WIFO ■ BULLETIN

No. 14/2017
September 2017

Thomas Url

Private Insurance Premium Income Declined in 2016

Private Insurance Premium Income Declined in 2016

The volume of single premium payments (with long-run guarantees) almost halved in 2016. Positive effects of the tax reform were more than compensated by low interest rates, making private households increasingly shy away from contracts with long commitment periods. On the supply side, insurers were less willing to underwrite long-run guarantees. This caused premiums in the life insurance business to decline by 9 percent and the total premium intake to shrink by 1.8 percent. Robustly growing private health insurance (+4.7 percent) and a recovery in non-life and accident insurance (+1.7 percent) did not prevent a further drop of the insurance density to 4.9 percent of GDP. Forecasts for 2017 and 2018 expect that this development will continue, albeit at a slower pace. The first year of experience with Solvency II revealed some scope for interpretation across the member countries' supervisory bodies. Austrian insurers emerged from the stress test in 2016 with sufficient amounts of solvency capital.

Contact:

Thomas Url: WIFO, 1030 Vienna, Arsenal, Objekt 20, thomas.url@wifo.ac.at

JEL-Codes: G22, E21, G28 • **Keywords:** Private insurance, Solvency II, stress testing

Referee(s): Josef Baumgartner • **Data processing:** Ursula Glauninger (ursula.glauniger@wifo.ac.at)

ISSN 1605-4709 • © Austrian Institute of Economic Research 2017
Impressum: Herausgeber: Christoph Badelt • Chefredakteur: Michael Böheim (michael.boeheim@wifo.ac.at) • Redaktionsteam: Tamara Fellinger, Ilse Schulz, Tatjana Weber • Medieninhaber (Verleger) und Redaktion: Österreichisches Institut für Wirtschaftsforschung • 1030 Wien, Arsenal, Objekt 20 • Tel. (+43 1) 798 26 01-0 • Fax (+43 1) 798 93 86 • http://bulletin.wifo.ac.at • Verlags- und Herstellungsort: Wien

Premium income of the Austrian private insurance companies declined somewhat in 2016, by 1.8 percent from the previous year (Table 1). The drop was driven by the weak performance of the life insurance branch where premium revenues fell by 9 percent year-on-year. Private health insurance, on the contrary, continued to grow by a robust 4.7 percent, while premiums in non-life and accident insurance picked up by 1.7 percent in 2016 from stagnation one year before. Table 1 shows the consequence of this lasting shift for the sectoral composition of the insurance business, away from life insurance towards the two other branches, which is responsible for the continued decline in insurance penetration. This indicator of the prevalence of private insurance products in an economy is defined by the ratio between insurance premiums and nominal GDP. Within Europe, Austria holds a mid-range position in this regard, mainly due to the comparatively minor importance of life insurance in Austria (*Austrian Financial Market Authority,* 2016, p. 24ff).

In Western Europe also, developments in the private insurance industry in 2016 were characterised by stagnating premium income in life insurance and solid growth in non-life insurance.

Developments in Western Europe followed a similar pattern in 2016, albeit less marked than in Austria: while premium income stagnated in life insurance, the non-life insurance sector enjoyed solid, though below-average growth. In East-central Europe, life insurers suffered premium losses, with notably the Polish market struggling with persistently low interest rates and tighter regulation for the distribution of life insurance products. Premium revenues in the non-life insurance sector recovered from the setback in the previous year. Companies operating in the region took advantage of the resilience of labour markets and relatively strong growth, raising both the number of contracts and premium rates (*Swiss Re,* 2017).

Within the European Economic Area (EEA), Austrian insurance companies fare poorly in direct selling of insurance products.

In the last few years, Austrian insurance companies raised the share of their premium revenues earned on foreign markets to almost half of total premium income. Data for 2016 are not yet available. In 2015, calendar-adjusted premiums from services and branches of Austrian companies in the EEA were again sluggish, amounting to no more than 492 million €, i.e., the attractiveness of this distribution channel kept decreasing (by 13.8 percent from 2014).

