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Research

Nordic Insurers: Property/Casualty Earnings Stay Strong, While Life Insurers Are In Transition

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Much like Europe's insurance industry overall, Nordic insurers face some tough challenges these days. Among them are prevailing low interest rates and the evolving regulatory landscape. These conditions are raising a host of questions, such as: What measures are Nordic insurers taking to cope with the prevailing low-yield investments? In particular, how are life insurers managing their "back-book" guarantees (that is, the rates of returns they have promised to policyholders)? Are insurers able to maintain healthy profitability amid current low interest rates? How have market dynamics evolved? What are the potential implications on the ratings S&P Global Ratings has on Nordic insurers?

Property/casualty (P/C) and life insurers across the Nordic region of Denmark, Finland, Norway, Sweden, and Iceland continue to ponder such questions. Nevertheless, S&P Global Ratings sees some differences in the underlying economies, financial systems, and insurance industries of each country that define the operating challenges for both life and P/C insurers in the region at least over the next two to three years. Here, our analysts analyze and compare the Nordic insurance sector's strengths and weaknesses, with a focus on the potential implications on our ratings on Nordic insurers.

Overview

- We expect Nordic life insurers will continue to focus on shifting their product portfolio, while the P/C sector sustains its very strong focus on underwriting profitability.
- Life insurers continue to manage a material back book of guaranteed business with different degrees of asset-liability mismatches.
- We believe our rated insurers are well positioned to cope with prevailing low yields and regulatory requirements, particularly P/C insurers, which have earnings power and solid capitalization based on our capital model and Solvency II.

Our insurance industry and country risk assessments (IICRAs) for the Nordic countries have much in common with each other. For example, we see country risk as low or very low in Denmark, Finland, Norway, and Sweden, and this is a key strength in our analyses. Because of Iceland's volatile and concentrated domestic economy, we assess country risk as moderate.

In our view, the Nordic life insurance sectors display greater risk than the P/C sectors. In particular, we view product risk as higher for life insurers than for their P/C counterparts, due to the low interest rates and material share of guaranteed business in insurers' back books, with in-force minimum guarantees ranging between 2.5% and 3.5% on average in the Nordics. This leads us to see weaker profitability prospects for the life insurance sectors compared with the strong profitability we generally see in the P/C insurance sectors. Nonetheless, we believe that our rated Nordic life insurers have successfully implemented measures to reduce the guarantees steadily over time and to shift to capital-light products (e.g. unit-linked products).

Apart from Iceland, our IICRAs for the Nordic P/C sectors are low risk, while the life sectors carry intermediate risk. At present, only two insurance sectors globally have the strongest IICRA possible: Switzerland's P/C insurance sector and Canada's life insurance sector.

Table 1

Nordic Insurance Industry And Country Risk Assessments

Country/Sector	IICRA*	Country Risk	Industry Risk
Property/Casualty			
Denmark	Low risk	Very low risk	Low risk
Finland	Low risk	Low risk	Low risk
Iceland	Moderate risk	Intermediate risk	Moderate risk
Norway	Low risk	Very low risk	Low risk
Sweden	Low risk	Very low risk	Low risk
Life			
Denmark	Intermediate risk	Very low risk	Intermediate risk
Finland	Intermediate risk	Low risk	Intermediate risk
Norway	Intermediate risk	Very low risk	Intermediate risk
Sweden	Intermediate risk	Very low risk	Intermediate risk

Note: Data as of Nov 22, 2017. *Our IICRA results from combining the country risk and industry risk scores. The risk categories range from "very low," "low," and "intermediate," to "moderate," "high," and "very high."

Nordic Insurers Are Mostly Coping Well With Solvency II Requirements

Before Solvency II came into effect on Jan. 1, 2016, as well as during 2016, insurers were focusing on Pillar 1 (quantitative requirements, including the amount of capital an insurer should hold) and Pillar 2 (requirements for governance and risk management, as well as for the effective supervision of insurers). During 2017, Pillar 3 (reporting and disclosures) has been a main theme for insurers, largely due to the extensive reporting required by mid-May for solo insurers and early July for insurance groups. The reporting was both qualitative through the Solvency and Financial Condition Report (SFCR) and the Regular Supervisory Report (RSR), and quantitative through the Quantitative Reporting Templates (QRT). During 2017, European Insurance and Occupational Pensions Authority (EIOPA) released two public consultation papers for the review of the SCR Standard Formula, a review of the interest rate risk module, potentially having the scope for the most material impact on solvency ratios for life insurers.

