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Insurance: what systemic risks in the insurance sector?

Speakers

Nina Arquint
Swiss Re , Head of Group Qualitative Risk Management

Alberto Corinti
Italian Insurance Supervisory Authority (IVASS) , Member of the Board of Directors

Graham Cox
Metlife , Executive Vice President, Global Risk Management

Sylvie Goulard
European Parliament , MEP, ALDE Coordinator in the Economic and Monetary Affairs Committee

Sandrine Lemery
Autorité de Contrôle Prudentiel et de Résolution (ACPR) , First Deputy Secretary General

Victoria Saporta
The International Association of Insurance Supervisors (IAIS) , Chair of the Executive Committee

Christian Thimann
AXA Group , Member of the Executive Committee, Head of Strategy, Sustainability and Public Affairs

Objectives of the session

This session was intended to clarify where we standed regarding the definition of NTNI and HLA and more generally the global framework dedicated to the systemic threats possibly posed by certain insurance groups. The panel also outlined possible adjustments required by the Global framework.

Executive Summary

Designing globally a better methodology for systemically important insurers

The IAIS was a technocratic body of supervisors, not a legislative body, and had no legal authority. Its role was to develop standards, which democratically elected bodies can then decide whether or not to adopt.

However, a 'glass ceiling' existed between the IAIS and the FSB: the FSB was pursuing its objectives without access notably to systemic risk management plans that were submitted to the IAIS, and a more detailed consideration would need to take place of what should be in these reports, to avoid systemic risk in the sector.

The Parliament had recently adopted an initiative report on the governance issue linked to global standard setting. Elected representatives of the population should be capable of explaining to voters where rules arose from; sometimes, this was not possible. This was very important provided that insurance regulation had significant potential impacts on growth and job creation. During the financial crisis, the G20 had played a major and positive role in finding a global solution; however, the G20 was also entirely undemocratic, and non-universal. Now there needed to be more consideration of how to increase cooperation and accountability.

In 2013, the IAIS published its First Methodology to assess globally systemically important insurers which contained provision for review every three years. The first review took place and an updated methodology was published in November 2015 for public comment. The IAIS has been considering comments received and revisions to be made to the 2015 Updated Methodology. Comments have been supportive of the direction of travel, although some had wanted to go further.

The IAIS was focusing on the development of 'absolute reference values'; clarification of what was going to happen within 'phase 3', the qualitative phase, and the reinsurance supplemental assessment; and the best way to make processes transparent for the benefit of firms. This new methodology would be published in the first half of this year, and would be applied to data that the IAIS had already started collecting, with a recommendation made to the financial stability body regarding designations in October.

Although there had been a lot of concern about nine groups being designated as internationally systemic, this should not detract from what the IAIS had done to work towards a common framework for the supervision of internationally active groups that recommends good practices, a common culture of supervision, and early warning systems, among other improvements. Given that the IAIS had no legal authority over any firm, no standard was legally enforceable; crisis management groups were already active, assessing liquidity and producing resolution plans. Initiating the development of the first ever capital standard in insurance was a significant achievement.

Systemic Risk and Reinsurance Groups

Reinsurance has been singled out for supplemental assessment in the latest IAIS G-SII designation methodology proposal, despite consensus that traditional reinsurance business is unlikely to be systemically risky. The rational provided by the IAIS is the concern that reinsurance might lead to institutional and/or geographical concentration risk. Many studies by IAIS, regulators, and rating agencies classify reinsurance as "unlikely to be systemically risky". Accordingly, reinsurance is neither a source nor an amplifier, but rather a mitigant of systemic risk. Concentration risk assessment is first and foremost quantitative in its nature and cannot be captured with a discretionary qualitative assessment. If there were concerns about large exposures – i.e. concentration risk, a solid quantitative assessment should primarily take place and not a totally discretionary qualitative assessment. At least one reinsurance institution prepared such a quantitative assessment and is making it available to the IAIS. The outcome of this assessment has proven to be quite impressive, having identified that reinsurance is far from systemic.

