Thomas Url

Life Insurance Business Continues to Suffer from Low Interest Rates

For the Austrian insurance industry, the year 2012 was marked by a decline in premium revenues. Simple premium payment in life insurance receded once again, but also the additional income receipts recorded in the non-life-insurance business was largely driven by price increases. The trend in Austria thereby follows the pattern observed in western Europe. Financial earnings recovered in 2012 due to markedly lower write-offs needed on fixed-interest securities. However, low interest rates on safe government bonds weighed on the return on new investments.

The author is thankful to Josef Baumgartner 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**

Premium revenues of the Austrian insurance companies contracted in 2012 for the first time since 1997, when tax-related one-off factors had a negative effect. The trend was shaped by the persistent decline in life insurance (–6.5 percent) and a modest increase in non-life-insurance premia (+2.1 percent). Private health insurance proved resilient to the sluggish economic environment, continuing its steady expansion at a rate of 3.4 percent in 2012. The share of the life-insurance business in total insurance premium revenues declined once again while private non-life and accident insurance gained further ground (Table 1), now claiming slightly more than half of overall premium revenues.

Insurance penetration declined in 2012, in line with the trend in western Europe.

Insurance penetration, the ratio of premium revenues to nominal GDP, is considered as a yardstick for the development of the private insurance market in international comparisons. The decline in life insurance revenues once more reduced insurance penetration in Austria (5.3 percent), but the gap vis-à-vis the western European average (7.7 percent) remained unchanged. With 4.6 percent against 2.1 percent, life insurance contracts are more common in western Europe than in Austria, while in the non-life-insurance sector insurance penetration is 3.1 percent in both cases.

The market share of foreign cross-border direct sales into Austria rose to 5.3 percent.

The effects of the European Internal Market on insurance services showed up more clearly in 2012. Insurers headquartered within the Single Market area may offer cross-border services in Austria, under home country supervision. In 2012, 28 foreign insurance companies used Austrian subsidiaries as their distribution channel (2011: 26); a further 897 companies were registered for the direct exchange of services (2011: 878). Evidence on the extent of cross-border activities is only available with a lag of one year: the revenues of registered insurers increased markedly in 2011 from the previous year. Via subsidiaries, premia of € 374 million were paid, and another € 544 million via direct service operations. The share of foreign premium revenues from cross-border insurance services in the Austrian market thereby rose to 5.3 percent (2010: 4.8 percent).

The internationalisation of Austrian insurance companies jumped in 2012, with premium revenues earned in east-central and south-eastern Europe up by an estimated 17.4 percent.

Soon after the opening of eastern Europe to the West, Austrian insurance companies concentrated their foreign operations on east-central and south-eastern Europe. Despite difficult economic conditions in the region, they managed to increase premium revenues to € 7.8 billion by 2012 (*Financial Market Supervisory Board*, 2013). With € 6.8 billion, the bulk of this amount was earned in EU countries, while revenues in western Europe receded by 9.5 percent year-on-year. The importance of foreign operations for Austrian-based insurance companies can at present be assessed only for 2011: the share of foreign in total premium revenues rose to an all-time high of 44.1 percent (2010: 43.6 percent). Early reports from the Association of Austrian Insurance Companies (Verband der Versicherungsunternehmen Österreichs, VVO) suggest a further increase for 2012. Premium revenues from east-central and south-eastern Europe may have increased by as much as 17.4 percent, despite adverse economic conditions in some countries (Versicherungsrundschau, May 2013, p. 16).

For the domestic market, the VVO expects premium revenues to remain broadly flat (+0.2 percent) in 2013, as the life insurance business is set to shrink by a further 3.1 percent. Non-life-insurance premium receipts should grow by 2.3 percent from 2012, while growth of the health insurance sector is projected at a steady 3.3 percent. On the basis of this projection, insurance penetration would decline further.

Premium revenues from the domestic market are set to remain subdued in 2013. The life insurance business in particular is unlikely to recover from last years' setbacks.

Table 1: Adjusted gross premia

	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
2008	18,107	40.6	8.5	50.8	5.70
2009	18,108	40.9	8.8	50.3	5.92
2010	18,713	40.0	8.8	51.2	5.84
2011	18,922	36.7	9.0	54.3	5.52
2012	18,743	34.6	9.4	56.0	5.31

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

In 2012, developments in the Austrian insurance market broadly followed the general pattern for western Europe. The recession in southern European countries and persistently low interest rates led to a fall in premium revenues in western European life insurance by 3.1 percent in volume on a dollar basis (*Swiss Re*, 2013). The trend in non-life insurance in the countries relatively less affected by the financial market crisis was mainly shaped by price increases rather than by larger business volumes; in the periphery countries of the euro area, motor vehicle insurance suffered particularly severe setbacks. Overall, premium revenues in western European non-life insurance edged down by an inflation-adjusted 0.4 percent (in common currency). In east-central and south-eastern Europe, insurance business developments were uneven, ranging from dynamic growth in Russia and Poland to contraction in Hungary and Slovakia. On balance, the expansionary forces prevailed, with life insurance growing by 5.1 percent and non-life insurance by 4.8 percent.