Table 1: Adjusted gross premiums

	All branches	Life insurance	Health insurance	Non-life and accident insurance	Insurance penetration[1]
	Million €	As a percentage of total premium			As a percentage of GDP
2012	18,743	34.6	9.4	56.0	5.1
2013	18,922	34.1	9.7	56.2	5.1
2014	18,928	35.6	10.0	54.4	5.2
2015	18,969	35.1	10.4	54.5	5.1
2016	18,630	32.5	11.1	56.4	4.9

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

Latest projections by the Association of Austrian Insurance Companies (*Verband der Versicherungsunternehmen Österreichs – VVO*) for the development of the Austrian market are based on data up to the first quarter 2017. They foresee a further contraction of the life insurance market (–3.1 percent), while health insurance should keep growing close to trend (+3.8 percent) and non-life and accident insurance may gain some momentum (+2.2 percent). Overall premium income may barely increase (+0.5 percent). Prospects for the life insurance branch remain subdued also for 2018 (–1.5 percent), as the sector expects interest rates to stay extremely low and Solvency II requirements for equity capital backing up single-premium payments in "classical" life insurance are high. However, solid expectations for health insurance (+3.3 percent) and non-life and accident insurance (+2.3 percent) should allow overall business to grow at a rate of 1.1 percent. Under such cautious prospects, insurance penetration in Austria may moderate to 4.6 percent by 2018.

While non-life and accident insurance is gaining momentum, the adverse conditions governing life insurance will lead to a further decline in Austria's insurance penetration.

1. Early feedback from practical experience with the impact of Solvency II

With the introduction of Solvency II at the beginning of 2016, the calculation of the required solvency capital has been brought more closely in line with the respective regulations for credit institutions. At the same time, the insurance sector has been submitted to comprehensive governance requirements (e.g., ORSA etc.), in order to ensure compliance with the regulatory framework and consumer protection provisions. During 2016, the European Insurance and Occupational Pensions Authority carried out a stress test for insurance companies under the conditions of Solvency II (*EIOPA*, 2016). The test referred to the period as from 1 January 2016, simulating two scenarios. The first scenario assumed a persistently flat yield curve, resulting from a combination of low productivity growth in the EU with a lack of long-term investment opportunities and a scarcity of risk-free assets. Underlying the second scenario was the assumption of an extended period of low interest rates accompanied by a sharp rise in risk premiums. These assumptions were applied to insurers' balance sheets and the respective valuation changes according to Solvency II were calculated. Any strategies of dynamic adjustment to the changing environment were left unconsidered; hence, the results represent a snapshot for a given risk pool, i.e., the risk situation prevailing at the beginning of 2016.

A total of 236 insurance companies from 30 countries were covered by the test. The sample focused on companies with a large share of long-term life insurance contracts, since this group would be particularly exposed to an extended period of low interest rates with regard to outstanding guarantee promises for a minimum return. EIOPA judges the quality of the equity capitalisation in Europe as being high, since on average 90 percent of equity falls into tier-1; for Austria, the share of 91 percent is slightly above this mark. On average, 109.6 percent of European insurers' technical liabilities (largely technical reserves) are covered by assets. Here again, the Austrian insurance sector, with a ratio of 115.1 percent, exceeded the European average.

EIOPA judges the equity base of European insurance companies as being sufficiently high; for Austrian companies it is above the European average.

The average ratio of solvency capital requirement (SCR) was 196 percent, i.e., the eligible equity capital of insurance companies covered 196 percent of the solvency capital requirement, implying a slight improvement from the outcome of the 2014 stress test (*EIOPA*, 2014). At the end of the stress period, only two European insurance companies would have been unable to fully cover their liabilities with their financial assets. Under the assumptions made, the stress test showed a decline in financial assets by an average 610 billion € and of liabilities by 550 billion € (–9.7 percent and –7.8 percent, respectively). The surplus of assets over liabilities (AoL) would accordingly shrink by 160 billion € or 28.9 percent. The Austrian Financial Market Authority (FMA) carried out a further stress test until end-August 2017 covering all insurance companies in Austria, under a scenario combining a sharp rise in interest rates with a higher risk premium. For life insurance providers, the consequences of a lasting low-interest-rate environment were once again analysed.

EIOPA's stress test led to a fall in the relation between asset investments and technical insurance liabilities by around 30 percent. The reaction of Austrian insurance companies was somewhat above the average.

As EIOPA summarises, small companies are better capitalised than large ones, but react to stress with relatively higher asset losses. Moreover, insurers with a high share of unit- and index-linked contracts were less exposed to stress. Companies offering long-term minimum return guarantees, i.e., with "classical" life insurances in their portfolio, proved more vulnerable in the given stress scenario. In 2017, EIOPA will therefore review the calculation methods for estimating the market value of long-term guarantees, which focus on the assessment and adjustment of a risk-free interest rate over horizons up to 150 years. This risk-free yield curve is the basis for the calculation of the best estimate for the market value of technical reserves of long-term life insurance products. These methods include tools which help avoiding the transmission of artificially high volatility of market interest rates into solvency capital requirements of the insurance industry.