We think the SFCRs have increased transparency about the impact of transitional measures and long-term guarantee measures such as the matching and volatility adjustments. Overall, SFCRs are a large step forward compared with Solvency I disclosures. However, despite the SFCRs' additional disclosures, a direct comparison of insurers' solvency position and financial strength within the same or between different markets is not straightforward, because of, for example, the use of (partial) internal models, the modeling of management rules, diverging use of transitional measures, and the risk-mitigating effect of technical provisions and deferred taxes.

For its part, S&P Global Ratings continues to use its risk-based insurance capital model as our main tool for assessing insurers' capital adequacy for rating purposes. This partly reflects our need to use a global tool to assess capital adequacy to ensure consistency and comparability worldwide. However, we will also use the output and insights from the Solvency II capital position in our rating analysis.

According to European Insurance and Occupational Pensions Authority (EIOPA) statistics, Nordic insurance companies have Solvency Capital Requirement (SCR) ratios in line with the European average, and in general the Nordic insurers' regulatory capitalization shows healthy solvency ratios above the requirement of 100%.

Overall, we view Nordic insurers as well positioned for the requirements of Solvency II, also regarding governance, risk management, and disclosures. One reason for this is that Nordic regulators have long used risk-based solvency models as supervisory tools, starting with Denmark's Finanstilsynet, which introduced such tools in 2001.

Since then, we have seen our rated companies in the Nordics develop their use of regulatory solvency models and internal models to manage their business and risk profiles. We believe this experience has supported the adoption of Solvency II.

We also believe the institutional framework plays an important role in a country's preparedness for implementing new regulation. We consider this framework strong in Denmark and Sweden, moderately strong in Finland and Norway, and intermediate in Iceland. We view these frameworks as well-established and supportive of the insurance sectors' stability.

High Entry Barriers Are A Key Advantage For Local Nordic Players

We expect operational barriers for entrants to Nordic insurance markets will remain high and discourage foreign competitors. This is a key advantage for Nordic insurers. We see their high cost efficiency, distribution setup and knowledge, and brands as the main safeguards against outside competition. The operational barriers are somewhat lower in Iceland, where using an intermediary would enable a non-Nordic insurer access, especially in the marine hull insurance sector.

Market concentration remains high in all Nordic countries, which also strengthens the barriers to entry. Though still high, the least concentrated market is Denmark where the five largest companies gather 54% of premiums. The most concentrated is Finland where the three largest companies pull in 77%. In P/C, five companies together hold a 62% market share in Denmark, and three hold more than 80% in both Finland and Iceland. Most insurers are domestic companies, but pan-Nordic insurers are also among the regional market leaders.

That said, market dynamic trends vary within the Nordics. For example, in the Norwegian P/C market, smaller insurers have shown a steady and gradual increase in market share to 30% in 2016 from 8% in 2004. These smaller insurers are mainly Norwegian companies, and many of them are well-known entities with operations in other financial services segments. In our view, this shows the need for a strong brand and the benefit of leveraging on an existing customer base and distribution channels from other financial services segments to gain market share.

In Denmark, we see similar but less pronounced trends, with the market share for the three largest P/C insurers decreasing to 46% in 2016 from 53% in 2008. We expect competition will continue, potentially affecting pricing and changing market dynamics.

