Thomas Url

Low Financial Returns Undermine the Life Insurance Business

Trends in the Austrian Private Insurance Industry in 2011

Due to a decline in the life insurance business, insurance penetration edged down to 5.5 percent of GDP in 2011. Developments in Austria followed the general European trend, with setbacks in demand for life insurance and a modest increase in the non-life-insurance branch. Current projections expect this trend to continue in 2012, given the persistent difficult conditions for high-yield investment and the narrowing spread vis-à-vis returns on direct placements on the Austrian capital market observed in 2011.

The author is thankful to Christine Mayrhuber for useful and constructive comments • The data were processed and analysed with the assistance of Ursula Glauninger • **E-mail addresses: Thomas.Url@wifo.ac.at, Ursula.Glauninger@wifo.ac.at**

With a modest increase in premium revenues in 2011, the Austrian private insurance industry trailed behind nominal GDP growth of 5 percent. Performance within the sector was uneven: while premium revenues in non-life and accident insurance rose by a substantial 7.2 percent, they fell by a surprisingly strong 7.3 percent in the life insurance branch. As the health insurance business remained on its steady upward trend, the composition of premium revenues shifted further away from life insurance towards the other two branches. Thus, the insurance penetration fell to a low not seen for more than a decade.

The market share of foreign insurers in cross-border service provision edged down in 2011.

The international integration of the Austrian insurance market remains high. Subsidiaries of foreign companies are in part directly registered with the Austrian Financial Market Supervisory Authority, otherwise they may use the opportunities offered by the Internal Market by operating in Austria under the supervision of their home country's authority. In 2011, 26 foreign insurance companies used this cross-border marketing channel by means of a branch office, compared with 27 a year before. For the provision of direct insurance services another 878 companies were registered (2010: 845). The latest related premium revenues are reported only for 2010: € 325 million (+7.6 percent) went abroad via branch offices, against € 517 million (–9.6 percent) via direct service operations. The market share of insurers from the European Economic Area (EEA) edged down from 5.1 percent in 2010 to 4.8 percent in 2011.

The share of foreign premium revenues in total revenues of Austrian groups climbed to almost 44 percent in 2011, with the bulk originating from Central, Eastern and South-Eastern Europe.

Corresponding to the activities of insurers from the EEA in Austria are the foreign operations of Austrian insurance groups which expanded even in the difficult environment created by the financial market and sovereign debt crisis. In 2010, Austrian insurers raised premium intakes abroad to the amount of € 8.2 billion, largely in Eastern and South-Eastern EU member countries (€ 5.3 billion). The share of foreign premia in total revenues of Austrian groups operating in the area climbed up markedly, from 36 percent in 2009 to 44 percent in 2010.

Prospects for the domestic market are currently subdued.

According to the projections by the Austrian Insurance Association (VVO), the outlook for the domestic market is at present subdued, with premium revenues expected to edge down by 0.9 percent in 2012. For the life insurance branch, VVO projects a further fall in premium revenues by 5.8 percent, whereas the health insurance business should keep the stable upward path followed over the last years (+3.2 percent); with an anticipated revenue increase of 2.6 percent, non-life and accident insurance should also maintain its latest pace of expansion.

The differential pattern of a shrinking life insurance and a modest increase in the non-life-and-accident-insurance business, as observed in 2011, was in line with the general trend in Western Europe. *Swiss Re* (2012A) publishes annual figures on premium revenues worldwide in constant prices (on the basis of CPI) and in common currency (US dollar). According to these data, life insurance in Western Europe suffered a severe setback of –9.8 percent in 2011, while in the non-life-insurance sector premium revenues edged up by 0.7 percent in real terms. However, these figures abstract from the effect of euro appreciation against the dollar by 4.7 percent, such that the changes are less marked on a euro basis. Central, Eastern and South-Eastern Europe exhibited a similar trend, though to a lesser extent: demand for life insurance stagnated (+0.1 percent), compared with a 6.7 percent increase (inflation-adjusted and in common currency) in the non-life-insurance branches.

Similar to the European insurance market, developments in Austria are uneven across branches.