Concerns Raised by Insurers

The European Parliament had recently adopted an initiative report on the governance issue; it had appreciated the direction that it had been given, but had some concerns, as did the insurance sector.

One institution stated that it was generally accepted that, in banking, size was the basis of designation as systematically important, but this was not the case in insurance: diversification meant that large groups were not necessarily riskier. The notion of residual risk also needed to be borne in mind as an insurance company's role was to accept and manage risks i.e. the products might be hedged or not hedged, or diversified or non diversified. They were of the view that the designation framework focusing on a few institutions and activities overlooked the biggest risk: namely, low interest rates, which endangered long-term savings, social security and social stability and had a significant impact on the financial sector. This was not just a risk for insurance, but for society more broadly; it was a risk for long-term savings, social security and social stability, because people did not get a return on their savings, and it was very difficult to get guarantees. This had a very broad-based impact on the financial sector.

There was a difference between FSB and the United States in relation to designation: the Metlife case demonstrated the possibility of judicial reviews in the United States, but if an institution was designated as a GSII by the FSB, it had no right of appeal. FSOC derived its authority to designate U.S. non-bank financial institutions as U.S. non-bank SIFIs, from the Dodd-Frank Act, which also provided designated firms with a legal means to contest their designation. In this context, Metlife requested a judicial review of FSOC's decision and the judge rescinded its designation. FSOC has filed an appeal. Metlife welcomed this decision as a recognition of certain of its claims.

There was a need for increased transparency; one insurance representative noted that her institution delivered data, but did not know how its scores were calculated, or at what level an activity was deemed to be systemically risky. Firms should be told what their situation was, in order to allow them to manage their systemically risky activities. The IAIS could consider developing a more proportionate approach to policy measures, whereby as institutions became less important, the policy measures applied to them decreased proportionately. This needed to be articulated to avoid large cliff effects.

Non Traditional/Non Insurance

The IAIS had published a paper regarding the definition of NTNI activity in November, separate from its proposed updated Methodology; this affected a number of work-streams. Its purpose was to articulate why the IAIS considered certain activities NTNI, and to connect this to transmission channels. Numerous comments had been received, with the industry generally welcoming the fact that the IAIS was trying to better articulate why certain products were NTNI, but being concerned that the IAIS was conflating macro prudential risk with micro risk, particularly in the case of variable annuities and the management of variable annuity risks with purchase of derivatives.

Most people agreed on the definition of non insurance activity, but the non traditional space was more difficult to define. One insurer had conducted work on this issue identified, which demonstrated that the notion of NT was not conceptually sound. Another agreed, noting that the ‘NT' aspects of NTNI were most concerning in terms of systemic risk. They had identified that it was very difficult to achieve a binary, strict classification of which products were NT: in an overall assessment of how systemic a company was, it was necessary to look at what the drivers of the systemic risk were, and what features of an insurance product were most likely to contribute to systemic impacts. Qualitative assessment needed to be taken into account.

Single large institutions’ failures are not the only source of market impact. Several medium institutions’ reactions to market stress must also be considered, as identified in the 2016 IMF global financial stability report. One example of this form of stress is low interest rates, which is something that is not captured within the definition of NTNI or via the designation of companies; it is an issue that impacts small and medium sized companies also. To tackle this, it would be necessary to take into account different measures, including macro surveillance programmes, micro supervision, and cooperation between supervisors.

Alternative Approaches

If activities gave rise to systemic risk, they should be appropriately noted and regulated across the industry as a whole. This approach was much less likely to disturb competitive balance within markets and give certain firms advantages over others; at least one representative of the insurance industry was pleased that the assessment methodology was being reviewed and reconsidered, as the current methodology confused the concept of vulnerability with the concept of systemic impact. Within the industry, there were extensive risk management programmes, but the many of the assessment Methodology presently in use ignored these product and balance sheet risk management tools.