The insurance market in western Europe also suffered from a difficult environment in 2012. Historically low interest rates weighed on life insurance sales, and the recession in the euro area periphery countries led to a fall in demand for non-life insurance.

Efforts at EU-wide harmonisation of insurance supervision temporarily stalled in 2012. After the last studies on the quantitative impact study (QIS 5) had been concluded, a Long Term Guarantee Assessment was carried out that revealed a need for further adjustments with respect to the calculation of equity capital requirements for long-term guarantees. In order to evaluate future payment flows for long-term life insurance contracts, the yield curve must be extrapolated far into the future. On the basis of different extrapolation methods and due to the high volatility of credit risk spreads, the new test showed the need for major adjustments of solvency capital and equity. At present it seems likely that the introduction of Solvency II will be postponed until 2016.

The new valuation rules for long-term insurance contracts under Solvency II entail major adjustments of solvency capital requirements. For this reason, the introduction of Solvency II is expected to be postponed until 2016.

Two further initiatives by the European Commission intervene into the distribution of investment and insurance products. The "Markets in Financial Instruments Directive" (MiFID) is likely to ban brokerage fees for independent agents selling investment products. The MiFID is to some extent the role model for the Insurance Intermediation Directive II (IMD II) that regulates the distribution of insurance products. With this Directive, the European Commission intends to settle the conflict of interest for insurance brokers between customer-oriented counselling and fee-maximising misconselling, by obliging brokers to provide information on the amount of their brokerage fee. Insurance brokers receive part or total of their income as commission fees from the insurance company at the conclusion of a contract. If the insurance clients are aware of the amount of the fee, they ought to be in a better position to assess the

The European Commission initiatives MiFID and IMD II concern the distribution of investment and insurance products; they may have major consequences for the industry.

brokers' incentives. In reality, however, such information is unlikely to facilitate a customer's decision since the level of the fee varies according to distribution channel and since this particular information rivals with other major contract characteristics – e.g., amount ensured or exclusions of liability – for the limited attention of the customer (*Url*, 2013). An assessment of IMD II should also consider any potential negative side-effects on the competitive environment. In certain areas of the Austrian property insurance market, the degree of concentration is already high at present. Should the higher transparency lead to a lower number of brokers, market access for small domestic or new foreign insurers will be hampered.

The brokerage fee model versus a charge-based model will in theory produce similar results for the distribution of insurance services. If fringe payments may be established, a charge-based model may even give rise to miscounselling more often.

In a theoretical study, *Focht – Richter – Schiller* (2013) compare different payment systems. Brokers may either receive a commission from the insurance company or the customer pays a charge to the broker. In a model that potentially allows for miscounselling by the broker in recommending a certain type of insurance contract to the client, the two alternative forms of remuneration are in most cases equivalent for imperfectly informed customers. In a charge-based model, proposed contracts may be unsuitable if the broker succeeds in persuading one or few insurance companies to offer fringe payments. Hence, *Focht – Richter – Schiller* (2013) conclude that a changeover from commission fees to a charge-based model will not prevent miscounselling.

Prices for insurance services up by 2.3 percent

At a rate of 2.4 percent, headline inflation in Austria exceeded the target of the European Central Bank also in 2012, even if the upward drift abated markedly from 2011. Although price increases for insurance products decelerated only marginally, the insurance component had a dampening effect on the overall inflation rate, mainly due to the development in private health insurance (Table 2). Premiums for partially comprehensive car insurance also acted as a stabilising force, whereas price increases for motor third party insurance were significantly above the overall inflation rate. For 2013, the price index suggests even a decline in private health insurance premia; price increases for motor third party insurance, the second-most important sector, should slacken in 2013 from their above-average pace observed during the previous years.

Stable claims ratios in the indemnity insurance sector exert little pressure for further price hikes in 2013. Insurance premia for owner-occupied homes are likely to increase above average in 2013.