Chart 2

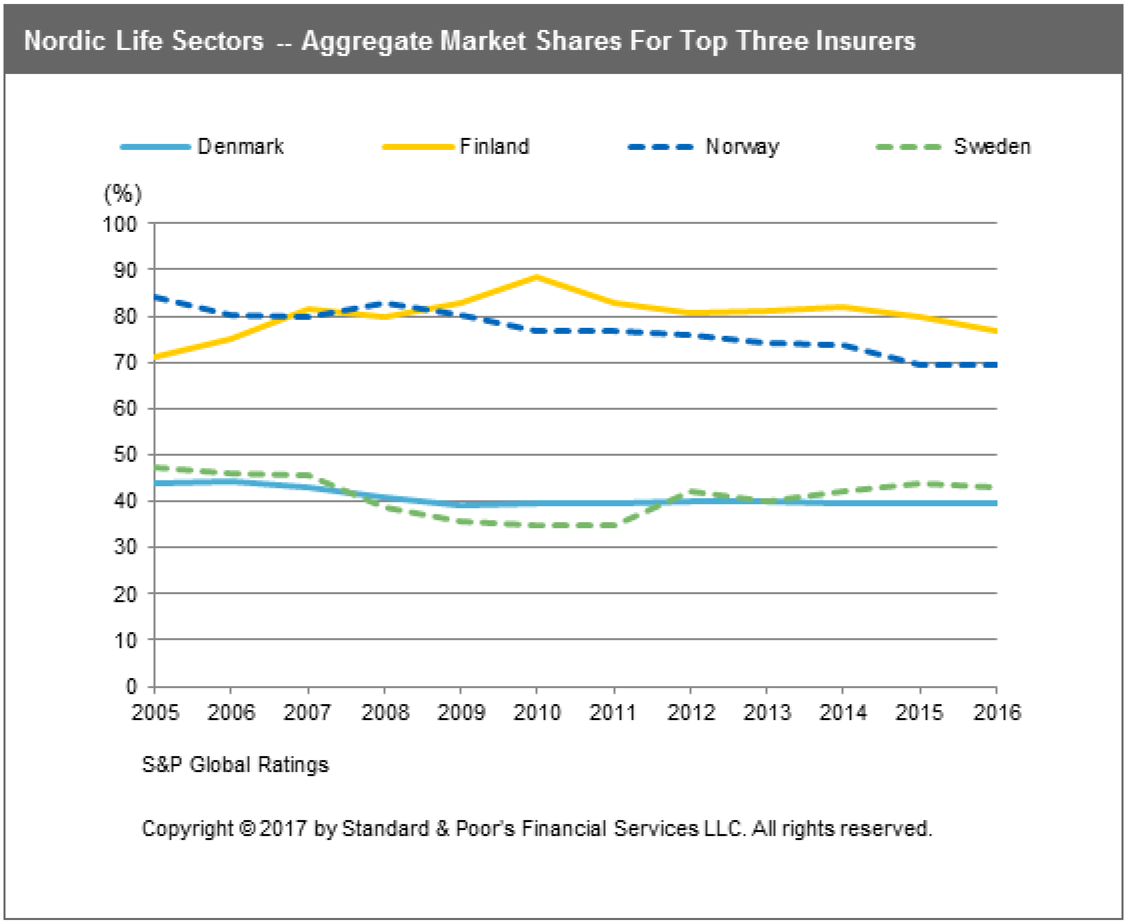
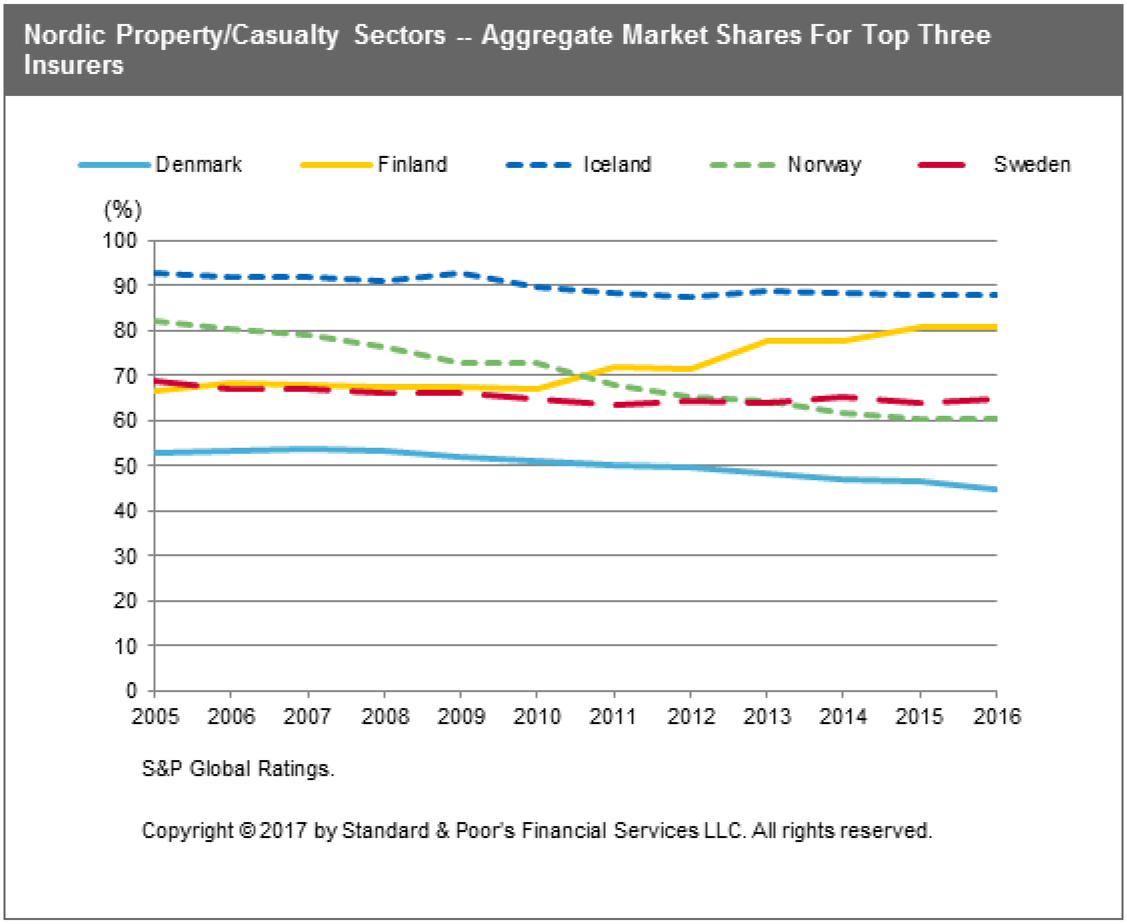