One insurer felt that if the IAIS and others persisted in assessing firms, they would need to not only look at the relevance of the firm compared to other insurance firms, but also as compared to financial markets as a whole. The comparison should be with some kind of objective benchmark of the sort of damage that a firm or an activity could do to the financial system. Separating vulnerability from impact of failure, considering risk management tools, and using objective benchmarks instead of relative analysis would produce a much more reasonable approach.

A representative of a different insurer replied that products could not be labelled as non traditional without understanding the individual product features, and the proposal should not introduce an entirely discretionary assessment. A representative of a supervisory authority commented that the ideal approach was one that combined quantitative proxies with more accurate qualitative information, while maintaining full transparency in relation to designation.

Expected Evolutions

The designation of individual large companies misses an additional equally important source of systemic relevance, which might come from small to medium sized firms' reaction to continued low interest rates coupled with asset price shocks, or through very large duration mismatches. These could affect a wide variety of firms. This activity based or sectoral source of systemic risk was different in nature, and therefore required different policy measures. To deal with the possibility of activities based or sectoral systemic risk, as opposed to that arising from individual companies, the IAIS was providing the appropriate 'building blocks'; one of these was ComFrame, which contained within it the ICS that the IAIS was developing.

Today, much of the focus in relation to systemic risk in the insurance space was on variable annuities, because managing these required dynamic derivative hedging; if markets were to stop, the owner of these would be 'stuck' with a lot of derivatives and liabilities that did not have any more cover. Companies should not be incentivised to not hedge to cover their risk, and as such, incentives to reduce interconnection needed to be put in place, with the systemic designation taking derivatives' interconnectedness into account in a thorough way.

The ICS represented an opportunity to improve the product based approach: it would be a better base for calculating the HLA, compared with the BCR, but would also allow for all supervisors to use the same metrics for measurement, and would avoid regulatory arbitrage between different jurisdictions. It would also allow product based classification to be abandoned to a certain extent, and would promote the development of better measurement of certain dimensions that were relevant to systemic risk analysis.

Detailed Summary

Designing globally a better methodology for systemically important insurers

A regulator noted that the IAIS the standard setting body, was 'essentially a technocratic body of supervisors'. Within Europe, the EIOPA was a member, and individual supervisors could become members as well as other bodies. This produced technical standards, and as part of this, also produced peer review assessments of these technical standards that were carried out by other technicians within supervisory authorities. The IAIS was not a legislative body, and had no democratic authority to legislate; rather, it produced standards, and democratically elected bodies could then decide whether to adopt these standards.

Regarding the IAIS's standard-setting work, the project it had engaged in 2013 – designing a better methodology for globally systemically important insurers – had been a contribution to financial stability. This was the first time that this kind of work had been published; it was a new area, and the IAIS had been acting as a thought leader. They had known at the time that their methodology had not been perfect; the data they had collected had been improving ever since, and a review was now taking place.

Taskforce work had been published; a revised methodology had been decided on, taking into account the IAIS's experience, and a consultation paper had been published in November 2015. More than 30 comments had been received on this paper, which had been broadly supportive of the direction of travel, although some had wanted to go further and some had made specific comments. The particular issues that the IAIS was focusing on included the development of 'absolute reference values', because the old methodology was entirely relative; the clarification of what was going to happen within 'phase 3', the qualitative phase and the reinsurance supplemental assessment; and how to make processes transparent, so that a firm would know why it had been designated or not been designated, and what it would need to do or not do to become designated. This new methodology would be published in the first half of 2016, and would be applied to data that the IAIS had already started collecting. The call for data had gone out to almost 550 firms on 15 April. The IAIS would make a recommendation to the financial stability body regarding designations in October.

