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### **Results of CEIOPS EU-wide Stress Test for the insurance sector**

CEIOPS has presented to the members of the EU Economic and Financial Committee (EFC) the findings of its European wide stress test exercise for the insurance sector.

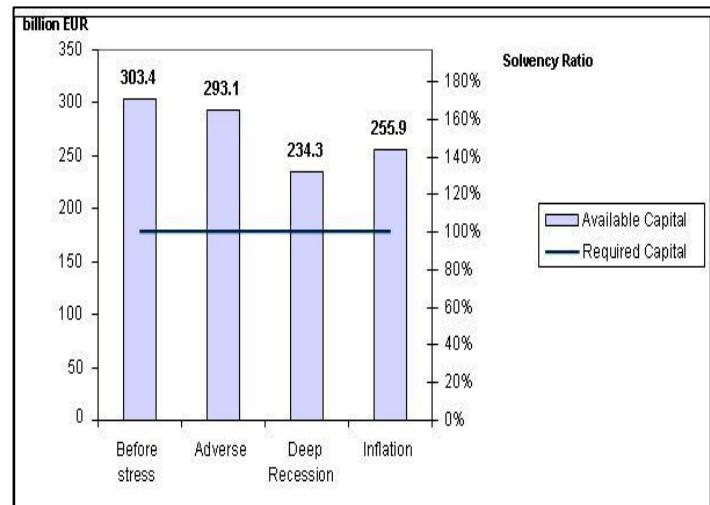
The aim of the stress test exercise was to evaluate the overall resilience of the insurance sector under several stresses to the economic and financial market environment. The exercise included 28 large and important European insurance groups, covering above 60% of premiums of the European insurance market.

Participating insurance groups were asked to calculate the impact of stresses on their solvency ratios under three scenarios: an adverse scenario and two additional severe scenarios (a deep recession and an inflation scenario).

The results of CEIOPS' stress test exercise indicate that the large and important European insurance groups would remain resilient even in severe scenarios. In all scenarios, the aggregated level of available capital exceeds the regulatory requirements.

In the adverse scenario, which mirrored the development of capital markets between end of September 2008 and end of September 2009, the exercise resulted only in a marginal impact of a loss of 10 billion euro, representing a 3% reduction of the available capital of the participating groups.

In the two severe scenarios, the impact on available capital was considerably higher, up to a 25% reduction of the available capital of the participating groups.



Gabriel Bernardino - CEIOPS Chair highlighted the findings of the stress test exercise that "*all participating insurance groups held assets sufficient to cover policyholder liabilities.*"

It should be noted that financial markets have improved since the reference date of end June 2009 and as a result, most participating groups should have been able to build up additional capital buffers thus improving their solvency ratios. Also, it should be taken into account that overall the European insurance industry remained resilient during the financial crisis. Public sector support was only necessary in a very limited number of cases prior to June 2009. These interventions have been included in the exercise.

Furthermore, CEIOPS Chair emphasised that "*Moving forward to the new Solvency II the regulatory solvency requirements will be more aligned with actual risks taken. Further, the Solvency II regime will also require a consistent measurement of assets and liabilities thus making future European-wide stress tests more comparable.*"

## **2. Background**

This exercise was endorsed by a formal mandate from the EFC<sup>1</sup> to conduct a stress test exercise for the European insurance sector as of June 2009 and report results back early in 2010.

CEIOPS stress test exercise was based on the situation at the end of June 2009, and was conducted in November-December 2009 following consultation with the participating groups and industry bodies (e.g. CEA, CRO Forum and CFO Forum) in October 2009. CEIOPS also organised a workshop in order to explain the exercise and clarify technical and procedural questions to participating groups and their lead supervisors.

Overall, 28 larger European insurance groups took part in the exercise. These groups represent approximately 60% of gross premiums of the European insurance sector. N.B. Given the large differences in size and activities of European insurance companies, the stress test results cannot be extrapolated to the European insurance sector as a whole.

The impact of the stress scenarios was measured against the solvency capital requirements in accordance with Solvency I and the Insurance Group Directive (IGD). Although there is a common denominator in form of a regulatory intervention point, the basis of solvency calculations due to differing accounting regimes and solvency calculation methods and hence outcomes vary significantly.

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<sup>1</sup> The Economic and Financial Committee (EFC) reviews financial stability issues semi-annually in its Financial Stability Table (FST) format, which convenes high-ranked representatives from the Ministries of Finance, national central banks, the ECB, the Commission, and the Chairs of the Banking Supervision Committee (BSC) of the ESCB and the EU Lamfalussy committees of supervisors.

The exercise consisted of testing three scenarios: an adverse scenario, a deep recession and an inflation scenario. The stress within these scenarios focused on market risks with an additional lapse risk stress in each scenario. In the basic assumptions for all three scenarios, no future revenue streams were included.

