Media Release

22 October 2021

MFSA Develops the First Domestic Insurance Stress Test Framework

The Malta Financial Services Authority has developed a Domestic Insurance Stress Test framework, which is the first comprehensive exercise of its kind to assess the resilience of the domestic insurance sector should there be an adverse scenario.

The scenario chosen for this stress test was a protracted period of extremely low interest rates, which could lead to a deterioration in corporate bond yields and equity prices, affecting the insurance companies' investments – and ultimately balance sheets.

The framework was developed by the Financial Stability function at the MFSA and is one of several risk assessment techniques that take a macroprudential view.

Stress tests are widely recognised as being an effective way to measure the resilience to severe but plausible events. Within the financial sector, this technique has gained prominence as a risk management tool. Also, as a financial sector supervisory tool, it is considered useful to identify pockets of vulnerabilities and is increasingly being used in addition to the more conventional risk analysis techniques.

Stress test results should not be strictly interpreted in terms of institutions passing or failing, but rather to highlight possible sectoral vulnerabilities that could emerge, should such adverse movements on the financial market materialise in the future.

The test covered a mix of life, non-life and composite insurance undertakings that operate predominantly in the domestic insurance market and information was sourced from data available at the MFSA.

The exercise assumes that no immediate adjustments were made through management interventions, and the institutions are assessed on a stand-alone basis, that is, without allowing for any support within a group structure, including a parent company.

Looking forward, the methodology could serve as a guide to the industry to understand better the way the Authority is analysing sectoral risks from a financial stability perspective. Possible enhancements include further development of the methodology, primarily to enhance the process used in generating the stressed scenarios, and secondly to capture changes arising in the solvency capital requirements.

Triq l-Imdina, Zone 1 Central Business District, Birkirkara CBD 1010
+356 2144 1155
communications@mfsa.mt
www.mfsa.mt

RESULTS

The exercise showed that domestic insurance undertakings, under the post-stress scenario, would incur an overall 7 percentage point drop in their assets-over-liabilities ratio in comparison with the baseline scenario. The post-stress ratio of 108% is derived from a -1.7% drop in assets and a 4.9% increase in liabilities.

This analysis confirms that apart from a surge in liabilities, the positive impact arising on bond prices does not completely offset the decline experienced by the other asset classes, such as equities and Collective Investment Undertakings.

About MFSA

@ MFSA Develops the First Domestic Insurance Stress Test Framework