A representative of a different supervisory authority recalled that there had been a great deal of concern about nine groups being designated as internationally systemic, but this should not obscure everything that had been done in the IAIS to work towards a common framework that spread good practices of group supervision, colleges of supervisors, a common culture of supervision, early warning systems, and the promotion of ORSA – which was a very effective tool of supervision – as well as a culture of assessing reserves and not only focusing on capital standards. These discussions had taken place with 50 internationally-active groups, and these were making good progress.

FSB, IAIS and national/regional regulator and legislator interaction

A representative of an insurer noted that there were questions about the legitimacy and democratic accountability of the supervisory process. The FSB arose from the banking tradition: central banks were still banks, and most acted as bank supervisors, banking as the counterparty, with the ECB being the classic example. However, the ECB did not have supervisory power over insurance; as such, discussing insurance in the FSB always gave rise to questions about the level of knowledge, expertise, and direct exposure. The FSB then issued declarations that had potential market impact without these having been validated through parliaments and legislatures. Thus far, this work had gone quite well, and the insurance representative was grateful to colleagues at the FSB for having been extremely attentive in relation to the HLA.

An international regulator stated that the IAIS was a committee of supervisors, who were insurance experts; it was therefore very important for the IAIS to carry out and produce all of the technical analysis. This was what happened in practice, in the same way as with the Basel Committee. It was then up to the European Commission, Parliament and Council to decide whether they wanted to adopt what the Basel Committee did or not, as democratic institutions. The FSB had a G20 mandate from the G20 leaders and finance ministers; the IAIS typically responded to committees of experts, and the people who were the most articulate were central banks that had insurance supervisors, or supervisors that dealt with insurance. The IAIS's efforts should be supported, because they understood insurance.

A representative of an insurer stated that the debate about the relationship between orientations, non legally binding norms and standards, and what was legally binding recurred every year. 2016 seemed like a particularly important year, not least because a court case had occurred that had classed the designation as arbitrary and capricious; it would be interesting to hear about the impact that this had on the FSB process, which was not an identical approach, but was also not fundamentally different.

A representative of a different insurer noted that, although people might or might not understand where standards arose from, this insurance company did not regard the FSB as a 'community of technocrats'. Rather, it was a community of central banks and financial ministries, mandated from the G20, and the work that it did was heavily political. In contrast to the Metlife case, which demonstrated the possibility of judicial reviews in the United States, if an institution was designated as a GSII by the FSB, it had no right of appeal. This distinction needed to be borne in mind.

Another representative of the insurance sector asserted that regarding governance, there was a 'glass ceiling' between the IAIS and the FSB: the reports on systemic risk management plans that were produced were not available to the FSB, but the FSB nevertheless continued to pursue ideas such as capital charges without access to these reports. This produced a 'peculiar' situation; the Panel member's institution was aware that there were risks, but these risks were managed, such as via Solvency II. Solvency II covered market risk, credit risk, counterparty risk, insurance risk, longevity risk, morbidity risk, mortality risk, climate risk, and operational risk; this institution also considered it to cover many financial market risks. The challenge now was to identify what needed to be added to what was in the reports, to avoid systemic risk in the sector.

A Member of the European Parliament stated that the Parliament had recently adopted an initiative report on the governance issue that had been linked to the need for global standard setting. Europe was in favour of open borders and a global level playing field, and the Parliament appreciated that some bodies, both inside and outside of the insurance sector or others, had the capacity to give some direction.

However, the Parliament also had some concerns. Members of the EU Parliament had visited the United States Congress in October, and had received the impression that the elected representatives of the population should be capable of explaining to voters where rules arose from; sometimes, this was not possible. This was not relevant for people who were sensitive to governance, as the insurance sector had an impact on financing and on the long-term economy. This was very important in the Eurozone, in Europe, and across the globe, because it was necessary to boost growth and create jobs provided that insurance regulation had significant potential impacts.