The reaction of insurers to the EIOPA stress test scenario differed, depending on their product portfolio and on company size. The instruments for smoothing equity capital requirements over variations in market interest rates shall in future be analysed more closely.

More than one year after the introduction of Solvency II, the Austrian insurance sector recognises not only the advantages of a holistic and risk-oriented perspective on the insurance business and better internal communication, but also disadvantages from the regulator's excessive data requirements and from national differences in the interpretation of the Solvency II provisions (*Barazon,* 2017). The use of internal models for the risk assessment is not yet very common in Austria; large companies rely to some extent on partial internal models such as for their investment in real estate or for the non-life and accident insurance business. Summarising the own assessment of the insurance sector, *Barazon* (2017) claims that Solvency II does not dampen insurers' risk appetite; however, for companies with low eligible equity capital, the impact of a change in business strategy or a product innovation on the solvency capital requirement may lead to a more conscious management of risk capital. Nevertheless, the decline in single premiums by 41.5 percent (2016) in the "classical" life insurance (according to the Association of Austrian Insurance Companies) indicates that insurers react at least in some segments to the new incentives from Solvency II by reducing overall risks. The guarantees associated with single premiums create equity capital requirements that are too high in an extended low-interest-rate environment.

Internal models for the calculation of equity requirements are not yet widely used in Austria. Insurers tend to react to equity-intensive requirements by shifts in their product portfolio.

In the context of due diligence obligations in the distribution of life insurance products, the EU Fourth Anti-Money Laundering Directive, which entered into force on 26 June 2017, requires the insurance industry to gather additional information on the background of financial market agents. In Austria, the Directive was implemented via the Financial Market Money Laundering Act (Finanzmarktgeldwäschegesetz, BGBl. I Nr. 118/2016) and the Registration of Economic Owners Act (Wirtschaftliche Eigentümer Registergesetz, BGBl. I Nr. 136/2017). For corporate entities, the insurance sector can only rely on the "Register of Economic Owners", which lists the owners of corporations, other legal subjects, trusts, foundations and trust-like institutions. Economic owner is the person who exercises control over a corporate entity; for shareholders and other ownership structures, a participation threshold of over 50 percent applies.

The EU Fourth Anti-Money Laundering Directive also concerns the insurance industry and requires close scrutiny of a customer's background or the ownership structure of a corporate entity.

The EU General Data Protection Regulation will enter into force in May 2018 and has by then to be translated into national law by the Austrian Parliament. The Regulation is closely aligned to the German data protection legislation, but leaves scope for national autonomy via many opening clauses. For the insurance business, the Regulation implies tighter documentation obligations for the processing of personal data. The latter may be processed electronically only with the explicit consent of the person concerned or on the bais of a legal provision. Providers of health insurance or

The EU General Data Protection Regulation tightens the documentation obligations for the processing of personal data.

life insurance must henceforth appoint data protection officers. The Regulation includes a legal claim to the deletion of personal data, with deadlines to be handled on economically justifiable terms.

2. Above-average price increases for insurance products in 2016

Inflation in Austria maintained a low rate in 2016, significantly undershooting the target rate of the European Central Bank (Table 2). The contribution of insurance products to the overall price increase was above-average, since all insurance items included in the commodity basket of the consumer price index posted stronger gains than the headline inflation rate, with the exception of householder's comprehensive insurance. Forerunner was once again health insurance, closely followed by premiums for partially comprehensive car insurance.

Low claims ratios in 2016 offer insurance companies margins for price cuts. According to preliminary consumer price data, insurance products should have a dampening effect on the inflation rate for 2017.

Up to July 2017, insurance price increases were below the overall rate of the consumer price index – for the first time since 2013. Price hikes were mainly recorded for the motor car insurance branch. In any case, the low claims ratio in indemnity insurance currently offers scope for price cuts. The claims ratio expresses the relation between insurance claims payments and premium income in indemnity insurance. At 64.9 percent of deferred premiums it was ½ percentage point lower than in the previous year and 2.5 percentage points below the 2014 figure. Claims ratios were particularly low in 2016 for householder's comprehensive (35.5 percent) and glass insurance (33.9 percent), but below-average claims payments were also recorded for general liability insurance, motor car passenger insurance, fire-industrial and burglary insurance.

The scope for price cuts will not be fully exploited, if other means like discounts are used instead. In the strong-selling motor third party insurance, average premiums in 2016 were 1.3 percent lower than in the previous year.