Chart 1



In the P/C insurance sectors, cost efficiency remains high in the Nordics, as indicated by the low average market expense ratios of 17%-20%. This adds to the difficulty for outsiders to enter Nordic markets.

The typical Nordic insurer's distribution setup is well developed and stable. Nordic insurers sell most of their products through their own sales teams, affiliated groups, trade unions, business partners, and banks. Broker distribution, an important channel in other parts of the world, plays a comparably small role in the Nordics, apart from distribution of corporate P/C, life, and pension insurance in particular. Therefore, gaining a foothold in the market would be tough for a nondomestic insurer without first building up distribution relationships.

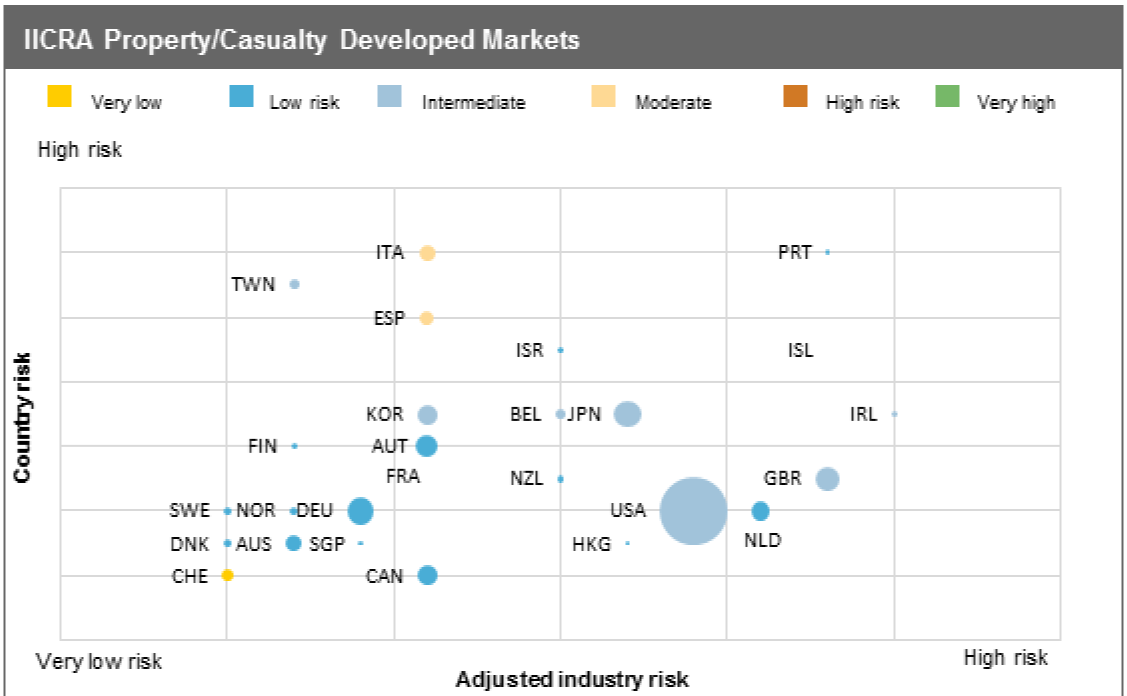
We do not expect big changes in the overall Nordic market composition over the next two to three years. However, as seen in some countries, we believe the trend of increased fragmentation could continue.