Level Playing Field Issues

Regarding the question of legal enforcement, nothing was presently legally enforced, but having designated a few internationally systemic companies was still an achievement. In the groups that had been designated as internationally systemic, crisis management groups were already active: in France, there was AXA, but also important parts of Aviva, Allianz and Generali, which had left the systemic list but still had a crisis management group. Those crisis management groups were small groups of supervisors who looked at the recovery plans that the companies made, assessed the liquidity plans of these groups, and made resolution plans. Despite there being no law in place, this was working well.

Another achievement had been producing the first ever capital standard in insurance; this had existed for a long time in banking, and with BCR and HLA, there was now an international standard. It was not a perfect standard, but represented an improvement and a disincentive to the creation of excessive risk and the kind of ‘too big to fail’ scenarios that had been seen during the crisis. The present methodology was predicated on size only playing a small role, but in actuality, size continued to play a big part.

An Insurance sector representative noted that the dispute of MetLife with FSOC, which had designated it as a non-bank SIFI in the US, had been done under the Dodd-Frank Act, Metlife’s objection had not been to the Dodd-Frank Act, but to their designation; the Dodd-Frank Act entitled companies to have judicial review of their designation. Although some people had said that Metlife was attacking Dodd-Frank, or regulation as a whole, this was not the case. The recent court case had overturned Metlife’s designation as a non-bank SIFI in the US, recognising that there were both procedural and substantive flaws in FSOC’s analysis, in its designation of Metlife.

Metlife was pleased with the court’s finding, as it had never felt itself to be systemically relevant and did not believe that it should be a SIFI or a GSII. However, this decision was being appealed by FSOC; the case was now at appellate level, and might ultimately be heard in the Supreme Court. Metlife would continue to defend its position vigorously in the courts; in the meantime, it was happy that a level playing field had been re established between Metlife and other insurance companies, both in the US and around the world.

Systemic Risk and Reinsurance Groups

A representative of a supervisory authority noted that the methodology that was already in place had been the result of a consensus that had been very difficult to achieve; moving to another consensus would be equally difficult. From a national supervisory perspective, transparency should be the goal, as was the case in banking; one lesson that could be learned from the Metlife ruling was the risks of not having enough transparency, or not knowing rules in advance. The methodology on reinsurance had been refined, mostly because they had not succeeded in producing results that suited everybody in relation to reinsurance. Now, in the reinsurance sector, the best approach would be to focus on large exposures, which was the only reason why reinsurance would differ from insurance from a systematic perspective.

A representative of an insurer stated that the activity of reinsurance is not systemically risky. Reinsurance is neither a source nor an amplifier, but rather a mitigant of systemic risk. Consistently, many studies by IAIS, regulators, and rating agencies classify reinsurance as "unlikely to be systemically risky". However, it seems that two remaining concerns were the reason behind the proposal to create a supplementary qualitative reinsurance assessment, namely institutional and geographical concentration risks. If there were concerns about large exposures – i.e. concentration risk, a solid quantitative assessment should primarily take place and not a totally discretionary qualitative assessment. At least one reinsurance institution prepared such a quantitative assessment and is making it available to the IAIS. The outcome of this assessment has proven to be quite impressive, having identified that reinsurance is far from systemic.

Concerns Raised by Insurers

The Panel member's institution felt that it was 'a bit stuck' in the process, for a number of reasons; the first had to do with size. Size in banking was the basis of designation, as everyone agreed, but in insurance, size had a different role. Because of diversification, large groups were not necessarily riskier; they might actually be more diverse and, therefore, more stable, as his institution was witnessing at the present time. By focusing only on five companies in Europe, three in the US, and one in China, the systematic linkages might not be seen.

Additionally, it was very important to look at the notion of residual risk, because the risks were managed. It was true that an insurance company's role was to accept and manage risks and, therefore, it was important to not just look at the product, but also to see how certain products were managed, to see whether there were residual risks. The products might be hedged or not hedged, or diversified or non diversified. Identifying how risk management took place, and then seeing whether there were residual risks and focusing on these residual risks in the systemic regulation, was vital.

