



GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

Mr Paul Sharma
IAIS FSC, Financial Stability Committee
International Association of Insurance Supervisors
c/o Bank for International Settlements
CH-4002, Basel Switzerland

February 25th 2013

Dear Mr Sharma,

The Global Federation of Insurance Associations (GFIA) through its 32 member associations represents insurers that account for around 87% of total insurance premiums worldwide. GFIA is active on a broad range of issues affecting the international insurance industry.

One area of particular concern is the on-going discussion on systemic risk in insurance. Here, while GFIA appreciates the efforts made by the IAIS to develop an approach that takes account of insurance specificities, we are concerned that as we are reaching the final stage of the process leading to the identification of G-SIIs, a number of key questions remain unanswered.

GFIA therefore urges the IAIS to bring clarity and give consideration to some of the questions raised by the industry, first in response to the consultations on the methodology and the measures and again at the recent New Orleans meeting. Some of the open questions are complex, and need careful consideration as the outcomes are likely to have a significant impact on the targeted entities and thus, we believe, further analysis and exchange with the industry should be allowed for.

It should also be acknowledged that a 'one size fits all approach', to the measures is not appropriate for G-SII's. It is important to recognise that a measure designed to decrease one insurer's potential exposure to systemic risk would not necessarily decrease another's. In essence the current diversity in industry practises and products contributes to overall health and stability of the insurance industry, and it is important that the IAIS's work on G-SIIs promotes continued risk diversification and the core differentiating factors of insurance.

GFIA wishes to reiterate its full commitment to the on-going process, which hopefully will result in solutions which contribute to enhancing financial stability; are workable in practice; and do not result in distortions of competition within the financial sector.

Methodology to identify G-SIIs

GFIA remains concerned that if left unchanged, the methodology proposed by the IAIS will result in entities being on the list not for the risk they pose to the financial system but because of their size.

As an example, GFIA is concerned that some of the proposed indicators in the methodology refer to activities undertaken by insurers that do not pose systemic risk. Making these activities subject to the proposed measures would not foster financial stability but unnecessarily limit the availability of related insurance products at a reasonable price to consumers.

In this regard, GFIA believes that attention should be given not to the current activities deemed as NTNIAs but to activities which, due to their characteristics such as purpose, interconnectedness, size and

complexity, might undermine the time available for recovery or orderly resolution and as a result present a potential contagion risk to the wider financial system. The focus should therefore be on activities with the potential to create situations of liquidity stress due to maturity transformation combined with large leverage. Work by the IAIS in this area should take account of the FSB work stream on shadow banking¹.

Furthermore we regret that the methodology continues to target some classes of business due to their perceived lack of substitutability based on a mistaken belief that a temporary availability problem as regards a particular insurance class of product will cause insurers to retrench, when in reality many insurers would view such an availability problem as an opportunity to grow their own business and fill the market void. Applying policy measures to these classes of business could be counterproductive.

GFIA also believes that the potential systemic risk posed by certain insurers as a result of activities they engage in should be assessed versus the global financial system as a whole, and not versus other insurance companies, as currently suggested. This would help to ensure that the relative level of systemic risk posed by activities conducted by insurers is viewed in the right context². This would be in-line with the FSB's definition for global systemic importance which considers the impact of institutions on "the global financial system and economic activity".

Finally, there seems to be a view held by some supervisors that insurers would benefit from being on a list of G-SIIs, as this status would give them access to more favourable funding conditions. GFIA wishes to reiterate its strong opinion that such reasoning is excessively bank-centric and has no rationale in insurance. We do not accept that there are any insurers under consideration who view the prospect of identification as a G-SII as in any way beneficial. In particular, insurers would get no overall benefit from lower funding costs resulting from an implicit government support, as insurers are primarily funded by policyholders' premiums.

Measures: General comments

GFIA would like to reiterate its view that measures should follow a gradual intervention approach. In this approach activities would be first identified based on their potential to generate systemic risk. In a second step, it should be analysed whether the potential for systemic risk of these activities is captured by existing risk management tools and supervisory practice. If deemed necessary, additional measures would be implemented in a graduated approach and be proportionate to the potential of the activity to generate systemic risk.

