

20 NOVEMBER 2025 · RESEARCH BULLETIN NO. 137

The complex linkages between euro area insurers and sovereign bond markets

by [Stefano Corradin](#), [Alessandro Fontana](#), [Christian Kubitza](#) and [Angela Maddaloni](#)^[1]

The balance sheets of euro area insurers have become less liquid and more sensitive to market conditions. However, insurers still rely heavily on holdings of sovereign bonds – particularly domestic ones – and tend to sell these assets to fund large claims after natural disasters. Capital markets union would promote diversified bond portfolios and likely mitigate these effects.

Sleeping giants between a rock and a hard place

Euro area insurers are among the largest institutional investors in the financial system. Managing several trillion euro in assets, their total assets amount to about one-third of those of the euro area banking sector. Combined with their long-term investment perspective, this makes them key investors in both government and corporate bond markets, with a significant impact on the real economy (Kubitza, 2025).

Over the past decade, euro area insurers have faced two main challenges in the management of their financial positions. The first challenge stems from the prolonged period of low interest rates and asset purchases until 2022, which affected investment profitability. This triggered concerns about the sustainability of traditional life insurance products offering high guaranteed returns. A second challenge relates to property and casualty (P&C) insurers, which manage risks arising from natural disasters and liability events – acting as an economic first line of defence against climate-related risks. These risks are increasingly recognised as a key threat to the long-term viability of the insurance sector, raising important questions. For instance, how might natural disasters affect financial markets through insurers' balance sheets? In Corradin, Fontana, Kubitza and Maddaloni (2025), we analyse these questions with data, focusing on the interplay between insurers and sovereign bond markets.

Hunting for yields while rates are low

Euro area insurers are among the largest institutional investors in both equity and debt securities, alongside pension funds, investment funds and banks. But their portfolios also include real estate and, in some markets, mortgage loans – varying considerably across business models and countries. Sovereign debt forms an integral part of the investment strategy of traditional life insurers and sovereign bond holdings are particularly large in countries with a small corporate bond market (Du, Fontana, Jakubik, Koijen, Shin, 2025). Government bonds typically have longer maturities than corporate bonds, aligning more closely with insurers' long-term liabilities. The “zero risk asset” regulatory treatment^[2] of euro area sovereign bonds makes them even more attractive for insurers' balance sheets.

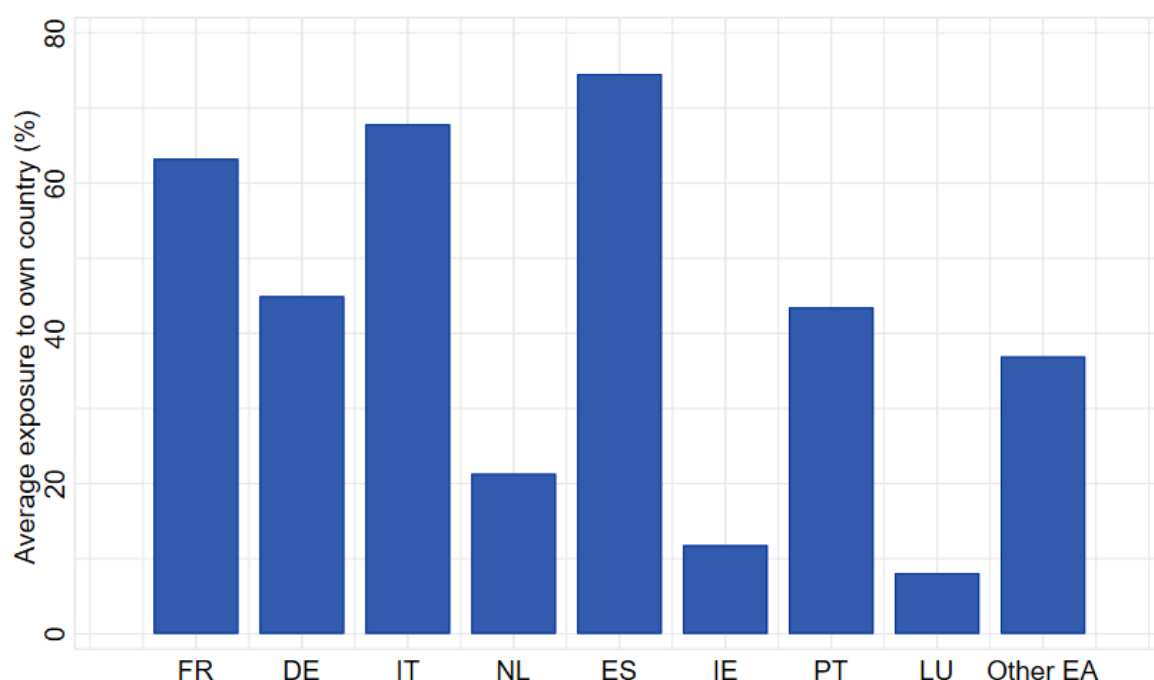
In recent years, insurers – particularly those in the life segment – have increased their allocations to alternative and less liquid assets, such as private debt, real estate, infrastructure and private equity. This shift reflects not only a search for yield during the prolonged low interest rate period but also a desire to diversify income sources. Life insurers are now more exposed to these assets than other insurers, with alternative investments accounting for nearly one-quarter of their total portfolios, increasing the risks to be managed. Insurers actively use derivatives to hedge various risks and repurchase agreements to manage liquidity. Nonetheless, their balance sheets have become somewhat less liquid and more sensitive to changes in market conditions.^[3]