Finally, the insurer's institution felt that having the designation framework focus on a few institutions and activities overlooked the biggest risk, which was low interest rates. This was not just a risk for insurance, but for society more broadly; it was a risk for long-term savings, social security and social stability, because people did not get a return on their savings, and it was very difficult to get guarantees. This had a very broad-based impact on the financial sector. By focusing on very few institutions and discussing individual products, they were missing out on the big debate about what might be the truly systemic risk represented by the low interest rate. The process for insurance should be adjusted to focus on these five main areas.

Regarding transparency, the institutions delivered data, but did not know how the scores were calculated, or at what level an activity was deemed to be systemically risky; it did not know how many firms would actually exceed such a level, or by how much, and how these scores would be distributed. The initial goal of this designation had been to reduce systemic risk, and in this sense, firms should be told what they were, in order to allow them to manage their systemically risky activities. This was not the case today.

A representative of a third insurance organisation stated that this institution agreed entirely with the market-based approach regulatory, but the question was why the SIFI designation was therefore necessary. This institution had produced a number of reports, and appreciated the discussion that had taken place with the supervisor crisis management committees. The SIFIs had produced systemic risk management reports, liquidity management reports, and recovery reports; these were very extensive documents, and it would be helpful to evaluate them and determine what the open issues were. The insurer did not perceive many of these reflections to still be open.

A representative of a supervisory authority commented that not everything was about capital. A great deal of people was worried about being designated as GSII because they would have a higher loss absorbing capacity, or more capital, on top of the BCR, which would become the ICS. Supervisors found a number of other measures, such as the crisis management measures and resolution groups, very useful. The IAIS needed to consider developing a much more proportionate approach to policy measures, whereby an organisation that had once been a GSII but was not any longer – such as Generali – might not be subject to HLA, but would still be subject to some measures, like recovery and resolution. As institutions became less important, the policy measures applied to them became less in proportion. This proportionality approach needed to be articulate to avoid large cliff effects, while receiving the benefits of the measures.

Non Traditional/Non Insurance

The IAIS had published a paper regarding NTNI in November, separate from its work on BCR and HLA. This was a concept that was quite important in the insurance space, because the IAIS's standard setting body had recognised for a long time that insurers' failure or distress would mainly be transmitted to the rest of the financial system if they undertook activities that were NTNI, vulnerable to liquidity runs and liquidity risks or occurring at a time when the market was down to correlated market exposures: i.e. the 'substantial market risk' concept. This concept was very important to the methodology for designating an insurer as GSII, because NTNI was 45% of its weight, but it was also an important concept in the BCR and HLA. This had been the rationale for this paper being separate, as it affected a number of work-streams. Its purpose was to articulate why the IAIS considered certain activities NTNI, and to connect this to transmission channels.

More than 20 comments had been received on this; the industry had generally welcomed the fact that the IAIS was trying to better articulate why certain products were NTNI, but had specific concerns around whether it was conflating macro prudential risk with micro risk, and the treatment of derivatives.

A representative of an insurer stated that most people agreed on the definition of non insurance activity; AIG's contribution to the crisis had been non insurance activity, and no one was engaged in this activity today. The issue was non traditional activity; his organisation had worked for over a year on this issue, and had struggled to determine what was traditional and what was non-traditional; this would be the case in the area of banking, too. They had identified that the notion of NTNI did not have a very strong conceptual basis. Looking at products was also difficult, because a product by itself had certain features, but it was difficult to say whether it was systemic or non systemic. Although it was necessary to look at how activities were managed, applying the notion of 'traditional' was not the ideal approach.

A representative of a supervisory authority noted that he was working on the issue of NTNI at the present time. In the context of the revision of the methodology, arriving at a clearer and conceptually solid definition of what NTNI was was a key task. His institution had not focused on all aspects of NTNI, but only on NT aspects, which were the insurance products that were most concerning in terms of systemic risk.