The claims ratio of 67.5 percent in the indemnity insurance branch was in line with its long-term average. While it was markedly below the long-term average for motor vehicle and householder's insurance, it was above the trend for fire, transport and water damage insurance. In the motor third party insurance, the low claims ratios observed since the mid-2000s persisted, while claims ratios headed down in burglary insurance (2012: 47.7 percent; 2009: 104.4 percent). Past experience suggests that sustained high claims ratios exert upward pressure on prices for the insurance products concerned. During the last years, this was the case for domestic fire and water damage insurance; accordingly, preliminary figures for 2013 show an acceleration of premium hikes for insurance of owner-occupied homes (Table 2).

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

	Weight 2013	2008	2009	2010	2011	2012	2013[1]
	In percent	Percentage changes from previous year					
Statutory premium							
Householder's comprehensive insurance	0.296	+ 3.6	+ 3.8	+ 2.0	+ 1.9	+ 2.7	+ 2.4
Home insurance	0.701	+ 4.2	+ 5.6	+ 1.6	+ 3.5	+ 2.6	+ 3.2
Private health insurance	1.837	+ 1.4	+ 2.7	+ 2.3	+ 2.2	+ 2.1	– 1.3
Motor third party insurance	0.886	+ 2.9	+ 2.4	+ 1.8	+ 2.7	+ 3.3	+ 2.0
Legal costs insurance for cars	0.039	+ 2.0	– 1.2	+ 0.0	+ 1.3	+ 2.4	+ 2.3
Partially comprehensive car insurance	0.549	– 5.4	+ 3.3	+ 5.6	+ 3.3	+ 1.3	+ 3.6
Private insurance forms, overall	4.307	+ 1.4	+ 3.1	+ 2.5	+ 2.5	+ 2.3	+ 1.0
Consumer price index overall		+ 3.2	+ 0.5	+ 1.9	+ 3.3	+ 2.5	+ 2.3
Contribution private insurance (percentage points)		+ 0.06	+ 0.14	+ 0.11	+ 0.12	+ 0.10	+ 0.04

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

Price formation in non-life and accident insurance can be better assessed on the basis of the average premium per risk rather than by taking the official consumer statistics, since it also allows for bonus grades, premium discounts and retentions. These price concessions granted on an individual base may cause important deviations from the standard contract price included in the CPI. However, in non-life insurance excluding motor car, this effect was hardly noticeable in 2012, as the increase in the average premium of 2.4 percent was identical with that included in the CPI. For motor vehicle insurance, premia were raised above average, by 3.5 percent in 2012, while the average premium for total non-life insurance rose by only 2.7 percent. Only for comprehensive motor vehicle insurance, the average premium per risk declined once again. All in all it appears that in 2012 a period of strong price competition with falling average premia, which lasted for about five years, has come to an end. The Austrian market shares this trend with the German and the French insurance market, where insurers' additional premium income were also largely driven by price increases (*Swiss Re*, 2013).

The trend in the average premium per risk is in line with consumer price data. Potential additional instruments of price discrimination were not applied in 2012.

New business in life insurance receding in 2012

Disposable income of private households edged up by 1.2 percent at constant prices in 2012. The gain in purchasing power was used for a moderate increase in consumption (+0.5 percent) as well as in the saving ratio (2011: 6.7 percent, 2012: 7.4 percent). This favourable combination for the build-up of private assets led to an increase in financial assets by 3.7 percent from the previous year. The distribution of wealth across different asset classes hardly changed, except for minor shifts from cash and deposits towards shares and investment certificates (Figure 1). Persistently low money market rates prompted private households to reduce short-term monetary placements, and the increase in share prices at the end of 2012 generated a positive price effect for shares and investment certificates. The risk awareness of investors remained high overall in 2012, such that the share of claims on life insurances and pension funds in total financial assets increased slightly (from 18.3 percent in 2011 to 18.4 percent in 2012).

New business in the life insurance branch contracted in 2012. With a total of slightly above 2 million new or modified contracts, new underwritings fell by 3.4 percent and the associated insured capital was down by 11.1 percent compared to the previous year. Within the sector, new contracts shifted away savings products (–6.9 percent) and the unit- or index-linked life insurance (–18.6 percent) towards annuity insurance contracts (+81.6 percent). Whether this shift was a consequence of the change of the mortality tables towards gender-neutral tariffs on 21 December 2012, or whether it was driven by higher demand for annuity insurance can only be judged once the data for 2013 become available. In any case, it is likely that underwritings have been carried forward into 2012, given that annuity life insurance has become significantly more expensive since for males the introduction of gender-neutral tariffs. Credit insurance mirrors the continued subdued demand of private households for credit, as in 2012 only the credit amount outstanding for housing loans increased. According to the data available until June 2013, even the stock of housing loans is curtailed nowadays, foreshadowing a further contraction of business for the current year.