Home bias and purchase programmes

Regardless of their domicile, traditional life insurers exhibit a strong home bias in their sovereign bond holdings, i.e. they favour domestic over non-domestic issuers (see Figure 1). Home bias in sovereign bond portfolios is also a common feature observed in the banking sector. However, likely drivers for the home bias in banks' portfolios, such as risk taking (Acharya and Steffen, 2015) or gambling for resurrection (Farhi and Tirole, 2018), are generally less applicable to the insurance sector. Moreover, financial repression (Becker and Ivashina, 2018; Ongena, Popov and Van Horen, 2019) is less prevalent according to practitioners.

Figure 1

Home bias in government and corporate bond portfolios of traditional life insurers



Notes: Data from EIOPA for the period from the fourth quarter of 2017 to the fourth quarter of 2024. Home bias is computed as the share of holdings of an insurance sector's domestic bonds relative to total government bond holdings. The countries are sorted by their average total exposure to government bonds. "Other euro area countries" represents a weighted average, by asset size, of the home bias shares of all other euro area countries not shown separately.

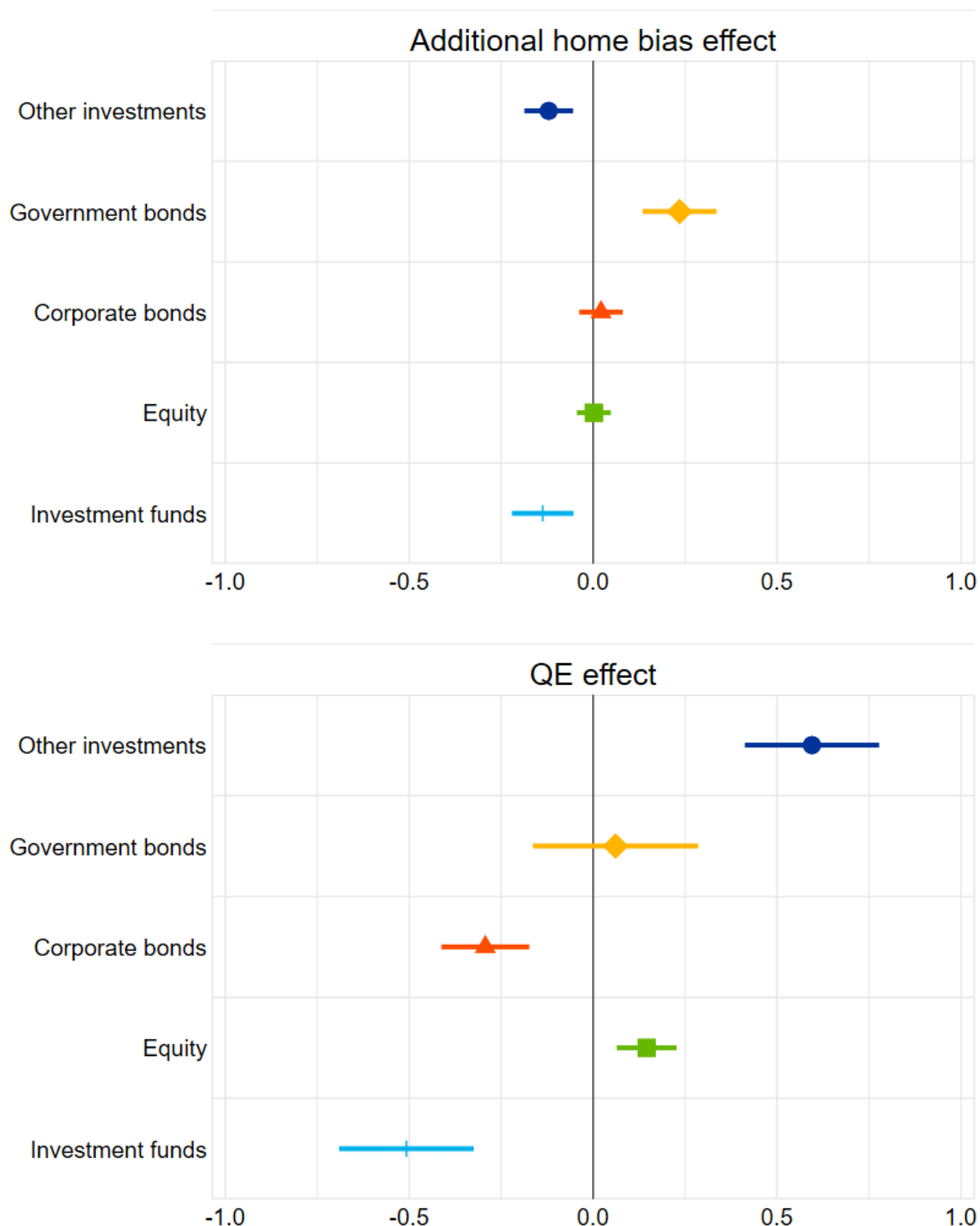
Traditional life insurers offer products that combine life protection with long-term savings. A key factor behind their home bias may be annual guaranteed returns and profit-sharing mechanisms, linked to the returns on the insurer's pooled investment portfolio. Until recently, the minimum guaranteed rates in several euro area countries, such as Germany or Italy, were based on domestic sovereign yields. Consequently, these yields serve as the natural benchmark for assessing the performance of life insurance products. Notably, this home bias also extends to other asset classes such as corporate bonds.