Table 1: Adjusted gross premium revenues

	All branches	Life insurance	Health insurance	Non-life and accident insurance	Insurance market penetration[1]
	Million €	As a percentage of total premium			As a percentage of GDP
2007	17,865	40.3	8.3	51.3	5.73
2008	18,107	40.6	8.5	50.8	5.70
2009	18,108	40.9	8.8	50.3	5.95
2010	18,713	40.0	8.8	51.2	5.82
2011	18,922	36.7	9.0	54.3	5.50

Source: Austrian Financial Market Authority, Statistics Austria. – [1] On the basis of direct domestic premiums charged.

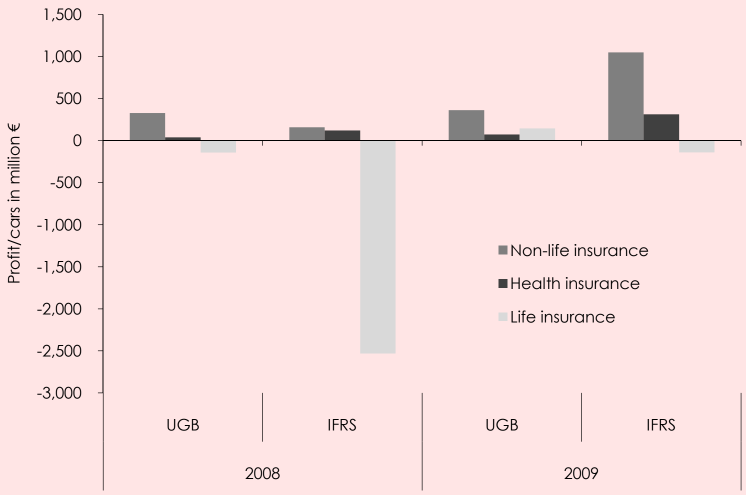
The authorities of the newly-created supervisory architecture (*Url,* 2011) started their operations at the beginning of 2011. For the insurance industry, the European Insurance and Occupational Pensions Authority (EIOPA) carried out further preparatory steps for the introduction of Solvency II. Among these were, apart from the development of technical regulation and implementation standards, of guidelines and recommendations, also two stress tests for insurers in the EEA. The first stress test examined whether the 58 participating insurance groups and the 71 single companies are able to withstand a hypothetical adverse macroeconomic scenario without violating minimum equity capital requirements. In this exercise, the equity capital requirements were already assessed according to Solvency II benchmarks. Across Europe, about 10 percent of participating companies would have failed to reach the new minimum capital standards, with the equity capital gap amounting to a total € 4.4 billion (*FMA,* 2012). The second stress test hypothesised a persistent low-interest-rate scenario. In this case, only eight companies would have missed the minimum equity capital threshold; however, the overall gap of € 6 billion was much larger than in the first stress test.

The new European supervisory authority for the insurance market starts its activities with preparations for Solvency II and with two stress tests.

After the global financial market crisis, accounting rules for financial services providers were scrutinised more closely, since the valuation of investment assets at market values had been identified as one of the main drivers behind the collapse of liquid market segments (*Url,* 2009). According to new calculations, both the valuation of financial instruments (IFRS 9) and the accounting of insurance contracts (IFRS 4) will imply significant changes and higher volatility for annual earnings and equity capital of Austrian insurance companies. Figure 1 compares the financial statement of Austrian insurers for 2008 and 2009 (in the definitions of the Austrian Corporate Law Code UGB) according to the strict lower-of-acquision cost-or-market price principle with a statement calculated ex-post according to IFRS rules, i.e., applying the fair-value principle, for the three insurance branches (*Weinberger,* 2011). In both years, the largest difference emerged in the life insurance branch. Thus, for 2008, a loss of € 143 million according to UGB standards compares with one of € 2.5 billion in IFRS standards. The new accounting rules transmit price variations on financial markets via the asset and liability side of the balance sheet onto annual earnings and exclude provisions for an equalisation reserve. Going forward, this will complicate the assessment of insurance companies' assets, earnings and finances.

A comparative calculation between UGB and IFRS rules yields widely divergent annual earnings for Austrian insurance companies.

Figure 1: Results of an ex-post application of IFRS to Austrian insurance companies vis-à-vis standard UGB accounting rules



Source: *Weinberger* (2011).