The number of newly underwritten life insurance contracts fell by 3.4 percent in 2012 from the previous year; the implicitly insured capital was down by 11.1 percent.

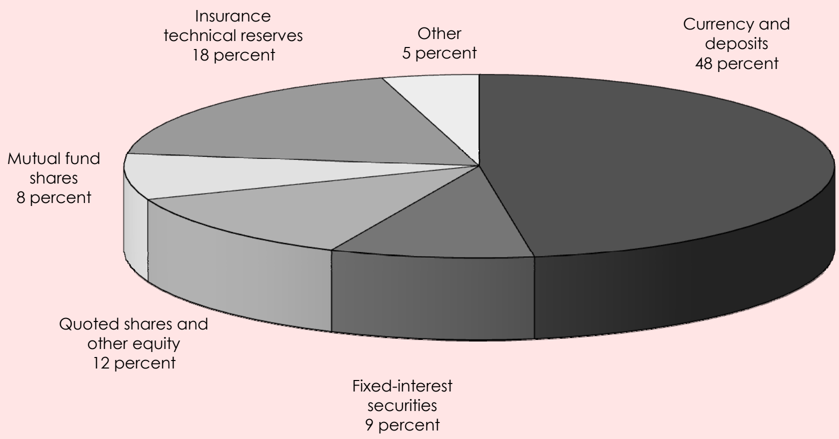
Premium revenues in the life insurance branch fell across the board in 2012, extending both to the classical and to the unit- or index-linked life insurance (Table 3). While the trend was set by the lasting fall of single premium payments (–18.8 percent), business also weakened for contracts with recurrent premium payments which dropped by 4 percent year-on-year. Comparatively better was the situation for unit- or index-linked contracts with recurrent premia (–1.3 percent). The state aided old-age insurance also belongs to this group suffering a slight decline in premium revenues (by 0.5 percent to a total of slightly below € 1 billion) in 2012, despite the number of contracts heading up. The insurance industry thereby succeeded in raising its market share in this kind of subsidised retirement provision to almost 94 percent. First estimates suggest a decline in the annual average premium per contract to € 643 (2011: € 668). Thus, the 50 percent-cut in the subsidy rate for 2012 to 4.25 percent of

The decline in life insurance premium revenues in 2012 was driven by the fall in single premium payments, but also receipts from contracts with recurrent premia fell short of the year-earlier level.

premium payments had a limited impact on the number of contracts, rather it reduced the level of payments per contract.

Figure 1: Composition of private financial wealth

2012



Source: Oesterreichische Nationalbank. Total financial wealth: € 483.8 billion.

Low interest rates continue to have negative repercussions on the subsidy for state aided old-age insurance. The subsidy rate would again have undershot the legal minimum of 4.25 percent in 2013 and was therefore fixed at this threshold. According to the data available so far, the subsidy rate will remain at the minium level in 2014. The ceiling for subsidies to premium-privileged retirement schemes is € 2,445.50 in 2013, rising to a projected € 2,504 in 2014.

The subsidy for state aided old-age insurance equals the minimum rate of 4.25 percent of premium payments in 2013, due to the low interest rate on security markets.

In order to boost the attractiveness of private old-age provision, several regulations for capital investment in the state aided old-age insurance were modified in 2013. Since the first wave of contracts stretching over a minimum time span of ten years expire in 2013 for the first time, the reform was also designed to keep the capital of maturing contracts within the retirement insurance system. As from 1 August 2013, insurers may only offer contracts where funds are invested according to the life cycle model, i.e., with shares accounting for at least 15 to 60 percent of the overall portfolio for insured persons below the age of 50, and between 5 and 50 percent for persons older than 50 years. This wide range facilitates flexible investment policies while reducing the cost of capital guarantees and the investment risk for older insurants. However, the life cycle model for investment policy is undermined by two rulings of the Austrian Supreme Court, dated 9 May 2012 and 14 November 2012. These rulings settle the conflict between an insurant's right of cancellation provided for by the Insurance Act ("Versicherungsvertragsgesetz") and the minimum duration of the contract required by the tax code in favour of the right of cancellation (*Palten*, 2013); thus, an insured person has the right to terminate a contract after 10 years, with longer maturities not being legally binding. Cancellations by clients after a duration of 10 years as admitted by the Supreme Court will therefore interfere with insurers' long-term investment strategies based on the life cycle model. Companies will need higher capital buffers, while the impact on asset management companies and funds is still unclear.