Our findings suggest that the Eurosystem's quantitative easing (QE) may have amplified insurers' exposure to domestic sovereign bonds.^[4] We measure the impact of QE depending on the central bank purchases of sovereign bonds that insurers held beforehand. Our results suggest that insurers with a stronger home bias in sovereign bonds tended to increase their holdings of sovereign bonds, even as they were being purchased by the central bank (see Figure 2, upper panel). This runs counter to the traditional portfolio rebalancing channel of QE, which predicts that when yields on safer assets fall due to QE investors shift into riskier alternatives.^[5]

Nonetheless, among insurers we do find a shift on average towards other investments^[6] such as private credit. The holdings of these investments increase more for insurers that held more QE-exposed assets beforehand (see Figure 2, lower panel).

Figure 2

Estimated effects of the Eurosystem's quantitative easing (QE) on financial investments by the traditional life insurance sector



Notes: Taken from Corradin, Fontana, Kubitzka and Maddaloni (2025). Data are from EIOPA (Solvency II public insurance statistics) and the ECB. The model is a two-way fixed effects panel regression model using data from the fourth quarter of 2017 and EIOPA weights. The panels show coefficient estimates from a shift-share regression. The left-hand variable is the share of asset holdings of asset class a (i.e. other investments) of the

traditional life insurance sector in country c at time t . The right-hand variable “ECB holdings” measures the impact of the ECB’s QE programmes on the portfolio allocation across different asset categories. We interact the latter variable with a dummy variable “home bias” that is equal to one when the “home bias” variable (defined in the notes to Figure 1) is above the median. The upper panel shows the coefficient of the interaction between the “home bias” variable and the “ECB holdings” variable. The lower panel shows the coefficient of the variable “ECB holdings”. The specification controls for country and time fixed effects. The sample period for all estimates is from 2017 to 2024.