Prices for insurance products dampened inflation in 2011

With an annual increase of 3.3 percent in 2011, Austria's overall rate of inflation significantly exceeded the target of the European Central Bank for the euro area. Yet, inflation was largely driven by oil products (+18.1 percent) and other energy commodities. Processed food (+4.7 percent) and tourist services (+4.4 percent) also exerted above-average upward pressure on prices (*Scheiblecker et al.*, 2012). Unlike in the year before, the prices of insurance products included in the consumer price index (CPI) had a moderating impact on overall inflation. This holds particularly for householder's comprehensive insurance and legal costs insurance for cars (Table 2), while comprehensive coverage excluding collision insurances and home insurance broadly followed the overall inflation trend.

Table 2: Private insurance items in the basket for the consumer price index

	Weight 2012	2007	2008	2009	2010	2011	2012[1]
	In percent	Percentage changes from previous year					
Statutory premium							
Householder's comprehensive insurance	0.296	+ 1.1	+ 3.6	+ 3.8	+ 2.0	+ 1.9	+ 2.7
Home insurance	0.702	+ 4.5	+ 4.2	+ 5.6	+ 1.6	+ 3.5	+ 2.6
Private sickness and accident insurance	1.840	+ 3.1	+ 1.4	+ 2.7	+ 2.3	+ 2.2	+ 2.1
Motor third party insurance	0.787	− 0.6	+ 2.9	+ 2.4	+ 1.8	+ 2.7	+ 3.5
Legal costs insurance for cars	0.008	+ 0.1	+ 2.0	− 1.2	± 0.0	+ 1.3	+ 2.0
Comprehensive coverage excluding collision insurance	0.585	+ 2.1	− 5.4	+ 3.3	+ 5.6	+ 3.3	+ 1.2
Private insurance forms, overall	4.218	+ 2.1	+ 1.4	+ 3.1	+ 2.5	+ 2.5	+ 2.4
Consumer price index overall		+ 2.2	+ 3.2	+ 0.5	+ 1.9	+ 3.3	+ 2.3
Contribution private insurance (percentage points)		+ 0.10	+ 0.06	+ 0.14	+ 0.11	+ 0.12	+ 0.10

Source: Statistics Austria. – [1] January to August.

Since loss ratios were relatively low, they did not exert upward pressure on premium setting in 2011.

From the perspective of insurance claims, developments in 2011 gave little reason for price increases. With a ratio of 65.1 percent of premium revenues, the loss ratio in non-life and accident insurance declined again from the previous year and was more than 2 percentage points below its long-term average (1983-2011). This key figure for the operational insurance business was particularly low for motor third party insurance and the passenger accident insurance where it has been consistently below-average since 2003. In the householder's comprehensive insurance also, the ratio of indemnities to premium revenues remained below the long-term average in 2011. Unlike in the period from 2007 to 2009 with its natural desasters, Austrian agriculture was hardly struck by damages from hail, which led to a marked improvement in operational conditions. However, payments in legal cost as well as fire and water pipe damage insurance turned out substantially above the long-term average. For all three insurance products, high claims payments have created upward pressure on premia over the last three years. Thus, in the first half of 2012, prices of householder's comprehensive and home insurance have picked up in the consumer price index (Table 2).

The average premium fell markedly in motor car insurance, but increased in the property liability branch.

A convenient gauge for pricing behaviour in the property liability insurance is the average premium per risk. This figure reflects, besides the amount insured, also possible discounts, deductibles, premium refunds and shifts between bonus brackets in car insurance. Due to these elements, the trend of the average premium may differ markedly from that of the standard contract included in the CPI. In the non-life (other than health) branch, the average premium rose by 2 percent year-on-year in 2011. As for car insurance, the price decline accelerated from –3.5 percent in 2010 to –4.3 percent in 2011, with comprehensive coverage insurance falling less (–2.1 percent) than for the much more important motor third party insurance (–5.2 percent).

According to *Swiss Re* (2012A), prices for non-life insurance rose modestly on the western European market. Limited price increases were achieved in contracts with private households. Premium rates for commercial clients are likely to have picked up only during 2012, although the weakening of business activity narrows the scope for price rises.

