



Fitch: Interest Rate Uncertainty Today, Likely Beneficial for Insurers Tomorrow

14 Jun 2011 5:00 AM (EDT) Fitch Ratings-London-14 June 2011: Fitch Ratings says in a new report that gradually rising interest rates, the agency's primary expectation for the coming years in key insurance markets, would generally be a favourable scenario for insurers. Interest rate levels and future movements are a high profile issue in today's economy and can have a material effect on insurers' financial strength. Notwithstanding the agency's primary expectations, alternative scenarios of a sharp rise in interest rates or protracted reduction in bond yields could have a significantly detrimental impact on certain insurance firms. In addition, Fitch notes that current accounting and regulatory frameworks can at times impede transparency and the understanding of interest rate risks.

In the report, the agency notes that interest rate risk is important for insurers, especially life insurers, given their long-term assets and liabilities as well as products which often have interest-sensitive features. Rising rates allow firms to earn more from their interest bearing assets and often aid margins on new business. However, although the specific exposures and sensitivities of insurers differ globally according to the product features offered, very low or rapidly rising interest rates have the potential to cause some insurers difficulties.

Fitch's key concerns about interest rates include insurers taking excessive credit risk to compensate for low yielding assets, taking positions as to future interest rate (or yield curve) movements in excess of their ability to bear that risk or maintaining concentrations in certain interest rate sensitive assets or liabilities, especially where these risks are not effectively mitigated.

The agency views interest rate risk as generally being well managed, although notes that there are limitations to what asset-liability management can achieve. These limitations include difficulties in modelling policyholder behaviour as well as matching assets to liabilities on very long-term insurance contracts.

Whilst market participants are understandably keen to monitor interest rate risk, especially for certain insurers, the agency notes that understanding and transparency can sometimes be impeded by accounting and regulatory treatments. Such treatments often differ significantly between countries, between insurers and in some cases can also depart substantially from the economic impact of the interest rate change.

The report "Insurer Interest Rate Scenarios: Uncertainty Today, Likely Beneficial Tomorrow " is available on Fitch's website www.fitchratings.com.

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