The adverse scenario presumed weak macroeconomic conditions similar to the situation experienced during 2008/2009. The shocks which had to be applied roughly mirrored the development of capital markets between end of September 2008 and end of September 2009. The aim of this stress test exercise was also to evaluate the resilience of the larger European insurance groups if extreme events, such as a sharp decline in interest rates, a drastic fall in share prices and a huge widening of credit spreads were to occur instantaneously and simultaneously. Although a remote event, the deep recession scenario provides an indication of what it would take for the European insurance industry to become distressed. The inflation scenario presumed a sudden increase in inflation followed by a sharp rise in interest rates, in particular short-term rates. The three scenarios included a lapse risk stress based on QIS4 specifications<sup>2</sup>, which required the calculation of a surrender strain in case of a significant increase in lapses.

The main risk drivers in the adverse and deep recession scenarios were the widening of credit spreads, followed by assumed losses from equity exposures. In respect of the inflation scenario, a change in interest rates was the main driver.

The stress test exercise aimed at providing a view of the resilience of the large and important insurance groups. However, it was the intention to assess individual capital needs as such assessment can only be conducted by national supervisors, who also remain responsible for any follow-up.

The following tables provide details on all components of the scenarios that were tested:

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<sup>2</sup> <http://www.ceiops.eu/index.php?option=content&task=view&id=716>.



<b>Risk modules</b>		<b>Adverse scenario</b>	<b>Deep recession scenario</b>	<b>Inflation scenario</b>
<i>Market Risk<sup>3</sup></i>				
Interest rate	0- ≤2Y	-50%	-60%	+500%
	2- ≤5Y	-50%	-60%	+100%
	5- ≤10Y	-30%	-50%	+50%
	10Y+	-15%	-40%	+40%
Equities (EEA, OECD)		-10%	-40%	0%
Equities (other)		-20%	-55%	0%
Real estate		-15%	-25%	0%
<i>Credit Risk</i>				
Spread risk		25% of F (see below) <sup>4</sup>	100% of F (see below) <sup>5</sup>	0%
<i>Liquidity Risk</i>				
Lapse risk		Mass lapse event covering the risk of a temporary and drastic rise of lapse rates <sup>6</sup>	Idem <sup>5</sup>	idem <sup>7</sup>

For credit spread risk, the values of the function F are provided in the table below. In the adverse scenario, the value of an A-rated corporate bond with a remaining maturity of more than 10 years is assumed to deteriorate with 6% in the adverse scenario while in the deep recession scenario it deteriorates with 24%.

<b>F(rating i, maturity i)</b>	<b>AAA</b>	<b>AA</b>	<b>A</b>	<b>BBB</b>	<b>BB or lower</b>	<b>Unrated</b>
1- ≤3 years	3.4%	4.5%	6.8%	7.7%	14.0%	8.0%
3- ≤5 years	5.4%	7.1%	11.5%	14.6%	27.0%	15.0%
5- ≤7 years	7.9%	10.3%	16.5%	20.1%	38.5%	21.5%
7- ≤10 years	8.5%	13.5%	21.5%	25.9%	49.0%	27.5%
10+ years	11.5%	19.1%	24.0%	27.5%	52.0%	30.0%

*Notes:*

<sup>3</sup> The percentages mentioned in the table are changes to levels as of June 2009, e.g. +100 % of the 2-≤5 years interest rate in the inflation scenario, is expressing that the 2 years interest rate of June 2009 raises from 1.5% points to 3% points.

<sup>4</sup> Equal to 25% of QIS 4 measures.

<sup>5</sup> Equal to 100% of QIS 4 measures.

<sup>6</sup> 50% of a mass lapse event in QIS4.

<sup>7</sup> 100% of a mass lapse event in QIS4.

*On 5 November 2003, the European Commission adopted the decision, to establish the Committee of European Insurance and Occupational Pensions Supervisors, which entered into force on 24 November 2003. Today this decision is repealed and replaced by Decision 2009/79/EC. The Committee is composed of high level representatives from the insurance and occupational pension funds supervisory authorities from the EU and EEA Member States, chaired by Gabriel Bernardino who is supported by a Vice Chair and four other members in a Managing Board.*

*CEIOPS fulfils the functions of the Level 3 Committee for the sector of insurance and occupational pensions in application of the Lamfalussy Process. This includes in particular: Providing advice to the European Commission, in particular in its preparation of draft implementing measures in the fields of insurance, reinsurance and occupational pensions, contributing to the consistent implementation of community legislation in the Member States and improving co-operation among Supervisory Authorities, including the exchange of information on supervised institutions.*