Life insurance: slump in single premium payments and low profit distribution

Private households' real disposable income declined by 1 percent year-on-year in 2011. As a result, private consumption growth fell below its long-term trend and was financed by a substantial cut in the private saving ratio from 8.3 percent in 2010 to 7.5 percent in 2011. The build-up of private financial assets thereby levelled off. Figure 2 shows the distribution of private households' financial assets by category. From the previous year, there were only minor shifts towards liquid and safe placements. Due to extraordinarily low interest rates, households built up their cash reserves and held some more fixed-interest-rate bonds in their portfolio; they reduced, on the other hand, holdings of shares and investment certificates, which is partly explained by the slump in stock market values. The share of life insurance and pension fund claims in total financial assets remained broadly constant at 18.1 percent. The decline in amounts insured by new contracts by 7.3 percent has so far not been reflected in the stock of insurance values.

The advance in pension insurance schemes mirrors the growing demand for private old-age provisions.

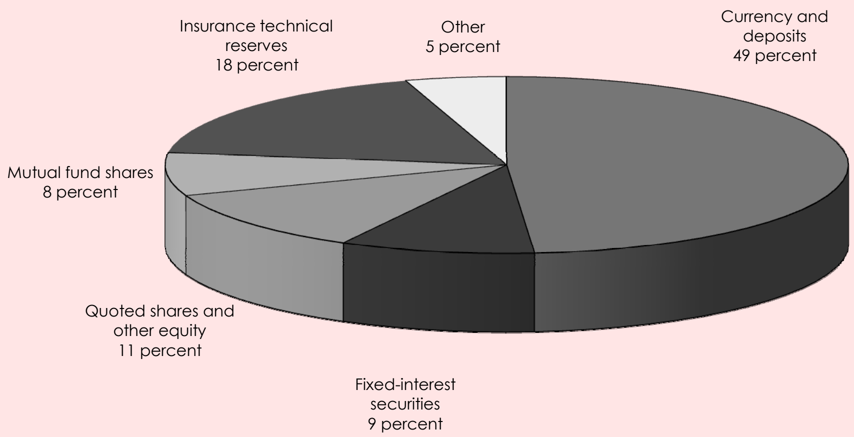
In 2011, pension insurance funds enjoyed a strong expansion in both the number of new contracts and the overall amount insured. For almost 150,000 new contracts, the newly underwritten amount insured jumped by 41 percent year-on-year to a total of € 2.3 billion. However, the risk insurance policies including residual credit debt insurance mirrored private households' low appetite for incurring new debt. In spite of a rising number of new contracts, their total insurance amount fell 0.8 percent short of the year-earlier level. In 2012, the changeover to new contracts with "unisex" rates (i.e., equal premia for male and female policy holders) may boost premium revenues since until 21 December contracts may still be underwritten under the old premium scale.

The increase in premium receipts for state aided old age provision failed to offset the slump in single premium payments.

The fall in premium revenues hit life insurance products to a different degree. While the "classic" life insurance registered a slight revenue increase of 0.9 percent in 2011, the market for single premium payments in unit- or index-linked life insurance contracts literally caved in (–55 percent). Insurance policies providing for current payments in unit- or index-linked life insurances showed a moderate increase. The state aided old-age insurance enjoying a public subsidy falls into this category. In 2011, it yielded premium revenues of € 1 billion to the insurance companies, an increase of 2 percent from the previous year. The market share of insurers in total premium revenues of state aided pension schemes thereby increased to 93 percent. At a total of 1.5 million contracts, the average premium per contract amounted to € 671 (–3 percent).

Figure 2: Composition of private financial wealth

2011



Source: Oesterreichische Nationalbank. Total financial wealth: € 468.9 billion.

The premium subsidy for state aided pension insurance was cut by half as from 2012.

In 2012, demand for state aided pension insurance is likely to slacken further. With the Stability Act (BGBl. I Nr. 22/2012), lawmakers cut the fixed premium component for this product to 2.75 percent of premium payments. The formula for the variable component now also includes a 50 percent reduction factor. Deviating from the new formula, the premium for 2012 has been set at an average 4.25 percent. Given the low bond yields between October 2011 and September 2012, the variable premium component would fall below the current effective minimum level of 1.5 percent. Thus, the premium subsidy for 2013 is likely to be raised to 4.5 percent, with the subsidised premium ceiling edging up to € 2,381 per year. At the same time, the Stability Act carries forward to 2014 the individual access to the retirement account for beneficiaries in the public pension system. Greater transparency of benefits to be expected from the public pension scheme may boost demand for life insurance in subsequent years.