P/C: Generally Strong, Backed By Underwriting Discipline

Overall, we continue to view the Nordic P/C insurance sectors as less risky than many other European P/C insurance sectors. Most of the larger Nordic players focus on profitability rather than growth, and we expect them to continue doing so in 2017-2019. Smaller P/C insurers, often domestic, have gained some market share in recent years, not the least in Norway and Denmark. This could put some pressure on pricing, but in the short term we do not foresee any material impact due to the high market concentration. Partly offsetting the positives are moderate exposure to natural catastrophes and some long-tailed products such as workers' compensation insurance and motor third-party liability (MTPL) insurance.

Our IICRAs for the P/C insurance sectors in Denmark, Finland, Norway, and Sweden are low risk (see chart 3). The only European P/C insurance sector we consider stronger is that in Switzerland, where we see an even steadier economy and a partially stronger institutional framework.

Chart 3



Source: S&P Global Ratings. Bubble size represents sector premium volume.

Healthy overall profits are set to continue

Profitability remains strong in Denmark, Norway, and Sweden, with the five-year average return on equity (ROE) at 13%-23%, benefiting from strong underwriting margins. Companies focus on profitability, mainly through cost efficiency, enhanced risk selection, and price increases in business lines where claims are increasing.

With low yields pushing investment income downward, we believe insurers have narrowed their focus even further on improving underwriting results. This is evident in the five-year average net combined ratios over 2012-2016 in these countries, which are well below 95%. (The combined ratio is the industry's main profitability metric: 100% denotes breakeven, and below 100% the insurer is making an underwriting profit.) These compare favorably with the corresponding net combined ratios in Germany, France, and the U.K. That said, the Swiss P/C combined ratio is very strong, with a five-year average over 2012-2016 at 88%.

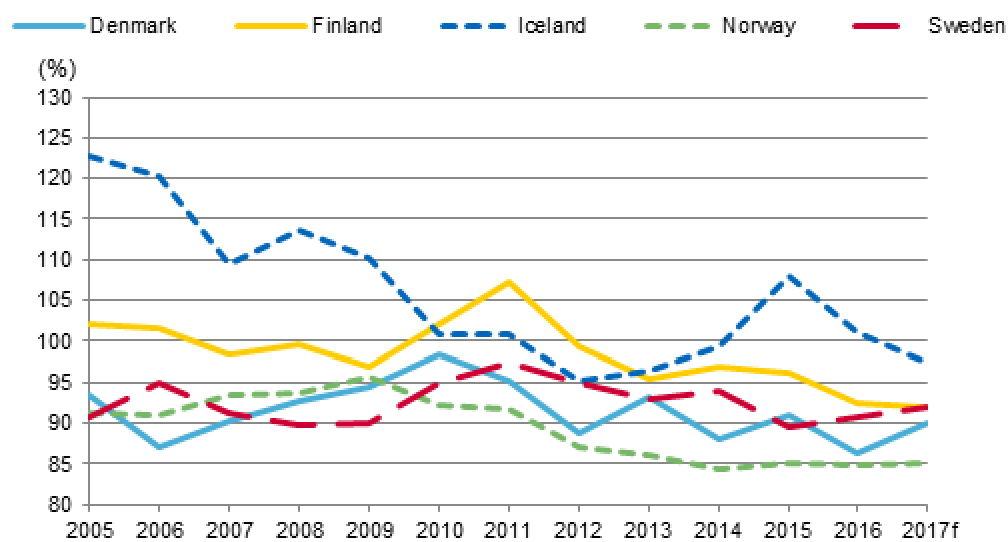
We also believe the strong 10-year average net combined ratios of 89% in Norway, 92% in Denmark, and 93% in Sweden point to highly disciplined markets where P/C insurers have been managed with profitability in mind for a long period, even in times when investment income was significantly stronger.

Underwriting results in Finland have particularly caught up to the results in the other Nordic countries, with a combined ratio of 92% in 2016 versus a five-year average of 96%.