At least three challenges had been encountered in the course of doing so. The first was that it was very difficult to achieve a binary, strict classification of which products were and were not NT. In an overall assessment of how systemic a company was, one should look at what the drivers of the systemic risk were, and what features of an insurance product were most likely to contribute to systemic impacts. From this perspective, it was important to have a common understanding of what drivers could lead to higher potential systemic relevance.

From this perspective, the structure of the new methodology could help. It was very difficult to reach a binary classification of these products based on quantifiable, standardised elements; rather, qualitative assessment needed to take place. There was a standardised element to the methodology, based on proxy at the end, complemented by a more qualitative phase, which was the discovery phase. This type of approach should be applied to the NTNI products; one example of this would be assessing whether a product could lead to substantial liquidity risk, as there were many incentives or disincentives to redeem that were not strictly quantifiable.

Discussing NTNI could lead to confusion between micro and macro consideration. For this reason, his institution's work aimed to focus on transmission channels, and the reasons for having an impact on the system, while avoiding consideration of probability of default and focusing only on the impact of failure. Not only failure had an impact, however; the reaction to market stress also needed to be considered, which could be a common reaction from different companies that were subject to this kind of stress. It was therefore not necessary for an insurance company to become insolvent for it to have an impact on the market; the most recent IMF report had been very clear on this. The Panel member's organisation was trying to identify which features of the market could amplify stress coming from the system.

One example of this was low interest rates, which was something that could not necessarily be dealt with within the definition of NTNI. This went beyond NTNI, and possible beyond the designation of companies; it was an issue that small companies would also need to deal with. To tackle this, it would be necessary to take into account different measures: not only designation, but also macro surveillance programmes, micro supervision, and cooperation between supervisors. NTNI should not be cast as something that could solve all the systemic risk concerns that existed. In the future, a different metric could be created to calculate market risks, which would help deal with different points of view.

Alternative Approaches

A representative of an insurer stated that if activities gave rise to systemic risk, these should be appropriately noted and appropriately regulated across the industry as a whole. This approach was much less likely to disturb competitive balance within markets and give certain firms advantages over others. His institution was pleased that the assessment methodology was being reviewed and reconsidered; the current methodology confused the concept of vulnerability with the concept of systemic impact, and it was very important to keep these two concepts separate. Although it might be appropriate to consider each, or both, considering them on a combined basis led to very confusing analysis.

It was not just important to analyse risk, but also to consider what was done within the industry to manage this risk. There existed extensive risk management programmes and organisations; however, many of the assessment methodologies that were presently in use ignored what these organisations did to manage risks, assessing only inherent risks and not the residual risks. In some cases, what these organisations did to mitigate a particular risk might increase sensitivity to another risk; this should be acknowledged and considered, but the fact that – for instance – these organisations posted collateral on derivatives could not be ignored.

Assessing firms was unnecessary if this was to be based on an activity related approach. However, if the IAIS and others were to persist in doing so, they would need to not only look at the relevance of the firm compared to other insurance firms, but also as compared to financial markets as a whole. The goal was to address activities or firms that had a significant adverse effect, or could have such an effect, on the financial markets; a firm's standing relative to other firms was irrelevant to that consideration. The comparison should be with some kind of objective benchmark of the sort of damage that a firm or an activity could do to the financial system. Separating vulnerability from impact of failure, considering risk management tools, and using objective benchmarks instead of relative analysis would produce a much more reasonable approach.

However, it would be even better to focus on what activities took place within the insurance space, and determine whether any of these were potentially systemically relevant.

A representative of a different insurer replied that products could not be labelled as non traditional without understanding the individual product features, and what, if any, systemic riskiness or transmission channels they contained. However, she would not agree with the proposal to introduce an entirely discretionary assessment. A qualitative supplementary assessment needed to be objective, consistent, comparable, transparent, and reproducible, for the sake of proper governance.