New investment regulations shall render the state aided old-age insurance more attractive. Yet, their implementation is complicated by recent rulings of the Austrian Supreme Court.

Table 3: Life insurance

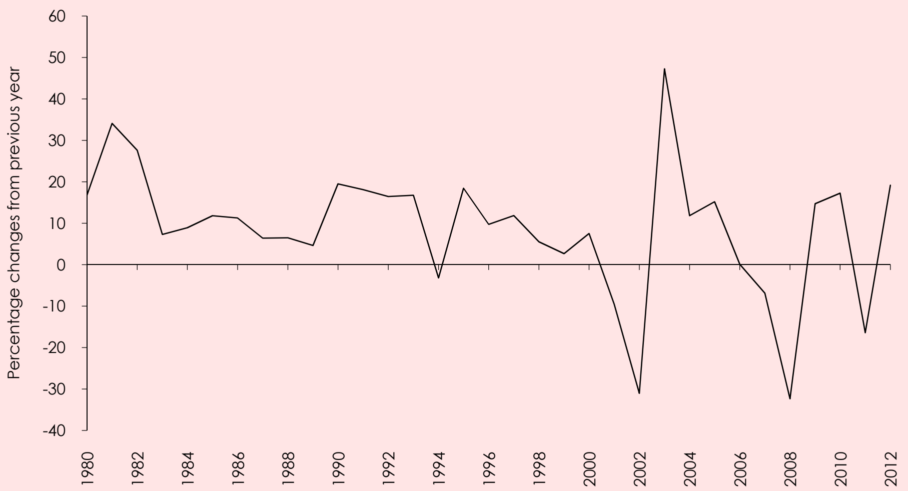
	Premiums gross	Premiums net[1] Adjusted	Retention rate	Surplus on financial operations	Claims payments	Increase in actuarial reserves
	Million €		In percent		Million €	
2008	7,359	7,076	96.1	1,641	5,473	814
2009	7,398	7,188	97.2	1,883	5,799	3,256
2010	7,483	7,268	97.1	2,208	5,854	3,221
2011	6,939	6,704	96.6	1,846	6,651	316
2012	6,488	6,269	96.6	2,200	6,407	2,448
	Percentage changes from previous year					
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
2012	− 6.5	− 6.5	+ 0.0	+ 19.2	− 3.7	+ 675.9

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

For the state aided old-age insurance, investment regulations regarding shares on under-developed stock exchanges have also been relaxed.

A further change that will reduce loss risks in the future relates to the limitation of investment in shares registered at under-developed stock exchanges. This constraint, originally intended to support the Vienna Stock Exchange, has proved particularly loss-generating during the financial market crisis. Indeed, small and less liquid stock exchanges tend to exhibit high volatility in times of crisis. This is confirmed by the slump in the Austrian ATX by 35 percent (2011) and 61 percent (2008) as compared with the euro-converted world market index MSCI of –4 percent (2011) and –38 percent (2008)[1]. In future, the proportion of investment in shares traded on under-developed stock exchanges is lowered to at least 60 percent. Also to the benefit of clients will be the new disclosure rules for commission fees, administrative cost and the cost of waiver of premium before a contract is concluded. However, the obligation to provide information on the investment strategy and the advantages and disadvantages of the hedging instruments used may give rise to confusion.

Figure 2: Surplus on financial operations of life insurance companies



Source: Austrian Financial Market Supervisory Board, WIFO calculations.

[1] December averages year-on-year.

For life insurance companies, the financial returns from the investment of the premium reserve stock are, on the one hand, the source for the contingent investment return granted to their clients, and a key factor for business profitability, on the other (profit sharing). Insurers take a long-term perspective with an emphasis on fixed-interest-bearing securities, they should therefore earn comparatively stable returns on capital, allowing a smooth endowment of actuarial reserves. Yet, the increase in financial market volatility since 2001 has had repercussions on life insurers' accounts. The surplus on financial operations which over the two decades from 1980 to 2000 had increased steadily in most years has declined repeatedly since 2001, with annual variations now being much higher (Figure 2). Indeed, the standard deviation of growth rates jumped from 8.6 percent in the earlier period to 23 percent after 2001. The buffers to accommodate the volatility of the returns on capital are, on the one hand, financial reserves which in 2012 returned to an average level, and the earnings from current operations, on the other, which increased strongly, from € 194 million in 2011 to € 357 million in 2012, yielding an improvement in the return on equity from 7.1 percent in 2011 to 12.2 percent.