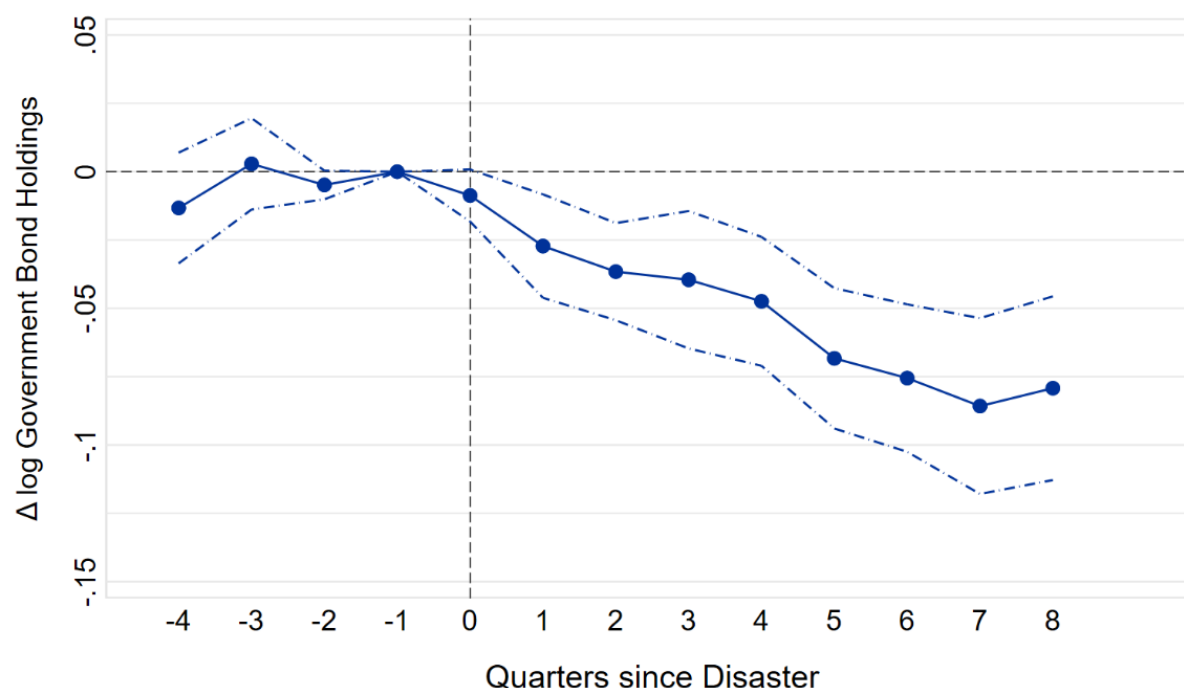
Waking up to climate risks and liquidity consequences

Property insurance is the primary mechanism through which households and firms insure against damages from natural disasters. Covering risks such as floods, storms or fires, it represents one of the largest P&C business lines in the euro area, with annual premiums of around €100 billion (close to 1% of GDP).^[7] We examine how euro area P&C insurers manage their liquidity in the aftermath of natural disasters.

Using detailed data on floods between 2013 and 2023, our results suggest that insurers respond to large claims primarily by selling government bonds, rather than by drawing on cash buffers or borrowing. These bond sales extend over several quarters and are concentrated in short-term securities, which are easier to liquidate without incurring large price discounts (see Figure 3). Corporate bond holdings are also sold, though to a smaller extent. This behaviour shows insurers’ reliance on liquid, high-quality assets to manage liquidity risks arising from insurance claims while maintaining overall solvency. Furthermore, in countries where insurers exhibit a stronger home bias, natural disasters are followed by temporary increases in domestic government bond yields, suggesting that localised liquidity shocks can spill over from insurance into sovereign debt markets.

