Solvency II requires European insurers to test their business models under a range of plausible insurance and market-stressed scenarios as part of a forward-looking assessment (ORSA). Insurers are required to project capital needs for three to five years under a baseline scenario. Those with high low interest rate exposures, like German insurers, may need to plan for periods of prolonged low interest rates or the "double hit," whereby asset prices drop and interest rates remain low, that is becoming more likely.

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Key Points (5 of 12):
* Eiopa Stress Tests Highlight How Low Yields Hurt German Insurers
* Investment Return as Low as 2.6% May Harm German Life Insurers
* ICIR Report Shows Risk of Ultra Low Yields Dent German Insurers
* Japan-Style Rate Scenario May Hit 14% of German Insurers by 2023
* Eiopa Calls for Broader Recovery Plans for European Insurers
Eiopa Stress Tests Highlight How Low Yields Hurt German Insurers
Analyst: Edmond Christou
Feb 26, 2015

The high sensitivity of German life insurers to a sustained low interest rate environment under the upcoming Solvency II regime was highlighted in 2014 Eiopa stress tests. Asset cashflows fall below liability cashflows after 11 years, exposing insurers to duration mismatches and interest rate risks, according to Eiopa's study. The pre-stress results indicate that German insurers may be exposed to the risk of financing liabilities at lower rates than asset returns, due to high IRR and duration mismatches.

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For interactive exhibit on Bloomberg, run: DOCC CF WD00000000218390872 P174<GO>
Government bonds comprised 29% of German life insurers' investments, based on 2013 data, with 34.3% in corporate bonds, and 30% in loans and mortgages. Cashflows from corporate bonds and loans made up the largest part of cash inflows for the early years, while government bonds became an important cashflow contributor in the longer durations. The average duration of assets is about 9.3 years compared to 20 years for liabilities.

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DOCC CF WD000000002183908072 P173<GO>
Investment Return as Low as 2.6% May Harm German Life Insurers

Analyst: Edmond Christou
Feb 24, 2015

The composite total return on German corporate, government and covered bonds grew 10% in a year, of which the return from price appreciation was 7% and income return 3%, based on 2013 allocation data provided in the Eiopa stress test. The maximum technical interest rate was lowered 100 bps to 1.75% in 2013 and cut another 50 bps to 1.25% this year. German life insurers may experience negative spreads if they continuously invest at less than 2.6% annually, according to a study by Serra and Harris in 2013.

For interactive exhibit on Bloomberg, run:
IND<GO>
ICIR Report Shows Risk of Ultra Low Yields Dent German Insurers

Analyst: Edmond Christou
Feb 24, 2015

The impact of low yields on insurers may appear sooner under an economic capital regime such as Solvency II than the current Solvency I. A study by the international center for insurance regulation reveals that under an interest rate level similar to 2013, less-capitalized insurers (BS 1, BS 2) representing about 30% of the German life insurers, would fall below a solvency level of 100% and fail to restore capital before 2018. The probability of default starts to escalate in 2017.

For interactive exhibit on Bloomberg, run: HTTP 3995706<GO>
German Insurers' Default Risk Escalates Under Low Yield Scenario

Analyst: Edmond Christou

Feb 24, 2015

Under a Japanese-style persistent low interest rate scenario, the solvency ratio for the least capitalized insurers (BS 1) representing 10% of German life insurers would fall below 100% level and fail to restore capital before 2019, compared to 2018 under the baseline interest rate scenario. The solvency ratio deteriorates earlier given the default rate escalates from 2016 in a Japanese-style scenario compared to 2017 in a baseline scenario, according to the international center for insurance regulation.

For interactive exhibit on Bloomberg, run:
HTTP 3995706<GO>
Insurance Reform May Ease Risk of Low Yields on German Insurers

Analyst: Edmond Christou
Feb 24, 2015

An analysis by the international center for insurance regulation assesses the impact of the German life insurance reform act on the Solvency II capital position of a German life insurers' balance sheets. The reform allows for a reduction in the profit participation caused by lower-hidden reserve payouts to policyholders and the eligibility of mortality results to offset lower asset returns. The analysis shows that the solvency position and the probability of default of least-capitalized insurers (BS 1) improves.

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HTTP 3995706<GO>
Overview > Risks for German Life Insurers Under Ultra Low Rates >> Exhibit 8 of 12

German Insurers On Borrowed Time With 16-Year Transition Needed

Analyst: Edmond Christou
Feb 26, 2015

The analysis in both Eiopa stress tests and the study by the International Center for Insurance Regulation confirmed that German life insurers are highly vulnerable to an interest rate risk in a wide duration mismatch. The analysis by ICIR didn't use an ultimate forward curve and didn't account for a transitional period or Long-Term Guarantees Assessment measures, making the result more sensitive to interest rate risks. This may support the need for a 16-year transitional period for the German insurers.

Additional Reading:
* Eiopa Heat Map Highlights German Insurers at Risk of Low Yields
* German Insurers' Penalized on Interest-Rate Risk Mismatch
* Small Insurers Show Less Resilient Results to Eiopa Stress Test
* Draghi's ECB Medicine May Prove Bitter Pill for German Insurers
* Highlights of the German Life Insurance Reform Act
* Japanese Insurance Crisis Becomes Abiding Lesson for EU Insurers

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Overview > Risks for German Life Insurers Under Ultra Low Rates >> Exhibit 9 of 12

Prolonged Low Returns Challenge German Insurers Under Solvency I

Analyst: Edmond Christou
Feb 25, 2015

The high guarantees and the duration mismatch between assets and liabilities challenge life insurers in a low yield environment. A paper by the German central bank analyzed the capital position under the Solvency I regime for 85 German life insurers in three low interest rate scenarios. In a baseline scenario, the result was based on 2013 interest rate levels. In a mild scenario, results were based on persistent low interest rates, as in Japan in the 1990s. The severe scenario assumed a 25% drop in annual returns.

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Japan-Style Rate Scenario May Hit 14% of German Insurers by 2023

Analyst: Edmond Christou
Feb 25, 2015

Analysis by the German central bank shows that the impact of 2013 interest rate levels on German life insurers remains manageable. Under a Japanese-style scenario, whereby interest rates remain low for a protracted period, 12 German life insurers with a market share of 14% may fail to meet their Solvency I capital requirement by 2023. Under a severe scenario, of low interest rates and a 25% decline in annual returns, 32 German life insurers, with a market share of 43%, may fail.

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DOCCU CF SD000000002195146476 P20<GO>
German Life Insurers May Cut Dividend in a Japan-Style Scenario

Analyst: Edmond Christou
Feb 25, 2015

In a mild scenario, whereby interest rates remain low for a long period, about 12 German life insurers would require as much as 2.4 billion euros ($2.7 billion) of capital to restore their Solvency I level to 100%, the Bundesbank said. This compares with 10.6 billion euros needed under a severe scenario of low interest rates and falling investment returns which would cause 32 insurers to fail. The number of defaulted insurers escalates to 36 assuming a maximum dividend distribution in a mild scenario.

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DOCCU CF SD000000002195146476 P20<GO>
Eiopa Calls for Broader Recovery Plans for European Insurers
Analyst: Edmond Christou
Feb 25, 2015

The regulator Eiopa highlighted in a letter to the European Commission the increased threat to insurers of a sharp decline in asset prices coupled with sustained low interest rates. Eiopa suggested that recovery plans should not be limited to systemically important insurers. The fragmented coverage of insurance guarantee schemes across Europe pose an additional risk, Eiopa said. A study by the Bundesbank showed that low interest rates may pressure the capacity of the Protektor protection fund.