Table 3: Life insurance

	Premiums gross	Premiums net[1]	Internal turnover ratio	Surplus on financial operations	Claims payments	Increase in actuarial reserves
	Adjusted					
	Million €		In percent		Million €	
2007	7,204	6,907	95.9	2,425	4,992	3,043
2008	7,359	7,076	96.1	1,641	5,473	814
2009	7,398	7,188	97.2	1,883	5,799	3,256
2010	7,483	7,268	97.1	2,208	5,854	3,221
2011	6,939	6,704	96.6	1,846	6,651	316
	Percent changes from previous year					
2007	+ 0.7	+ 0.9	+ 0.3	– 6.9	+ 24.5	– 29.8
2008	+ 2.2	+ 2.4	+ 0.3	– 32.3	+ 9.6	– 73.2
2009	+ 0.5	+ 1.6	+ 1.1	+ 14.7	+ 5.9	+ 299.9
2010	+ 1.1	+ 1.1	– 0.0	+ 17.3	+ 1.0	– 1.1
2011	– 7.3	– 7.8	– 0.5	– 16.4	+ 13.6	– 90.2

Source: Austrian Financial Market Authority. – [1] Estimate.

The development of the surplus from financial operations for 2011 mirrors low interest payments and valuation losses. Although the insurance industry had only 3.5 percent of its assets invested in shares, financial earnings dropped markedly (Table 3). Value adjustments of Austrian insurers' financial stakes are likely to have been largely responsible for the decline. At the same time, insurance claims disbursements rose significantly, such that the required build-up of reserves remained limited. The latter was nevertheless unusually low in 2011 in relation to premium revenues, financial returns and insurance payments. Despite the low profit distribution, the shortfalls in premium revenues and financial earnings led to a slump in earnings from current operations by 35 percent. Since insurers at the same time reduced their equity capital, the return on equity of 7.1 percent was only slightly below the 9.1 recorded in 2010.

Difficult conditions on capital markets squeezed insurers' financial earnings in 2011.

Private health insurance staying on its long-term trend

The treatment of patients with a (supplementary) private health insurance in public hospitals has been an issue of discussion also in 2012. In this context it has been alleged that due to the fees paid by the private insurers their clients would benefit from shorter waiting times. With the amendment of 19 July 2011 (BGBl. I Nr. 69/2011) to the Medical Institution Act (Krankenanstalten- und Kuranstaltengesetz), the federal government prescribed the establishment of transparent waiting lists on an anonymous base for waiting times of four weeks and above for medical operations and clinical diagnostics in the areas of ophtalmology, orthopaedics and neurosurgery. Implementation details for these waiting lists are to be regulated by Länder law.

Table 4: Health insurance

	Premiums gross, adjusted	Claims payments[1]	Internal turnover ratio	Surplus on financial operations	Increase in actuarial reserves
	Million €	Million €	In percent	Million €	Million €
2007	1,490	1,118	75.0	115	253
2008	1,542	1,133	73.5	94	218
2009	1,599	1,166	73.0	123	259
2010	1,644	1,178	71.7	163	277
2011	1,704	1,207	70.8	143	305
	Percentage changes from previous year				
2007	+ 3.2	+ 2.2	– 0.9	– 23.5	+ 6.5
2008	+ 3.5	+ 1.4	– 2.0	– 18.4	– 14.0
2009	+ 3.7	+ 2.9	– 0.7	+ 31.7	+ 19.0
2010	+ 2.8	+ 1.0	– 1.8	+ 32.2	+ 6.8
2011	+ 3.6	+ 2.4	– 1.2	– 12.3	+ 10.2

Source: Austrian Financial Market Authority. – [1] Including reimbursed premium.

In spite of the critical discussion about the advantages of private health insurance, premium revenues continued to increase steadily also in 2011 (Table 4). As in the last few years, the increase in premium volumes was accompanied by a rising number of insured risks (+1 percent), of which both single-person and group policies benefited. Having increased by 50 percent between 2008 and 2010, the number of claims edged up by a more modest 3.5 percent in 2011. Since the number of cases had virtually no impact on disbursements for insurance claims, the massive increase may be explained by a change in recording. The growth differential between premium revenues and claims payments has now been observed for some years and has driven the claims ratio in the health insurance branch to a record low. Despite decreasing financial returns, insurers markedly increased their reserves at the expense of the actuarial result. The operational profit of the health insurance branch fell by almost one-third from the previous year; the return on equity capital abated to a still-high 29 percent.

