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Bulletin:

European Central Bank's Fresh Stimulus Will Maintain The Squeeze On Investment Returns For Europe's Insurers

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LONDON (S&P Global Ratings) March 11, 2019--On March 7, 2019, the European Central Bank (ECB) announced that it will continue to pursue its accommodative monetary policy, signaling a macroeconomic softening in Europe. Given the ECB's decision, S&P Global Ratings now anticipates that the current low-yield environment could be further prolonged. We highlighted this as one of our key risks for European insurers in our 2019 EMEA insurance outlook (see "With European Insurers Well Positioned For Economic Uncertainty, Focus Shifts To Future," published on Feb. 12, 2019).

We do not expect to take rating actions on any European insurers as a direct result of the ECB's announcements. Nevertheless, the decisions will weigh on investment returns for all insurers, especially life insurers that mainly focus on Europe. The ECB will delay rate hikes and prolong its quantitative easing program. It will also continue to reinvest in its asset purchasing program and has announced a third round of targeted longer-term refinancing operations (TLTROs). These measures, combined, will likely keep interest rates and investment yields low for longer.

We have been warning of a rising risk of negative spreads between investment returns and guaranteed policy rates for European life insurers--the ECB's decisions increases that risk, rather than making it more remote. Insurers have taken numerous steps over the past decade to push out the inflection point, including lowering of guarantee rates on new products and shifting investment allocations. They also diversified their risk profiles away from rate-sensitive business lines, to reduce reliance on investment yields.

However, shifting the business mix is a slow process. Given the already relatively low guarantee levels, insurers have little room to reduce guarantee rates further without eroding competitiveness. Management teams could make further changes to asset allocations in order to generate more returns in short order. This would help insurers to stay afloat, but could carry substantial other risks in the form of asset price volatility, foreign exchange exposure, or liquidity risk. To date, we haven't seen a material increase in risk in insurers' asset allocations, but there are some shifts underway. We will keep a close eye on this.

We consider it vitally important for non-life players to continue to focus on underwriting profitability in the current environment. Average combined (loss and expense) ratios have been strong in Europe in recent years. In the absence of strong investment returns, insurers have tried to ensure their underwriting is profitable by concentrating on adequate pricing and on reducing expenses. Prolonged low yields should ensure that this heightened focus on underwriting profit will persevere. We continue to expect non-life business to remain profitable in 2019. Multiline companies will benefit from the diversified earnings this business provides.

Although the ECB's accommodative monetary policy helps to ensure favorable financing conditions for insurers, we expect issuance levels to continue to decline, in line with trends over recent years. We anticipate that the bulk of issuance in 2019 will be to refinance upcoming calls. Although the favorable conditions may encourage issuers to prefinance earlier than we previously expected, we don't expect to see a rush of new issuance. European insurers already have robust regulatory solvency and capital positions.

We will continue to monitor and comment on these trends through the year.

RELATED RESEARCH

- ECB's Fresh Stimulus Spotlights Rising Risks For European Banks, March 8, 2019
- With European Insurers Well Positioned For Economic Uncertainty, Focus Shifts To Future, Feb. 12, 2019

This report does not constitute a rating action.

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