Did Insurers Become Risk-Loving During “Low-for-Long” The Role of Returns, Ratings, and Regulation

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European life insurance companies are important bond investors and had traditionally played a stabilizing role in financial markets by pursuing “buy-and-hold” investment strategies. However, since the onset of the ultra-low interest rates era in 2008, observers noted a decline in the credit quality of insurers’ bond portfolios. The commonly-held explanation for this deterioration is that low returns pushed insurers to become more risk-taking. We argue that other factors—such as surging rating downgrades, bond revaluations, and regulatory changes—also played a key role. We estimate that rating changes, revaluations, and search for yield each account for about one-third each of the total deterioration in credit quality. This result has important policy implications as it reestablishes the view that insurers’ investment behavior tends to be passive through the cycle—rather than risk-seeking.

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