Whether the scope for price cuts is actually used for cuts in the standard premium rates captured by the consumer price index, will depend on insurers' other revenue sources, such as returns on their investment, and on the use of alternative terms of the contract. Low returns on investment will make companies less willing to reduce premiums; likewise, generous granting of discounts, higher retentions or premium redemptions will narrow the margin for cuts in premium rates for standard contracts. For this reason, WIFO regularly calculates average premiums per risk for selected insurance types, thereby gathering information on the impact on other options of price formation. In the high-selling motor third party insurance, average premiums in 2016 were 1.3 percent lower than in the previous year; the premium increase in the partially comprehensive car insurance squeezes the decline for the entire motor car insurance to 0.1 percent. For the entire indemnity insurance branch, the average premium was 1.8 percent lower in 2016 than in the year before. One reason has likely been the migration of some large-scale risks in industrial fire insurance and transport insurance towards foreign domiciled insurance companies. This migration lowers the average premium in the absence of corresponding adjustments of prices or other terms.

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

	2017 Weight in percent	2012	2013	2014	2015	2016	2017[1]
		Percentage changes from previous year					
Statutory premium							
Householder's comprehensive insurance	0.369	+ 2.7	+ 2.5	+ 2.1	+ 1.6	+ 0.9	+ 0.9
Home insurance	0.745	+ 2.6	+ 3.2	+ 3.9	+ 1.6	+ 1.5	+ 0.9
Private health insurance	1.477	+ 2.1	– 1.3	+ 1.7	+ 2.8	+ 2.2	+ 1.0
Motor third party insurance	1.186	+ 3.3	+ 2.0	+ 1.6	+ 1.5	+ 1.6	+ 2.0
Legal costs insurance for cars	0.035	+ 2.4	+ 1.9	+ 1.0	+ 2.1	+ 1.3	+ 0.2
Partially comprehensive car insurance	0.171	+ 1.3	+ 3.2	+ 2.3	+ 1.9	+ 2.1	+ 2.6
Private insurance forms, overall	3.983	+ 2.3	+ 1.0	+ 2.2	+ 2.1	+ 1.8	+ 1.4
Consumer price index overall		+ 2.4	+ 2.0	+ 1.7	+ 0.9	+ 0.9	+ 2.0
Contribution private insurance (percentage points)		+ 0.10	+ 0.04	+ 0.09	+ 0.09	+ 0.08	+ 0.06

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

3. Low-interest-rate environment dampens premium income in life insurance

The European Commission, having harmonised and strengthened consumer protection with the Directive on Insurance Distribution, now targets a further strengthening of cross-border competition for retirement insurance products in the Internal Market. The Pan-European Personal Pension Product (PEPP) shall establish an EU-wide harmonised pension insurance product to be supplied by all financial service providers (*European Commission,* 2017A). This product not only represents a keystone for the stimulation of the Capital Market Union, but shall also promote private retirement arrangements in countries with less developed markets.

The European Commission has issued a proposal for a Pan-European Personal Pension Product (PEPP), designed to create an EU-wide harmonised pension insurance product for all financial service providers.

One consequence of this move could be more intense cross-border competition between different financial service providers for private households' long-term investment. The effect on competition across financial sector branches should take place only during the savings phase, since the guidelines for financial service providers confine the offering of perpetual annuities to insurance companies and pension funds. Neutrality between service providers thus obliges the Commission to submit a PEPP proposal with different payout options, i.e., annuities as well as lump sum payments. The Commission expects an EU-wide harmonised product to be more cost-efficient than the existing national pension products and to be better portable between member countries of the Single Market. In terms of procedure, a uniform certification by EIOPA of the PEPPs of individual providers is foreseen. A safe default investment option under which savers recoup at least the capital saved will be offered in every PEPP. Savers will be able to switch to another savings option once every five years, at capped cost, i.e., limited to a maximum of 1.5 percent of the transferred amount. Providers will be able to offer different types of payment options – annuities, lump sums, a combination of both, or regular withdrawals. Austrian experience with state-aided old age insurance shows that the combination of at least 10-year options for portfolio restructuring with capital guarantees has led to high guarantee costs, while consumer satisfaction has proved poor. In 2015, i.e., 13 years after the introduction of this instrument, and despite a number of ex-post adjustments, payouts from these contracts have been higher overall than payments into the scheme.

National differences in preferential tax treatment of pension products have always been an obstacle to the portability of entitlements to future benefits from pension funds.

