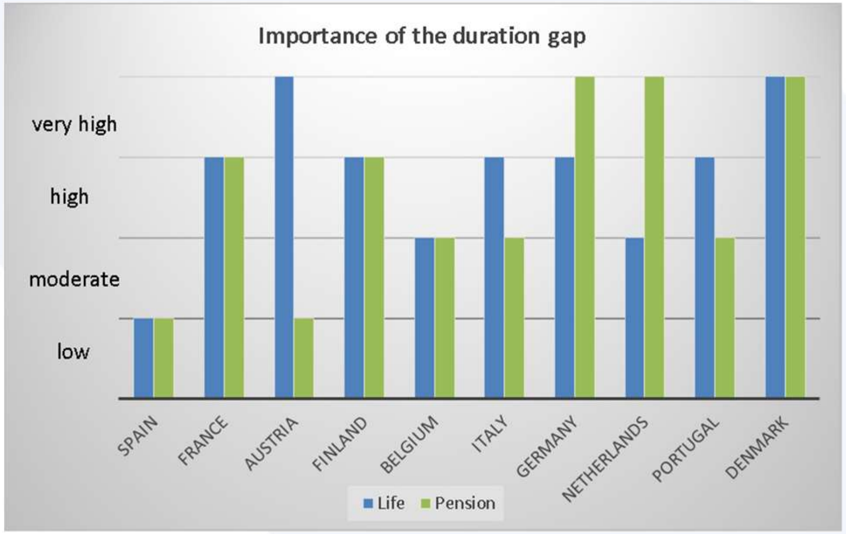
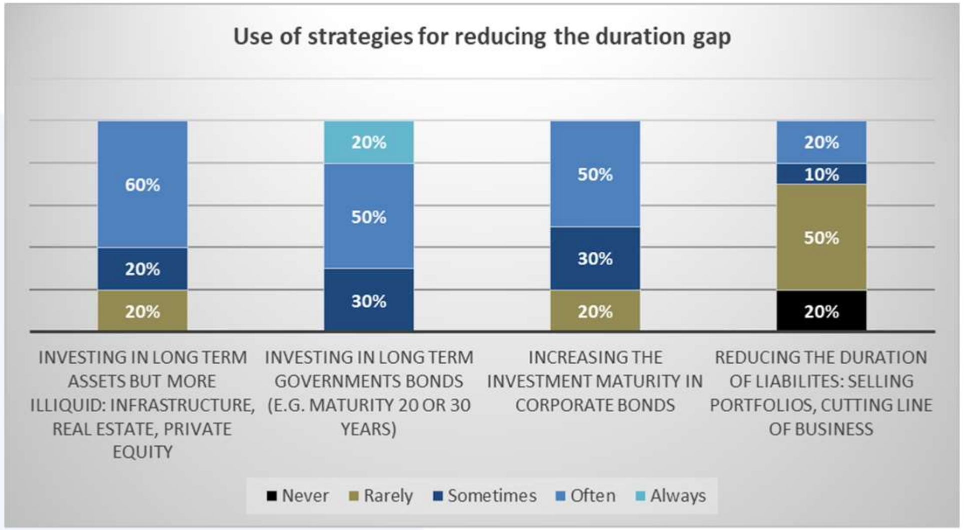
Life/Pension