A representative of a supervisory authority stated that qualitative assessment was not a perfect solution: the more the system was prone to inaccurate evaluation, the more the risk of not being transparent, or not having a level playing field, increased. The challenge was not relying only on quantitative proxies, but also going more in depth regarding on the more accurate qualitative evaluation, while not losing transparency. As such, there should be clear criteria, complemented by quantitative elements in this discovery phase. There should be full transparency in explaining to a company why it had been designated and, in all cases, what degree of systemic risk was associated with the company. A balance needed to be struck between the two objectives.

Expected Global Evolutions

An international regulator stated that the designation of individual companies whose potential failure, distress or correlation with markets could cause broader effects was not all that needed to be done in relation to systemic risk; rather, it was just one dimension and one potential source of systemic risk, as was made clear in the IMF paper and was widely recognised. The policy measures that were adopted should be commensurate with the source of the systemic risk. There was a second source, which might come from low interest rates coupled with asset price shocks, or through very large duration mismatches. These could affect a wide variety of firms: either the sector as a whole or a set of firms within a particular sector, such as small firms. This activity based or sectoral source of systemic risk was different in nature, and therefore required different policy measures.

To deal with this, the IAIS was providing the appropriate ‘building blocks’, one of which was ComFrame: this was the common framework for supervising the entire sector. ICS was contained within this; the ICS that the IAIS was developing, or the market-consistent element of the ICS which was similar to the underlying logic of Solvency II in Europe, had ways of assessing interest rate risk across the sector, including counter-cyclical measures through the volatility adjustments and volatility dampeners. GSII methodology, NTNI, and similar measures were not the answers to systemic risk issues; this was not all that the IAIS was doing in this field, or the most important. ICS and ComFrame were equally or more important to tackling the sources of systemic risk that could arise from low interest rates and asset price shocks.

A representative of another supervisory authority added that there should also be a global capital standard to measure the risk associated with a company; this presented an opportunity to improve the product-based approach. The ICS represented this kind of opportunity, not only because it would be a better base for calculating the HLA compared to the BCR, but also because it would allow all of the supervisors to use the same metrics for measurement, and would avoid regulatory arbitrage between different jurisdictions. Finally, it would also allow product based classification to be abandoned, to a certain extent, and would promote the development of better measurement of certain dimensions that were relevant to systemic risk analysis.

A representative of a supervisory authority stated that systemic risk insurance had arisen from size, originally; it had then focused on derivatives, NTNI and NT. Today, most of the focus was on variable annuities, because these had a guarantee given on the products that moved with market value, which required dynamic derivative hedging. With dynamic derivative hedging, if markets were to stop, the owner would be ‘stuck’ with a lot of worthless derivatives; this was one area in which interconnection with the rest of the world and the rest of the SIFIs could be demonstrated. They would also be stuck with liabilities that did not have any more cover. Everyone now agreed on financial guarantees; the discussion that now needed to take place was about variable annuities, what kind of products existed, and what the risks involved were.

Regarding derivatives, companies should not be incentivised to not hedge to cover their risk. A company was usually better off hedging than not doing so; however, without incentives to reduce interconnection, there would be large amounts of hedging with lots of counterparties. This had been addressed in some places, but not in others. The systemic designation needed to take into account derivatives’ interconnectedness in a thorough way.

A Member of the European Parliament summarised by stating that, during the financial crisis, the G20 had played a major and positive role in finding a global solution; however, the G20 was also entirely undemocratic, and non-universal. The only African country represented on the G20 was South Africa; in Europe, only some member states were present, with others represented by the Commission, which in this case had had the role of ‘babysitter of smaller member states’ rather than representing Europe as a whole. In an emergency situation, you had to act quickly and do what it was possible to do. However, there needed to be further consideration of what types of cooperation and accountability needed to exist; this conversation could take place at the next Eurofi. People should not be excluded because they lived in countries that were less rich than others; this was not democratic.