The attractiveness of a standard pension product for private households also depends on the tax treatment in different member countries. Such differences in direct or indirect subsidisation of retirement products have always complicated the portability of entitlements to pension fund benefits. The *OECD* (2016) has issued a compilation of such differences in degrees and targets of indirect subsidies for its member countries. Hence, with the growing importance of public retirement schemes in a country, the level of subsidies to occupational and private pension plans tends to decline. Countries also differ as to the targeting of subsidies by stages of the product cycle: some countries concentrate subsidies on the savings phase, while others focus on privileging payouts. Cross-border transferability may thus give rise to "subsidy-shopping", where customers choose for each product phase the most favourable provider location, thereby largely avoiding taxation. From this perspective, the recommendation by the Commission to align the tax treatment of PEPP to that of existing domestic pension products appears somewhat misplaced (*European Commission,* 2017B).

Premium income from single premium contracts in "classical" life insurance almost halved in 2016.

The latest initiative by the European Commission is unlikely to have rapid impact on premium income of the life insurance branch. After the already weak performance in the previous year, the downward trend accelerated in 2016 (Table 3). In the category of the "classical" life insurance with single premium payments, revenues fell by no less than 41.5 percent (according to the VVO), and even current premium income in "classical" life insurance edged down (–0.5 percent). Likewise, current premiums in fund- and index-linked life insurance receded (–3.8 percent), while only the quantitatively marginal business of single premiums in fund- and index-linked contracts posted an increase. This pattern suggests that an explanation ought to be sought in both supply- and demand-side factors.

Table 3: Life insurance

	Premiums gross	Premiums net[1]	Retention rate	Surplus on financial operations	Claims payments	Increase in actuarial reserves
	Adjusted					
	Million €		Percent		Million €	
2012	6,488	6,269	96.6	2,200	6,407	2,448
2013	6,454	6,345	98.3	2,182	6,369	1,189
2014	6,745	6,631	98.3	2,028	7,177	1,428
2015	6,664	6,555	98.4	2,058	8,484	– 840
2016	6,063	5,952	98.2	1,961	7,732	– 142
	Percentage changes from previous year					
2012	– 6.5	– 6.5	+ 0.0	+ 19.2	– 3.7	+ 675.9
2013	– 0.5	+ 1.2	+ 1.7	– 0.8	– 0.6	– 51.4
2014	+ 4.5	+ 4.5	+ 0.0	– 7.1	+ 12.7	+ 20.1
2015	– 1.2	– 1.1	+ 0.1	+ 1.5	+ 18.2	– 158.8
2016	– 9.0	– 9.2	– 0.2	– 4.7	– 8.9	– 83.1

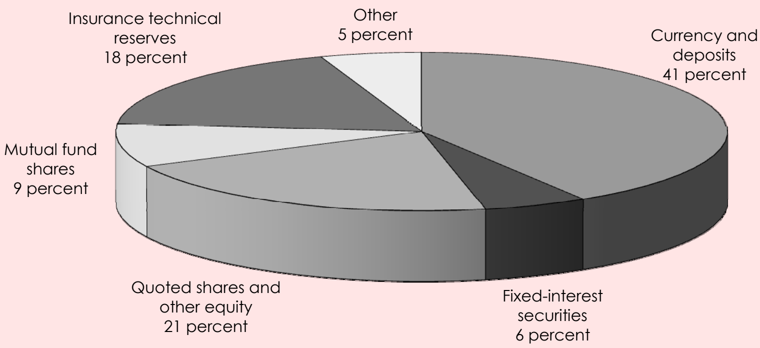
Source: Austrian Financial Market Authority. – [1] Estimate.

Private consumption, and with it demand for insurance products, was boosted by income developments in 2016. Thanks to the tax reform of 2015 (*Schratzenstaller*, 2015), real disposable income gained a healthy 2.3 percent year-on-year (nominal increase +3.4 percent). Households were thus in a position to step up spending by an above-average rate (+1.5 percent in real terms), and at the same time reinforce saving. The private saving ratio (excluding claims from occupational pension schemes) climbed by 1 percentage points in 2016 to reach 7.2 percent of private disposable income. Acquisition of financial assets rose by 27.1 percent to +13 billion €; together with the appreciation in the stock of assets, financial wealth increased by 2.8 percent. However, due to the expectation of low interest rates persisting, the providers of long-term investment products, such as life insurance, were unable to tap this potential. The composition of financial wealth shifted from fixed-interest securities towards cash and deposits. The share of claims to life insurance and pension fund benefits remained stable (Figure 1). Low interest rates on long-term assets prompt private households to adopt a stand-by position and raise their demand for liquidity. This shift in demand for financial assets can be observed for the euro area as a whole and is deemed the main driver of buoyant growth of the money supply M1 that only includes short-term assets (+9.5 percent in August 2017). While the shift towards short-term assets implies low interest receipts, private households thereby avoid losses and keep a free hand to swiftly switch to alternative investments in case of interest rates picking up.