Enhanced supervision

GFIA agrees that supervision has a key role to play in identifying and addressing supervisors' concerns, including those of a systemic nature. Comprehensive group-wide supervision is the most effective measure to effectively address systemically relevant activities in insurance. Supervisors must be able to recognize and monitor all the activities within an insurance group and, through colleges and a strong group lead supervisor, develop sound strategies to cope with them. What remains unclear is how "enhanced" supervision would be defined in practice, keeping in mind the important differences in approaches between jurisdictions.

For GFIA supervision should be risk-based and focused on the source of systemic risk. Consequently, any 'enhanced supervision' mechanism should be applied where there is a clearly identified supervisory gap/need, and with reference to the existing regulation.

¹ The Financial Stability Board, Consultative Document: Strengthening Oversight and Regulation of Shadow Banking, 18 November 2012.

² For a cross-industry analysis, see Geneva Association, Cross industry analysis 28 G-SIBs vs. 28 Insurers Comparison of systemic risk indicators December 2012

One area which in GFIA's opinion requires further attention is the requirement for G-SIIs to separate activities. Such an approach would raise serious concerns if applied to a wide range of activities regarded as NTNI, but not raising systemic risk concerns. GFIA considers that separation should only be considered as a measure of last resort in very limited circumstances, for certain non-insurance activities which raise systemic risk concerns. If applied widely, this approach is likely to have negative consequences, such as reducing the supply of certain products.

Recovery and resolution

Unlike banks whose shorter term liabilities and interconnectedness can exacerbate crisis situations, the long term nature of insurance liabilities and their extended run-off, along with existing tools available to regulators, typically provide for orderly resolutions of insurance firms. GFIA therefore fails to see any demonstrated need for additional resolution measures in insurance.

GFIA welcomes the IAIS' commitment to work on the FSB key attributes to enable their application in an insurance context, with the incorporation of insurance-specific elements. Such work is of vital importance, as certain tools, which can work in a banking context, could be detrimental in insurance. For instance, accelerating an insurer's wind-up could result in unnecessary destruction of value, policyholder detriment and could trigger pro-cyclical actions such as forced asset sales in depressed markets.

On these issues, GFIA supports the work conducted by the CRO Forum, which provides an appropriate benchmark for how good risk management and appropriate recovery practices can avoid the need for insurers to enter into resolution.

Higher Loss Absorbency

GFIA remains fundamentally concerned about the possibility that group-wide Higher Loss Absorbency (HLA) could be imposed as a measure to address systemic risk concerns in insurance. First and foremost, GFIA does not believe in the effectiveness of such an approach as systemic risk in insurance is not inherent to the core insurance business model, but linked to specific activities³. As the Sharma report⁴ acknowledged, the failure of many insurance undertakings is not a consequence of inadequate capitalisation but rather a result of a chain of multiple causes which generally originates with "underlying internal causes, being problems with management or shareholders or other external controllers". Moreover, group-wide HLA would not be targeted to the causes of systemic risk in insurance, in contrast to the risk based approach to supervision advocated by the IAIS. Group-wide HLA cannot be effectively calibrated due to the lack of global solvency and capital standards and would also distort competition between G-SIIs and the rest of insurers.

Importantly as well, group-wide HLA requirements would have serious negative consequences for insurers and policyholders such as higher costs and reduced capacity of insurance coverage. The requirements could also affect the whole economy by limiting the role of insurers as long term investors.

GFIA believes that only targeted HLA should be considered and that only as a measure of last resort for specific activities which are a source of systemic risk. It should take into account existing national or regional regimes. Further analysis is required in order to understand which activities should be subject to targeted HLA and how the application would work in practice.

Please do not hesitate to contact us should you wish to explore the issues raised in this letter in greater detail.

³ IAIS (2011) "Insurance and financial stability"

⁴ 'Prudential Supervision of Insurance Undertakings' (the 'Sharma Report'), December 2002

A handwritten signature in black ink that reads "Frank Swedlove". The script is cursive and fluid, with the first letters of each word being capitalized and prominent.

Frank Swedlove

Chair, Global Federation of Insurance Associations

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