In Iceland, the five-year average net combined ratio is 99%, according to our estimate. Since 2010, insurers have increasingly focused on underwriting profitability, on the back of a reduction in investment income. During the winter of 2014-2015 and into the spring, Iceland was hit with numerous storms that caused a big jump in claim frequency, which resulted in a market combined ratio of 108% for 2015. However, this has prompted Icelandic insurance companies to raise prices, likely leading to some further recovery in underwriting results in 2017-2018.

Chart 4

Nordic Insurance Industry Net Combined Ratios



f--Forecast. Sources: The Financial Supervisory Authority, Iceland; Financial Supervisory Authority, Finland; Federation of Finnish Financial Services; Finance Norway; Insurance Sweden; and the Danish Financial Supervisory Authority.

In our view, average loss ratios for Nordic countries are comparable to those of many other European countries.

However, with low average market expense ratios of 17%-20% in the Nordics, the combined ratios are lower than for most other European countries. In our view, lower distribution costs, significant technology usage, and locally focused company setups help keep expense ratios lower than those of many other European insurers. The low expense ratios are, in our view, a rating strength of the Nordic insurance industry in that they protect profit margins.

P/C appears less susceptible to major natural catastrophes

Overall, we consider exposure to natural disasters moderate in Denmark, Norway, and Sweden. Helped by benign claims from such events as storms, flooding, or landslides, the P/C insurance sectors in these countries have remained very profitable over the past five years. Countrywide risk pooling in Norway and comprehensive reinsurance programs lessen the impact of natural catastrophes on insurers' earnings, in our view.

Although Iceland can experience earthquakes, volcanic eruptions, and mudslides, among other natural disasters, these are covered by the Icelandic Catastrophe Fund, Vidlagatrygging, a public corporation functioning as an insurance company. In addition, all residential and commercial properties in Iceland are insured against natural disasters through obligatory fire insurance.

The risk of natural catastrophes in Finland is low, in our view. The impact from weather-related events is less prominent than in other Nordic countries, which we view positively in our assessment of product-related risks in Finland.

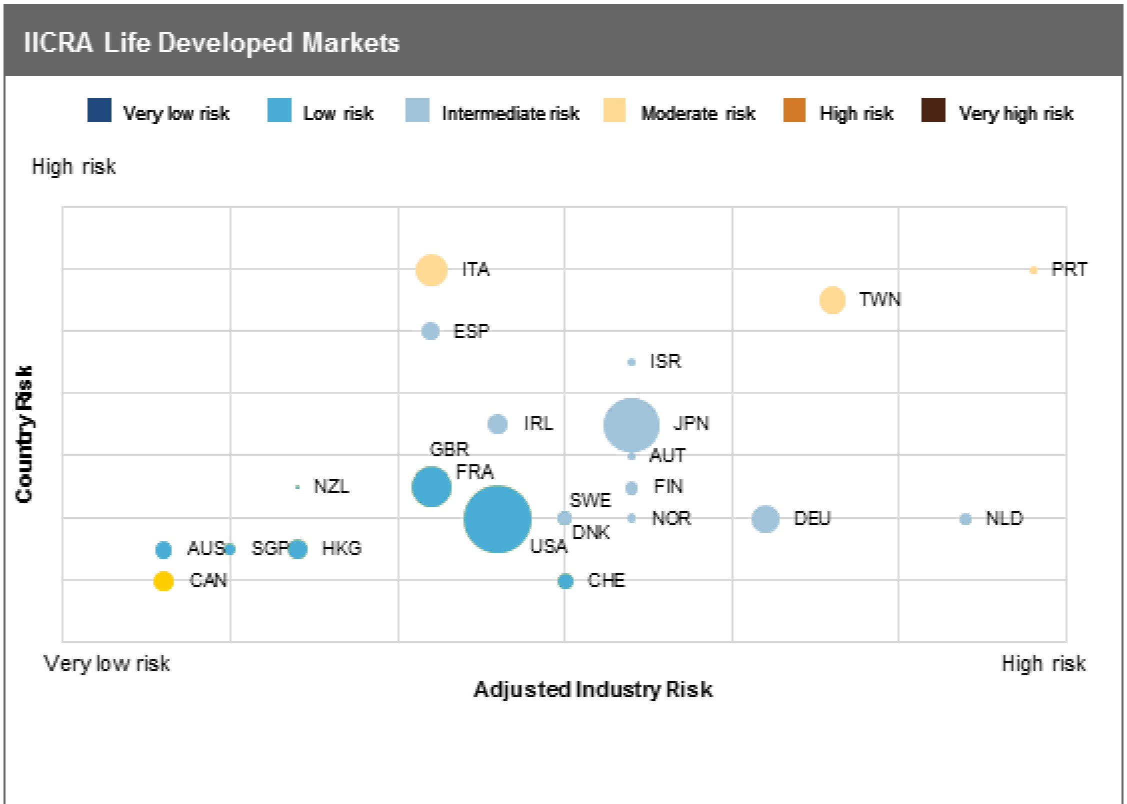
Insurers also face moderate exposure to long-tailed business. This exposure varies across the Nordic countries and relates mainly to workers' compensation and MTPL-related claims. Workers' compensation liabilities are particularly long-tailed in Finland, followed by Denmark and Norway. MTPL-related liabilities have in general the longest duration in Finland and Sweden.