Positive income effects from the tax reform 2015-16 have been more than offset by the interest-dampening effect of the ECB's bond purchase programme. For the time being, private households shy away from committing to the long retention periods of pension plans.

Figure 1: Composition of private financial wealth

2016



Source: Oesterreichische Nationalbank. Total financial wealth: 625.1 billion €.

On the supply side, the Financial Market Authority, by repeatedly lowering the maximum interest rate for the calculation of premium rates and technical reserves in life insurance contracts (since 1 January 2017: 0.5 percent; BGBl. II Nr. 266/2016), has set a binding ceiling for guarantee promises in "classical" life insurance. Hence, insurance companies cannot offer private households higher guarantees for either new contracts or premium upgradings in existing contracts. At the same time, the market-based calculation of solvency capital for contracts offering long-term guarantees requires a particularly high back-up with eligible equity. This raises capital cost in the "classical" life insurance to an extent that renders the distribution and subscription of single-premium policies unattractive, which counters the government objective of encouraging occupational and private retirement provisions laid down in the Federal Government Programme for 2013-2018 (*Federal Chancellery*, 2013).

The decline in guarantee promises and tighter equity requirements for long-term guarantee contracts reduce the supply of the latter.

Given such difficult conditions, new life insurance business was nevertheless stable, as far as the number of contracts is concerned. The total amount insured (–7.2 percent), however, mirrors the slump in single-premium payments. The number of new contracts shifted in favour of annuity insurances in 2016 (+8.5 percent), although the amount insured receded also in this segment, by 9.7 percent year-on-year. In view of the weak demand by private households for new consumer credit (+2.8 percent) and housing loans (–0.9 percent), new business in the credit insurance was lacklustre (+0.8 percent).

The number of newly-settled contracts could be kept stable only at reduced insurance amounts.

The state-aided old-age insurance suffered also in 2016 from hardly attractive conditions on capital markets and the cuts in subsidy rates in 2012. Detailed information on the number of contracts is not yet available from the Financial Market Authority; according to data released by the Association of Austrian Insurance Companies, insurers received 891 million € in premiums in 2016, 4 percent less than in the previous year. The statutory rule for the calculation of the subsidy rate is related to the average yield on government bonds, weighted by outstanding amounts. On annual average 2016, this yield amounted to 0.04 percent, implying that the subsidy rate will remain at the statutory minimum of 4.25 percent in 2018.

In state-aided old-age insurance, payments exceeded receipts for the first time in 2016.

The subdued current condition for the life insurance is also mirrored by the decline in financial returns as well as in claims payments (Table 3); technical reserves were further reduced in 2016, albeit at a slower rate. Hence, the result from ordinary business activities remained at the below-average level of the earlier year; the return on equity abated once again, from 6.6 percent in 2015 to 6.3 percent in 2016.

4. Sustained enlargement of the risk pool in health insurance

In the distribution of roles between private and public health insurance, private insurance in Austria specialises in covering hotel costs, access to private clinics and filling certain gaps in public insurance coverage. The trend of expenditures in the public health sector thus sets the scene for the assessment of private insurance. The number of persons eligible for benefits of public health insurance rose by 1.3 percent year-on-year in 2016; total revenues increased by 4.5 percent, and premium income by 3.4 percent. Reimbursements of expenses for services rendered and other revenues rose above-average. Expenditures in the public health system rose by 4 percent to an overall 17.8 billion € in 2016, slightly exceeding the target rate of +3.6 percent p.a. stipulated by the Health Target Control Act (*Gesundheits-Zielsteuerungsgesetz*). Due to the government's efforts to restrain access to invalidity pensions, spending on rehabilitation benefit increased particularly strongly (+26.4 percent). Growth of expenses on physician services of +3.7 percent was broadly in line with the overall expenditure trend.

In this setting, private health insurance performed rather strongly, both in terms of premiums and claims payments (Table 4). The number of insured risks in individual and group insurance advanced to a total 3.2 million, with group insurance growing somewhat more strongly (+3.6 percent). The higher number of insured persons and price hikes boosted premium income (Table 4). At the same time, the pace of claims payments abated slightly in 2016. Payments on hospital cost coverage, with a share of two-thirds the major spending category, advanced by a moderate

Growth of population, employment, and disposable income bodes well for the extension of insured risks as well as for the increase in premium revenues.

1.2 percent. Much stronger was the increase in expenditure on physicians' services (+9.1 percent) and medical and therapeutic appliances (+9.7 percent).