The marked increase in volatility of financial returns in the last years has complicated a steady endowment of actuarial reserves.

Private health insurance: increase in the number of claims unabated

Public health care policy in 2012 continued its efforts to provide public health services at lower cost. According to the OECD, Austria spent a total of 11 percent of GDP on health care in 2011, slightly less than Germany (11.6 percent) and Switzerland (11.4 percent), but significantly more than the OECD countries on average (9.6 percent of GDP). The bulk of expenditures in Austria (77.7 percent) was provided by public institutions, the rest by private complementary health insurance, out-of-pocket payments by insurants and other sources. The Health Target Control Act ("Gesundheits-Zielsteuerungsgesetz", BGBl. I Nr. 81/2013) provides for the elaboration of quarterly plans with targets for the public health service. The latter set a ceiling of 3.6 percent for the annual increase in public health care cost. This overall target is broken down to sub-targets at the Länder-level. Compliance with the targets is monitored; but non-compliance is just communicated in a report by the Federal Ministry of Health.

The shift from stationary towards ambulatory medical treatment is supposed to make the biggest contribution towards dampening the rise in health care cost. Relying on central inter-disciplinary admission and first-support centres shall keep medically not required ambulatory and stationary treatment away from hospitals. While the new Act has not addressed the lack of integration between financing and service provision, the social security agency as the main provider of financial resources is to be given a stronger say in health care management. Since the shift of service provision from hospitals towards small private health care centers will drive up the cost for the social security agency, it remains to be seen whether the improved co-ordination between the federal level, the Länder and the social security agency will be able to cope with the implicit incentive problems. An international comparison suggests that the mandatory deductibles for patients generally reduce health care cost per capita (*OECD*, 2011). For the time being Austrian health care policy nevertheless rules out a substantial increase in patients' contributions as an option for keeping health care costs in check.

The Health Target Control Act is supposed to shift the provision of certain health services from hospitals towards practice-based physicians.

Efforts undertaken so far to rein in cost pressure have been tentatively successful in 2012, as the total number of hospital stays of 2.486,106 was broadly flat year-on-year, while the number of days spent in hospital fell by 1.7 percent. Private health insurance did not benefit from this trend since the number of claims rose by 3.5 percent in 2012 as in the year before. Because premium revenues kept pace with rising claims, the claims ratio remained at the relatively low year-earlier level. The increase in premium revenues was driven by both volume and price effects: on the one hand, the number of insured risks went up by 1.5 percent, and prices were raised, on the other (Table 2). In 2012 the build up of reserves matched the one from the year before. Higher returns on capital gave rise to higher earnings from current operations (2012: € 99.3 million) and an increase in equity capital. Thus, the rate of return on equity in the health insurance branch of 29.1 percent remained broadly unchanged from the 28.9 percent recorded in 2011 (Table 4).

Both the number of hospital stays and the number of days spent in hospital declined in 2012. The number of claims in private health insurance nevertheless rose unabated.

Table 4: Private health insurance

	Premiums gross, adjusted	Claims payments	Claims ratio	Surplus on financial operations	Increase in actuarial reserves
	Million €		In percent	Million €	
2008	1,542	1,095	71.0	94	218
2009	1,599	1,115	69.8	123	259
2010	1,644	1,126	68.5	163	277
2011	1,704	1,145	67.2	143	305
2012	1,762	1,192	67.6	160	302
	Percentage changes from previous year				
2008	+ 3.5	+ 2.7	– 0.7	– 18.4	– 14.0
2009	+ 3.7	+ 1.8	– 1.8	+ 31.7	+ 19.0
2010	+ 2.8	+ 1.0	– 1.8	+ 32.2	+ 6.8
2011	+ 3.6	+ 1.7	– 1.8	– 12.3	+ 10.2
2012	+ 3.4	+ 4.0	+ 0.6	+ 12.0	– 1.2

Source: Austrian Financial Market Authority.

Positive actuarial result in non-life and accident insurance

Developments in the non-life and accident insurance in 2012 were characterised by a slight increase in the number of insured risks and an above-average rise in the number of claims. The spending restraint on part of private households and companies' hesitation to invest was most visible in a drop of car purchases by 4.7 percent. Against this background, the number of insured risks in motor vehicle insurance edged down by 0.8 percent. At the same time, liability claims went up by 4 percent on the back of a substantial increase in car accidents. More than half of this increase was accounted for by the region of Lower Austria and Vienna. The divergence in the trend of risks (+1.5 percent) and damage claims (+6.7 percent) was also observed in the non-life insurance. Significant deviations from this pattern occurred in the insurance of machinery and electrical appliances as well as in the insurance against business interruption caused by technical problems of machinery: in this area, the number of insured risks increased markedly, while damage claims hardly went up. Despite the sluggish growth of credit to private households (2012: +0.7 percent), credit insurance reported an above-average expansion of insured risks by 4.7 percent.