Rising number of contracts in non-life and accident insurance

In 2011, the number of ensured risks in non-life and accident insurance was raised by 3.4 percent. Two-thirds of the total stock were accounted for by non-life (without health) and one-third by motor car insurance. In both areas, insurers managed to increase the number of contracts, with car insurance having been somewhat more dynamic (+6.1 percent). A substantial enlargement of risks was observed in the insurance of machinery and electrical appliances as well as in the "other insurances" category. The trend decline in credit insurance risks observed since the onset of the financial market crisis decelerated in 2011, without coming to a halt (–3.5 percent). As the current business cycle projections expect the lower turning point for the second half of 2012, no stabilisation may yet be seen in this branch. On the expenditure side, the number of claims edged down by 1 percent in 2011 from the previous year – a first explanation for the decline in the claims ratio in property insurance and the favourable actuarial result. Shaped by developments in the single-person, and group accident insurance, the number of liability cases in the entire accident insurance branch rose by 5.5 percent.

Premium revenues in non-life and accident insurance increased at a higher rate in 2011 than the risks (Table 5). While such difference could be expected from the analysis of price developments, the strong upswing in car insurance at declining average premia per risk (–4.3 percent) could have had a stronger dampening impact on the total outcome. The increase in average premia in the dominating property insurance by 2 percent more than offset this effect. Unlike for the two other insurance branches, the financial result improved markedly, which in 2012 may widen the scope for price competition in the area of property insurance. Actuarial reserves rose by more in 2011 than in the last few years, but the increase was in line with the medium-term average. With a positive non-actuarial result, the sector boosted the result from current operations to a total € 778 billion, achieving a return on equity capital of 9.8 percent (2010: 8.8 percent).

Table 5: Non-life and accident insurance

	Premiums gross, adjusted	Surplus on financial operations	Claims payments	Increase in actuarial reserves
	Million €			
2007	9,171	880	6,216	35
2008	9,205	584	6,340	1
2009	9,112	697	6,811	11
2010	9,586	828	6,323	21
2011	10,279	901	6,690	31
	Percentage changes from previous year			
2007	+ 3.2	– 9.0	+ 3.6	– 11.4
2008	+ 0.4	– 33.6	+ 2.0	– 96.3
2009	– 1.0	+ 19.2	+ 7.4	+ 747.5
2010	+ 5.2	+ 18.8	– 7.2	+ 87.1
2011	+ 7.2	+ 8.8	+ 5.8	+ 49.7

Source: Austrian Financial Market Authority.

Lower financial earnings weighing on the rate of return on investment

On the European money market, the trend towards rising interest rates for daily and 3-months deposits continued in early 2011. However, in view of the distortions on European capital markets, the ECB cut its key interest rate in mid-2011 and accompanied this move at the end of the year by a first Long-Term Refinancing Operation (LTRO), followed by a second tranche in spring 2012. Thereby, the ECB supplied European financial institutions with around € 500 billion in December. While the return on German and Austrian 10-year government bonds diminished in the course of the year, the yield gap between government bonds of countries at the EU periphery and German federal government bonds widened. Rating downgrades for the periphery countries added to this growing differential. Institutional investors gained from rising prices for German and Austrian fixed-interest bonds, whereas holders of titles from periphery countries suffered losses. Thus, returns from capital investment and interest earnings increased for the first time since 2008, but at the same time capital investment outlays and interest expenditure (which include price losses) jumped by 39 percent. In view of this difficult situation, insurers kept their portfolio structure of the previous year, accepting slightly lower returns in the life and health insurance branches. The differential between the effective return on investment in the life insurance sector vis-à-vis the yield on Austrian government bonds outstanding narrowed 2010 by about 1 percentage point, rendering single premium payments in life insurance unattractive. The earnings situation in non-life and accident insurance remained stable, however (Table 6).

Table 6: Insurers' return on invested capital

	Yield on government bonds	Life insurance	Health insurance	Non-life and accident insurance
	Percent yield			
2006	3.6	5.9	4.2	7.2
2007	4.3	5.2	3.1	6.2
2008	4.1	3.4	2.4	3.6
2009	3.3	3.8	3.1	3.8
2010	2.5	4.5	3.9	3.9
2011	2.6	3.7	3.3	3.9

Source: Austrian Financial Market Authority. WIFO calculations.