High premium revenues, a more moderate growth in claims payments and a strong surplus on financial operations in 2016 allowed technical reserves to be reinforced within their medium-term range. Health insurers achieved a remarkably positive result from ordinary business activity of 149 million €, yielding a rather high return on equity of 36.7 percent, after 41.5 percent in 2015.

Table 4: Private health insurance

	Premiums gross, adjusted	Claims payments	Claims ratio	Surplus on financial operations	Increase in actuarial reserves
	Million €		Percent	Million €	
2012	1,762	1,192	67.6	160	302
2013	1,828	1,231	67.3	207	326
2014	1,889	1,262	66.8	194	345
2015	1,969	1,318	67.0	226	366
2016	2,061	1,361	66.0	249	411
	Percentage changes from previous year				
2012	+ 3.4	+ 4.0	+ 0.6	+ 12.0	– 1.2
2013	+ 3.8	+ 3.3	– 0.4	+ 29.2	+ 8.0
2014	+ 3.3	+ 2.5	– 0.7	– 6.4	+ 6.0
2015	+ 4.3	+ 4.4	+ 0.2	+ 16.7	+ 5.8
2016	+ 4.7	+ 3.2	– 1.4	+ 10.1	+ 12.5

Source: Austrian Financial Market Authority.

5. Lower average premiums in the non-life and accident insurance

The non-life and accident insurance branch enjoyed a smooth course of business in 2016. Generally speaking, property insurance benefits from steady population growth in the last years and the accompanying increase in the number of households in Austria (2016 +1.3 percent); as a consequence, also the number of motor cars rises (+1.5 percent). The smooth upward trend is also transmitted to the number of insured risks in indemnity (+2.7 percent) and accident insurance (+6.9 percent). Since average premiums in 2016 were edging down notably in the high-selling motor car insurance, the rise in premium income did not entirely keep pace with the number of insured risks (Table 5).

Table 5: Non-life and accident insurance

	Premiums gross, adjusted	Surplus on financial operations	Claims payments	Increase in actuarial reserves
	Million €			
2012	10,493	1,046	7,086	12
2013	10,639	961	7,194	14
2014	10,294	928	6,944	10
2015	10,335	708	6,761	14
2016	10,506	733	6,821	21
	Percentage changes from previous year			
2012	+ 2.1	+ 16.2	+ 5.9	– 60.4
2013	+ 1.4	– 8.1	+ 1.5	+ 12.3
2014	– 3.2	– 3.5	– 3.5	– 28.3
2015	+ 0.4	– 23.7	– 2.6	+ 44.6
2016	+ 1.7	+ 3.6	+ 0.9	+ 46.7

Source: Austrian Financial Market Authority.

While the private insurance industry is appreciated by the general public mainly for its services in the event of damage, it also plays an important role for damage prevention, by defining premium rates, deductibles and especially exclusions from insurance, and by setting general policy conditions. These contract terms signal the risks of certain behaviour or circumstances to potential customers, thereby creating incentives to undertake preventive measures. In this respect, product differentiation also plays an important role since it serves to either encourage or discourage certain risk groups to join the risk pool. With regard to insurance against natural disasters, the Association of Austrian Insurance Companies has tried for some years to provide such private insurance via a mandatory combination with fire insurance contracts – a combination that exists in some European countries. This option would carry the advantage that the public sector would normally not need to step in with transfers from the Disaster Relief Fund ("Katastrophenfonds"), confining itself to a role of reinsurer in cases of particularly large disasters. On the other hand, the idea is to pool several types of risk (flood, earthquake, avalanche etc.) in one policy in order to make the product attractive for all Austrian households. This approach shifts excessive premium burdens for particularly risk-exposed areas towards customers in less exposed ones, neglecting the eminent role of insurance premiums as a signal for the size of potential damage (*Sinabell – Url,* 2008). A too strong deviation from risk-adequate pricing of disaster insurance diminishes, from an overall economic perspective, the potential of this instrument for damage prevention.

Proposals by the insurance industry for the introduction of a mandatory insurance against damages from natural disasters would largely decouple the level of the insurance premium from the probability of facing a damaging event. This pricing policy would make poor use of the potential for damage prevention related to the contract terms.

Ongoing activities of the Association of Austrian Insurance Companies to promote higher risk awareness of firms and households showed further results in 2016. The number of indemnity insurance claims declined by 0.6 percent year-on-year overall, and by 2.5 percent when motor car insurance is excluded. Claims fell particularly strongly in the branches of storm and minor natural hazards (–29.3 percent), industrial fire (–28.2 percent), and fire loss of profits (–13.8 percent). Despite the lower number of losses, claims payments increased slightly overall.

The decline in the number of losses in 2016 facilitated a limited increase in claims payments.