Life: Managing The Back Book And Guaranteed Portfolio By Moving To Capital-Light Products

In our view, the life insurance sectors in Denmark, Finland, Norway, and Sweden carry higher risk than the corresponding P/C insurance sectors. The main reason is the mismatch between the amount and terms of insurers' assets and their long-term life insurance liabilities in combination with relatively high guarantees on in-force life insurance contracts. However, most of the region's life insurers have taken measures over the past decade to reduce risk in their product portfolios. These include a general shift of new business toward unit-linked products without guarantees or to products with different types of lower guarantees, the built-up of specific reserve buffers, or the transfer of parts of the guaranteed rate in-force books into capital-light products.

If interest rates remain low for a longer period, in combination with a sharp fall in investment asset values, the challenges for life insurers would increase and become more concrete because the Nordic life insurance sectors display a relative high exposure to equity (or other high-risk assets). Other European life insurance sectors that face high guarantees in their back book are Austria, Germany, and The Netherlands. We assess their IICRA also as intermediate risk (see chart 6).

Chart 5



Source: S&P Global Ratings. Bubble size represents sector premium volume.

Guarantees abate slowly following shift in product portfolio

Life insurance and pension policies vary, but the guaranteed interest rate on in-force policies averages 2.5%-3.5% in the Nordics. Despite insurers' measures to shift the product portfolio, it will take time until the guarantees in the back books abate and the guaranteed business no longer dominate many companies' risk profiles. Therefore, asset-liability management risk is still high, in our view, and we believe it will take years before the pressure on earnings and capital adequacy dissipates.

The degree of asset-liability mismatch differs by country. In our opinion, long-term bonds are more available in Denmark than in other Nordic countries, and Danish life insurers actively hedge interest rate risk. Nevertheless, reinvestment risk is heightened amid current low interest rates.

Finland's debt market is considerably smaller than the other Nordic markets, and Finnish life insurers hedge interest rate risk to a lower degree. In addition, they have a high proportion of equities in their investment portfolios, making their investment returns prone to volatility. According to our estimates, equities make up about 28% of the assets backing Finnish life insurance business with guarantees.

Life insurers' equity holdings in Sweden are even higher at about 50% (including property investments through subsidiaries), but they're substantially lower in Denmark (about 25%) and Norway (about 15%). Still, this is high in a European context, for example, compared with the German life insurance market.

Recently, many life insurers have continued to change their asset allocation to compensate for lower bond yields by increasing credit risk and investments in illiquid assets. These companies are showing an increased appetite for investments in real estate, infrastructure, private equity, and hedge funds. We believe this trend could continue over the next two years since we expect interest rates to remain low.

Lower profitability in life than in P/C

Profitability as measured by return on equity (ROE) is a neutral factor for our life IICRAs in all four Nordic countries. The five-year average ROE is about 11% across the region and considerably lower than the strong ROE of 13%-23% in the P/C insurance sectors. We expect low interest rates will continue to squeeze life insurers' profitability, and we forecast ROE will be below 10% in each of the four Nordic life insurance sectors we cover over the next two years. Companies' bottom-line earnings fluctuate, largely because of asset-liability mismatches and a relatively high proportion of equity investments. In addition, all companies in Denmark and Sweden use a market-value approach to report assets and liabilities, which makes both their earnings and balance sheets more volatile than in other jurisdictions.