Deliberations on a comprehensive private insurance against natural desasters in Austria have been carried one step further by a resolution adopted by the Council of Ministers.

The implementation of a full-fledged insurance against natural desasters through private insurance took one step further in autumn 2012, when the Council of Ministers adopted an action plan for the adjustment to climate change. The plan foresees the introduction of a combined fire and natural desaster insurance that shall offer full coverage of damages caused by natural desasters. In this respect, the insurance industry aims for comprehensive coverage of risks deriving from floods, earthquakes, down to avalanches. Popular acceptance of such a combined policy may be higher than for separate contracts. A risk-adequate premium schedule and due consideration of precautionary measures in the design of the premium structure are necessary for raising acceptance with clients and for achieving the objectives of such an insurance (*Sinabell – Url*, 2006, 2008). The combined policy will probably be underpinned by a public guarantee for damages from extreme events, for which also EU funds can be made available, if needed. Likewise, the European Commission is considering insurance options for the coverage of damages from natural desasters and has circulated a draft Green Book on the subject for consultation (*European Commission*, 2013).

The increase in premium revenues in the non-life and accident insurance branch in 2012 was mainly driven by price increases.

Growth of premium revenues in the non-life and accident insurance branch decelerated markedly in 2012 (Table 5). The main reason was the decline in the number of insured risks in motor vehicle insurance and the sluggish increase in non-life insurance. On the other hand, both the consumer price index data (Table 2) and the average premium level for non-life insurance show that the industry was able to raise prices on a broad base in 2012. Due to the strong increase in claims payments, the claims ratio converged towards its long-term average. The comparatively low build-up of actuarial reserves enabled the insurance sector to achieve a balanced operating result in 2012. Given the low returns on new investment, a successful technical result is a key requirement for operational business viability. Thanks to an increase in financial earnings, the earnings from current operations rose to a total € 938.2 million in 2012; the rate of return on equity climbed from 9.8 percent in 2011 to 10.7 percent.

Table 5: Non-life and accident insurance

	Premiums gross, adjusted	Surplus on financial operations	Claims payments	Increase in actuarial reserves
	Million €			
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
2012	10,493	1,046	7,086	12
	Percentage changes from previous year			
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
2012	+ 2.1	+ 16.2	+ 5.9	− 60.4

Source: Austrian Financial Market Authority.

Decline in financial earnings squeezes insurers' return on investment

The interest rate scenario in the EU in 2012 was once again characterised by efforts of the European Central Bank (ECB) to ensure a smooth supply of liquidity for all financial institutions. By way of a further cyclical stimulus, the ECB in July cut its main refinancing rate by 25 basis points to 0.75 percent. Money market rates for maturities up to one year have already before been regularly below the ECB policy rate, such that short-term investments yielded only minimal returns in 2012. The situation is unlikely to change in 2013, since the ECB last May proceeded to a further cut of the main refinancing rate by 25 basis points and does not envisage a change in its policy stance in the current outlook.

Low market interest rates during the last years induced the Financial Market Supervisory Board in 2012 to lower the interest rate ceiling for life insurance contracts from 2 percent to 1.75 percent.

During 2012, the extremely high risk premia on government bonds of euro-area periphery countries moderated. The ECB policy of direct purchases of securities produced first positive results. The flight towards secure financial assets continued nevertheless; the market rate on German federal government bonds with a maturity of ten years fell to a low of 1.3 percent in December. While the convergence of interest rates to the low German level implies capital gains for investors, it seriously complicates the task of life insurers in their search for profitable and low-risk investment opportunities that allow them to achieve the minimum return guaranteed by insurance contracts. The Financial Market Authority therefore decided in autumn 2012 to lower the interest rate ceiling for the calculation of premium scales and actuarial reserves in life insurance contracts from 2 percent to 1.75 percent (BGBl II Nr. 354/2012). The lower rate has become binding for contracts concluded as from 21 December 2012.

Stock markets in 2012 made up for part of their losses incurred in previous years. The MSCI world market index gained 17.2 percent on a euro basis (end-2012), the more volatile Vienna ATX even 28.5 percent[2]. The gains on the Vienna market are relevant for the investment for the state aided old-age insurance, since Vienna figures among under-capitalised stock exchanges.

[2] December average compared with one year earlier.