The result from technical operations rose to a peak of 217 million €. Yet, the limited surplus on financial operations dampened the result from ordinary activities (945 million €). The return on equity edged up from 8.1 percent in 2015 to 9.1 percent in 2016.

6. Insurers' returns on investment remained stable

In 2016, the European Central Bank (ECB) stepped up its bond purchase programme to 80 billion € per month, which pushed yields on low-risk fixed-interest government bonds even into negative territory; for Austria, yields averaged 0 percent (Table 6). For short-term bonds, the ECB maintained its zero-interest-rate policy. For deposits in the European System of Central Banks (ESCB), financial institutions had to pay 0.4 percent p.a. Hence, money market rates were persistently negative. For financial service providers offering retirement saving products, the low returns create a problem of how to (re)invest maturing securities and fresh premium receipts, since only higher-risk investments carry returns above actuarial interest rates. On the other hand, financial service providers have a sufficiently large portfolio of fixed-interest securities with long residual maturities to avoid a sudden slump in average returns.

The insurer's return on invested capital, as calculated by WIFO (*Url*, 1996), exceeded the yield of government bonds also in 2016 (Table 6), remaining broadly unchanged from the previous year. Financial service providers increasingly divert towards investment in foreign securities and issues of non-financial corporations. As a consequence of the financial market crisis, bank issues still play only a minor role in insurers' portfolios. Infrastructure investments appear to meet investors' interest to some degree; however, given the potential for regulatory intervention into price formation for infrastructure services, the implicit political risks are high and difficult to assess. The integration of such investment into the calculation scheme for solvency capital represents a further obstacle. Low financial returns will for some time remain a challenge for the insurance sector, as the period of extremely low interest rates is expected to last for several more years (*Baumgartner – Kaniovski,* 2017).

In 2016, the insurance industry's return on invested capital once again exceeded the yield of Austrian government bonds by a comfortable margin. Low returns on new investments will for some time pose a challenge for the sector.

Table 6: Insurers' return on invested capital

	Yield on government bonds	Life insurance	Health insurance	Non-life and accident insurance
		Percent		
2012	1.5	4.4	3.5	4.5
2013	1.1	4.3	4.0	4.0
2014	1.0	3.9	3.5	3.9
2015	0.4	3.9	3.9	2.9
2016	0.0	3.7	4.0	3.0

Source: Austrian Financial Market Authority, WIFO calculations.

7. References

Barazon, R., "Durch Solvency II wurden die Versicherungen noch stress-resistenter", Versicherungsrundschau, 2017, (5), pp. 10-15.

Federal Chancellery (BKA), Arbeitsprogramm der österreichischen Bundesregierung 2013-2018, Vienna, 2013.

Baumgartner, J., Kaniovski, S., "Update of the Medium-term Forecast for the Austrian Economy 2017 to 2021", WIFO Bulletin, 2017, 22(5), pp. 43-49, http://bulletin.wifo.ac.at/60478.

European Insurance and Occupational Pensions Authority (EIOPA), Insurance Stress Test 2014, Frankfurt am Main, 2014.

European Insurance and Occupational Pensions Authority (EIOPA), Insurance Stress Test 2016 – Report, Frankfurt am Main, 2016.

European Commission (2017A), Proposal for a Regulation on a pan-European Personal Pension Product (PEPP), Brussels, 2017, COM(2017) 343 final, http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017PC0343&from=EN.

European Commission (2017B), Recommendation on the tax treatment of personal pension products, including the pan-European Pensions Product (PEPP), Brussels, 2017, COM(2017) 4393 final, https://ec.europa.eu/info/sites/info/files/170629-personal-pensions-recommendation_en.pdf.

OECD, Pensions Outlook 2016, Paris, 2016.

Austrian Financial Market Authority (FMA), Bericht über die Lage der österreichischen Versicherungswirtschaft, Vienna, 2016.

Schratzenstaller, M., "The Tax Reform 2015-16 – Measures and Overall Assessment", WIFO Bulletin, 2015, 20(20), pp. 222-237, http://bulletin.wifo.ac.at/58372.

Sinabell, F., Url, T., "Flood Risk Exposure in Austria – Options for Bearing Risk Efficiently", Schmollers Jahrbuch, 2008, 128, pp. 593-614.

Swiss Re, "Globale Assekuranz 2016: Der chinesische Wachstumsmotor läuft auf Hochtouren", Sigma, 2017, (3).

Url, T., Kennzahlen der österreichischen Versicherungswirtschaft, WIFO, Vienna, 1996, http://www.wifo.ac.at/wwa/pubid/21313.