Low Financial Returns Undermine the Life Insurance Business

Trends in the Austrian Private Insurance Industry in 2011 – Summary

With a modest increase of premium revenues by 1.1 percent in 2011, growth of Austria's private insurance companies remained below that of nominal GDP (+5 percent). Performance within the sector was uneven: while premium revenues in non-life and accident insurance rose by a hefty 7.2 percent, they fell by a surprisingly strong 7.3 percent in the life insurance branch. Private health insurance showed the customary smooth development (+3.6 percent), such that the composition of premium revenues among the three major insurance branches shifted further towards the non-life insurance business. Austria thereby followed the general trend in Europe of receding demand for life insurance and slowly-expanding non-life insurance business. Accordingly, insurance penetration declined to a ratio of 5.5 percent of GDP in 2011, the lowest reading in more than a decade. Current projections assume this trend to continue in 2012.

The market share of foreign insurers in cross-border service provision edged down in 2010. At the same time, Austrian insurers managed to raise their share of foreign business to almost 44 percent of premium revenues, with operations in Central, Eastern and South-Eastern Europe accounting for the major part (€ 5.3 billion).

Insurance products had a dampening impact on inflation in 2011. Allowing for discounts, deductible, premium refunds and shifts between bonus-malus brackets premiums in car insurance were cut markedly; rising premiums in non-life (other than health) insurance were below the overall consumer price inflation. In 2011, claims ratios were low from a long-term perspective, which favoured such consumer-friendly pricing policy.

The persistently low interest rates on money and capital markets, the widening interest rate gap between bonds of European periphery countries and German government bonds and the correction on international stock markets weighed significantly on insurers' financial earnings in 2011. With an average return of 3.7 percent on invested capital in the life insurance branch, the spread vis-à-vis benchmark bond yields narrowed to 1.1 percentage points. A long-term scenario of low interest rates may create losses for life insurers, notably if contracts include earnings guarantees and customers have the opportunity to exercise implicit options.

The low-interest environment creates severe problems for insurance companies in the longer run, since financial earnings enter into the pricing of premia while at the same time the low interest rates impact on balance sheet positions. Moreover, substitution relations exist between life insurances and other forms of saving which affect the demand for insurance products. Insurance products of short maturity withstand the current low-interest period without major problems since premia may be adjusted after the contract expires. Almost all non-life and accident insurances fall into this category. For insurance products of long maturity the potential for incurring losses is much higher, and long-term life insurances with a high minimum interest guarantee may, in combination with implicit options, push an insurance company's equity capital below the minimum threshold, as revealed by the stress test of EIOPA (*FMA*, 2012). According to *Swiss Re* (2012B), nominal and real interest rates have been subject to major fluctuations since 1900. Swiss Re recommends insurance companies to adopt hedging strategies against interest rate risks, to offer voluntary changeovers to new contracts and to elaborate flexible guarantee conditions that may adjust to lower interest rate scenarios in a long-term perspective.

Low interest rates over an extended period of time significantly undermine the profitability and sustainability of the insurance industry.

References

Österreichische Finanzmarktaufsicht (FMA), Jahresbericht der Finanzmarktaufsichtsbehörde 2011, Vienna, 2012.

Scheiblecker, M., et al., "Österreichs Wirtschaft im Jahr 2011: Erholung verstärkt sich", WIFO-Monatsberichte, 2012, 85(4), pp. 257-321, http://www.wifo.ac.at/wwa/pubid/44056.

Swiss Re (2012A), "World Insurance in 2011", Sigma, 2012, (3).

Swiss Re (2012B), "Facing the Interest Rate Challenge", Sigma, 2012, (4).

Url, T., "Financial Market Crisis: Origin, Short-Term Reaction and Long-Term Adjustment Requirements", Austrian Economic Quarterly, 2010, 15(1), pp. 54-77, http://www.wifo.ac.at/wwa/pubid/39071.

Url, T., "Private Insurance Business Proving Resilient in a Turbulent Environment", Austrian Economic Quarterly, 2011, 16(4), pp. 234-243, http://www.wifo.ac.at/wwa/pubid/43354.

Weinberger, G., "IFRS 4-Studie", Versicherungsrundschau, 2011, (12), pp. 10-11.