Duration gap and ALM strategies



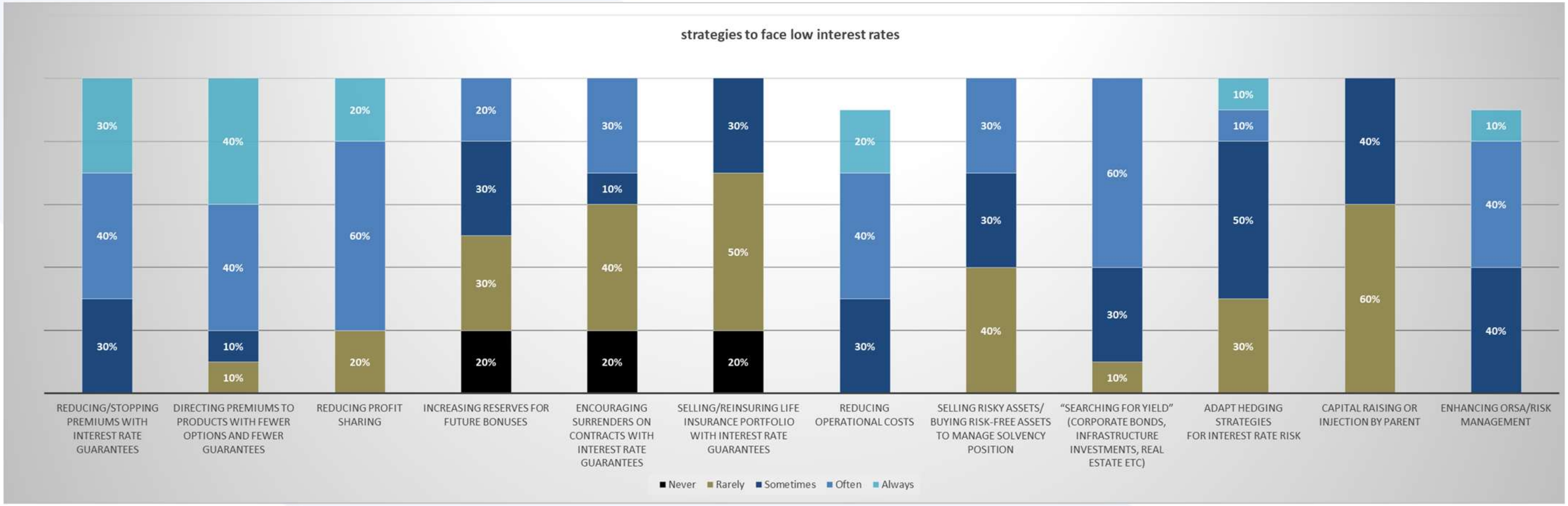


Key findings and messages

- In most countries there is a moderate to (very) high issue concerning the duration gap. This is normally handled by a long term bond strategy – especially government bonds.
- One main problem is the lack of long-term investment possibilities with sufficient interest rate sensitivity and sufficient return to earn the guaranteed interest rate.
- Strategies to reduce the liability's duration are seen as reputational risky and are not very common.

Life/Pension

Strategies to face and changes due to low interest rates



<u>Key findings and messages</u>

- The main focus is on strategies for lowering the future guarantees in the business by selling products with less guarantees.
- Secondly on the asset side the search for yield and interest rate hedging are important.
- Also in local GAAP there are changes (e.g. additional reserve for low interest rates, smoothing of profit sharing to p/h, etc.)
- The use of LTG measures hasn't changed significantly.

Life/Pension

Conclusion & key messages

- The life insurance sector has begun a transformation for several years in order to be more resilient to an environment of protracted low interest rates : less 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 issues remain which could put these conclusions into question, including :
  - ✓ Life insurance business model is at stake : no guarantee => no value for money? guarantees linked to inflation index in Pension ?
  - ✓ Policyholders behavior : more surrenders or less in the future ?
  - ✓ Actuarial valuation : negative interest rates : lower bound ?
  - ✓ Hedging strategies and investment strategies, considering Solvency II framework : how could we reduce the duration gap ?
  - ✓ New framework and regulations : income statement volatility under IFRS17, 2020 Solvency II review -> more reporting – less product innovation
- In this framework, it appears that the enhancement of the ORSA, long-term solvency projections eventually with early indicators give the most effect in managing low interest rate periods

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P&C Insurance

Conclusion & key messages

- Low interest rate environment will have an impact on Non-Life insurance market, mostly with 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...)
- The impact will reflect on Income statement, but also on solvency position.
- Various strategies will be adopted by Non-Life insurers, such as: increasing the level of premiums, reducing acquisition cost and general fees, reducing loss ratio, improving combined ratio, stopping the least profitable lob`s, optimizing the profitability of investments.
- Non-Life insurers that are significantly dealing with long term business could have significant effects of low interest rate environment: due to the fact that within LIR environment earnings from asset side will be missing, insurers might increase their premiums, or on the other hand try to realize better yields on investments, by taking a more risky market positions. Which ever strategy they choose, there will be an impact on income statement and solvency position for them.


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