Gains on the stock market and higher valuations of government bonds from euro area periphery countries in 2012 were not sufficient for a further increase in life insurance companies' earnings from their financial assets and interest. The yield on insurers' investments was higher than in the year before (Table 6), since the outlays for capital gains and interest fell by more than half. Asset price losses, which are also included under this item, could by and large be avoided in 2012. Due to the long-term investment strategy of the insurance industry with a portfolio combining old and new securities, the average return on capital invested performs much more smoothly than the market interest rate. The gap vis-à-vis the market interest rate on federal government bonds thereby widened to nearly 3 percentage points in 2012. Over the years to come, the persistently low yield on fixed-rate bonds is likely to weigh on insurance companies' return on investment.

The decline in government bond yields in 2012 allowed write-offs on investment in fixed-rate government bonds to be markedly lower than in 2011.

Table 6: Insurers' return on invested capital

	Yield on government bonds	Life insurance	Health insurance	Non-life and accident insurance
	Rate of return in percent			
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
2012	1.5	4.3	3.5	4.5

Source: Austrian Financial Market Authority. WIFO calculations.

Life Insurance Business Continues to Suffer from Low Interest Rates – Summary

The western European private insurance market continued to suffer during 2012 from the repercussions of the financial market and sovereign debt crisis. The life insurance branch saw premium volumes decline, while non-life insurance business contracted in the EU periphery countries. Even in countries less affected by the sovereign debt crisis, higher premium revenues were mainly driven by price increases. The Austrian market exhibited by and large the same pattern. Life insurers lost 6.5 percent in premium revenues from the previous year, against an increase of 2.1 percent in the property and accident insurance. With a 3.4 percent plus in premium receipts, private health insurance was the only branch to stay resilient and even raised the number of insured risks by 1.5 percent. Premium revenues overall edged down by 0.9 percent year-on-year, further lowering insurance penetration to 5.3 percent of GDP. Premium revenues in 2013 are expected to stagnate (+0.2 percent). In 2012 Austria's internationally operating insurance companies were able to compensate losses on the domestic market by further expanding in central, eastern and south-eastern Europe.

Prices for insurance services included in the Austrian consumer price index increased by an average 2.3 percent in 2012, with the strongest inflation recorded for motor third party, household property and owner-occupied home insurance. The trend increase is confirmed by the average-premium-per-risk indicator which also accounts for premium discounts. The loss ratio in property insurance was close to its long-term average in 2012, exerting little upward pressure on prices for current operations in 2013.

On the basis of a small increase in the number of insured risks in indemnity insurance and higher prices, insurance companies not only succeeded in raising sales revenues, but also achieved a balanced result in the technical account. This is vital for the further viability of insurance companies, given the low returns on assets. The yield on invested insurance capital rose to 4.3 percent (life insurance) and 4.5 percent (non-life insurance) in 2012, mainly owing to lower depreciation rates for securities.

References

European Commission, Grünbuch Versicherung gegen Naturkatastrophen und von Menschen verursachte Katastrophen, COM(2013)213 final, Brussels, 2013, http://www.parlament.gv.at/PAKT/EU/XXIV/EU/11/17/EU_111745/imfname_10399763.pdf.

FMA, Jahresbericht der Finanzmarktaufsichtsbehörde 2012, Vienna, 2013.

Focht, U., Richter, A., Schiller, J., "Intermediation and (Mis-)Matching in Insurance Markets – Who Should Pay the Insurance Broker?", Journal of Risk and Insurance, 2013, 80(2), pp. 329-350.

OECD, Health at a Glance 2011, Paris, 2011.

Palten, E., "OGH: Aktuelle Entscheidungen – und 7 Ob 216/11g im Licht des VersRÄG 2012", Versicherungsrundschau, 2013, (6), p. 21.

Sinabell, F., Url, T., Versicherungen als effizientes Mittel zur Risikotragung von Naturgefahren, WIFO, Vienna, 2006, http://www.wifo.ac.at/wwa/pubid/28181.

Sinabell, F., Url, Th., Flood Risk Exposure in Austria – Options for Bearing Risk Efficiently", Schmollers Jahrbuch, 2008, 128(4), pp. 593-614.

Swiss Re, "World Insurance in 2012", Sigma, 2013, (3).

Url, T., "Auswirkung der Offenlegung von Vergütungen für die Versicherungsvermittlung", in Gisch, E., Kronsteiner, F., Riedlsperger, G., "Versicherungsvermittlung in Österreich", Neuer Wissenschaftlicher Verlag, 2013, pp. 151-169.