Figure 3

Estimated effects of floods on euro area P&C insurers government bond holdings



Notes: Taken from Corradin, Fontana, Kubitzka and Maddaloni (2025). The figure depicts the point estimates β_x and 90% confidence intervals, where x is the time horizon for the cumulative change in balance sheet items, based on the following specification:

$$\Delta \log \text{Gov Bond Holdings}_{c,t-1:t+x} = \beta_x \text{Damage}_{c,t} + \Gamma' C_{c,t} + \epsilon_{c,t}$$

where $\Delta \log \text{Gov Bond Holdings}_{c,t-1:t+x}$ is the (cumulative) growth in government bond holdings of P&C insurers in country c from quarter $t-1$ to $t+x$. $C_{c,t}$ is a vector of control variables, namely quarterly GDP growth, quarterly growth in the Harmonised Index of Consumer Prices and the quarterly change in one-year government rates, all lagged by one quarter. β_x estimates the response to a flood with average damages.

These findings underscore that insurers act as liquidity users during climate-related shocks, with implications for both market functioning and sovereign financing. A high degree of home bias limits cross-border risk sharing and amplifies the impact of natural disasters on domestic bond markets.

Capital markets union could cushion the impact on sovereign bond markets

Insurers are often viewed as the sleeping giants of the financial markets: long-term, stabilising investors. However, their growing importance as financial intermediaries calls for continued monitoring and analysis, given their role in bond markets.

Enlarging their exposure to riskier and less liquid assets during the low interest rate period shored up insurers' returns, but heightened risks to financial stability. In addition, the increasing frequency and severity of natural disasters creates pressure on insurers to maintain sufficient liquidity to meet large and unexpected claims. Our finding that insurers finance these claims by selling short-term,

high-quality bonds suggests that during stress – financial or environmental – their actions may amplify rather than dampen market volatility. Strengthening market depth and integration through the capital markets union would likely help insurers to diversify their bond portfolios and mitigate these amplification effects.

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This article was written by Stefano Corradin (Lead Economist, Financial Research Division, ECB), Alessandro Fontana (Senior Financial Stability Expert, Risks and Financial Stability Department, EIOPA), Christian Kubitzka (Senior Economist, Financial Research Division, ECB) and Angela Maddaloni (Head of Financial Markets Section, Financial Research Division, ECB). It is based on *ECB Discussion Paper 28 “Insurance Companies in the Euro Area: Asset Allocation and Impact on*

Financial Markets”. The authors gratefully acknowledge the comments of Alex Popov and Zoë Sprokel. The views expressed here are those of the authors and do not necessarily represent the views of the European Central Bank or the Eurosystem.

2.

Under the Solvency II regulatory framework for the European insurance sector, euro area sovereign bonds are treated as assets with zero credit risk.

3.

While liquidity risk is not explicitly governed by capital requirements in Solvency II, EIOPA has increased scrutiny of liquidity risk management by insurers in recent years. Large and sudden insurance claims can drain P&C insurers’ liquidity, whereas high surrender rates may drain life insurers’ liquidity, especially with rising interest rates (Kubitza, Grochola and Gründl, 2025). Moreover, large margin calls on derivatives positions may force insurers to sell assets (Alfaro, Bahaj, Czech, Hazell and Neamtu, 2024; Jansen, Klingler, Ranaldo and Duijm, 2025).

4.

The purchases of sovereign bonds under the QE programme were carried out through the Public Sector Purchase Programme (PSPP) and the Pandemic Emergency Purchase Programme (PEPP).

5.

See Corradin, Fontana, Kubitza and Maddaloni (2025) for details.

6.

EIOPA uses the category “other investments” to define assets that are not in the main groups of government bonds, corporate bonds, equities, and investment funds. This category includes mortgages and loans, property, and structured notes.

7.

As property insurance is often a prerequisite for mortgage lending, it plays a crucial role in the resilience of households and the financial system. Recent evidence by Damast, Kubitza and Sørensen (2024) shows that property insurers also transmit monetary policy. When policy rates rise, valuation losses on insurers’ long-term assets prompt them to increase insurance prices, which tightens real estate market conditions. Thus, property insurers lie at the intersection of climate risk management, financial stability and monetary policy transmission.

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