Our Ratings For Nordic Insurers Are Mostly Stable Or Selectively On Positive Outlook

Our Nordic insurance ratings are on average in the 'A' to 'A-' range (see table 2) reflecting our favorable view of the companies' continued strategies to cope with prevailing low yields and regulatory requirements. Most rated players benefit from a strong franchise and healthy competitive position, which enable them to achieve resilient earnings. Furthermore, our rated Nordic insurers also show solid capital adequacy, for many P/C focused insurers in the extremely strong ('AAA') range, according to our capital model.

Table 2

Current S&P Global Ratings' Nordic Insurance Ratings

Company	Rating	Outlook	BRP	FRP	Capital Adequacy	Risk Position	Solvency II ratio (%)
Assuranceforeningen Gard – gjensidig*	A+	Stable	N/A	N/A	N/A	N/A	197
Assuranceforeningen SKULD (Gjensidig)	A	Stable	Strong	Strong	Very Strong	Intermediate Risk	133
Codan *	A	Stable	N/A	N/A	N/A	N/A	215
Danica Pension *	A	Stable	N/A	N/A	N/A	N/A	240
Forsakringsaktiebolaget Alandia	BBB+	Positive	Satisfactory	Moderately Strong	Extremely Strong	Moderate Risk	240
Garantia	A-	Stable	Satisfactory	Strong	Extremely Strong	Intermediate Risk	435
Gjensidige	A	Stable	Strong	Moderately Strong	Strong	Moderate Risk	147
If P&C *	A+	Stable	N/A	N/A	N/A	N/A	197

Table 2

Current S&P Global Ratings' Nordic Insurance Ratings (cont.)

Company	Rating	Outlook	BRP	FRP	Capital Adequacy	Risk Position	Solvency II ratio (%)
Kommunal Landspensjonskasse	A-	Stable	Strong	Moderately Strong	Upper Adquate	Intermediate Risk	209
Länsförsäkringar	A	Stable	Strong	Very Strong	Extremely Strong	Moderate Risk	236 §
Norwegian Hull Club	A	Stable	Strong	Very Strong	Extremely Strong	Intermediate Risk	218
OP Insurance Ltd. (former Pohjola Non-life Insurance) *	A+	Stable	N/A	N/A	N/A	N/A	127
PRI Pensiongaranti	A	Stable	Strong	Strong	Extremely Strong	Moderate Risk	547
Sampo Group	A+	Stable	Very Strong	Strong	Extremely Strong	Moderate Risk	154
Sirius International Insurance Corp.	A-	Stable	Strong	Strong	Extremely Strong	High Risk	235
Statoil Forsikring AS *	A	Stable	N/A	N/A	N/A	N/A	219
Storebrand Liv	BBB+	Positive	Strong	Lower Adequate	Moderately Strong	Moderate Risk	200
Sveriges Angfartygs Assurans Forening (The Swedish Club)	BBB+	Stable	Satisfactory	Moderately Strong	Extremely Strong	Moderate Risk	182
Telia Forsakring AB *	A-	Negative †	N/A	N/A	N/A	N/A	286

*Rating and outlook based on group rating methodology and derived from parent company. §Solvency Ratio for the LF Alliance P/C insurance operations. BRP--Business risk profile. FRP--Financial risk profile. N/A--Not applicable. Sources: S&P Global Ratings, Annual reports, SFCRs of the companies.

Related Criteria And Research

Related Criteria

- Insurers: Rating Methodology, May 7, 2013

Related Research

- Denmark’s Life Insurance Sector Carries An Intermediate Industry And Country Risk Assessment, May 22, 2017
- Denmark’s Property/Casualty Insurance Sector Carries A Low Industry And Country Risk Assessment, May 22, 2017
- Finland’s Property/Casualty Insurance Sector Carries A Low Industry And Country Risk Assessment, June 13, 2017
- Finland Life Insurance Sector Carries An Intermediate Industry And Country Risk Assessment, June 16, 2017
- Norwegian Life Insurance Sector Industry And Country Risk Assessment Revised To Intermediate, Nov. 28, 2016
- Norwegian Property/Casualty Insurance Sector Carries A Low Industry And Country Risk Assessment, Dec. 16, 2016
- Iceland Property/Casualty Insurance Sector Carries A Moderate Industry And Country Risk Assessment, Dec. 21, 2016
- Swedish Life Insurance Sector Industry And Country Risk Assessment Revised To Intermediate, Nov. 20, 2017
- Sweden’s Property/Casualty Insurance Sector Carries A Low Industry And Country Risk Assessment, Nov. 20, 2017

Only a rating committee may determine a rating action and this report does not constitute a rating action.

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