GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

August 30th, 2013

Mr Vladimir Putin
President of the Russian Federation
The Kremlin;
23, Ilyinka Street,
Moscow, 103132,
Russian Federation

Dear President,

The Global Federation of Insurance Associations (GFIA) through its 35 member associations represents insurers that account for around 87% or more than $4.0 trillion[1] in total insurance premiums worldwide. We were very pleased to have had the opportunity earlier this year to meet with the Russian Deputy Minister of Finance, Mr Alexey Moiseev, to introduce the GFIA and to discuss the role insurance can play in Russia's 2013 Presidency of the G20.

A healthy and competitive private insurance industry has a vital and positive impact on society. It provides compensation in times of need, investment in infrastructure and economic growth, promotes financial inclusion in developing countries, and provides financial incentives for responsible behaviour. In addition, it advocates for improvements that make highways, buildings and work places safer and lives longer and more fulfilling.

The global insurance industry is very well capitalised and highly competitive, in spite of an exceptionally low interest rate environment, a prolonged period of weak economic growth and unprecedented natural catastrophes[2]. This robust performance is the result of regulatory and supervisory systems that have generally performed well, and insurers' careful management and long-term business model that have made the sector a strong performer during and since the financial crisis. So, the focus of new supervisory tools should be on addressing only problems or gaps which have been objectively identified.

As a consequence of providing approximately $4.6 trillion[1] of protection in 2012, the insurance industry is a major investor in the world's economy, with nearly $25 trillion of assets under management in 2011. To ensure the sector continues to fulfil its vital economic role efficiently and effectively it is important that policymakers keep in mind the unique characteristics of the insurance business, in terms of both its business model and its economic role. It is therefore essential that any regulatory measures are tailored accordingly and that markets are open to international trade.

Under your leadership, the agenda of the upcoming G20 Summit in St Petersburg includes a number of issues of real importance to the global insurance industry. Given the significant weight policymakers attach, not only in G20 nations but across the globe to the conclusions that will be reached at the Summit, we would like to take this opportunity to heighten your awareness of the following four key messages, which we believe should be explicitly referenced in your St Petersburg action plan:

[1] Swiss Re sigma report on world insurance premiums based on 2012 data (2013)
[2] 2011 global insured catastrophe losses were the highest ever recorded with $105 billion in total insured losses

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1) **Insurers are not banks. The insurance business model requires a tailor-made supervisory approach.**
    - Untargeted additional capital is not the most appropriate way to address systemic risk concerns in the insurance sector. Certainly some of the failings that contributed to the financial crisis could be best addressed through improving international coordination and cooperation between supervisors and ensuring that group risks are appropriately recognised and dealt with. Simply increasing overall capital requirements would not have solved the very limited but high-profile problems actually experienced by the sector during the crisis but will lead to higher costs for policyholders and/or reduced supply of insurance
    - Recovery and resolution is another area in which 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 the unnecessary destruction of value, to the detriment of various stakeholders - including policyholders - and could trigger pro-cyclical actions such as forced asset sales in depressed markets.
    - Improving coordination and cooperation among supervisors and establishing high-level principles for a common understanding of insurance risks is essential to enhance the supervision of insurance groups. Therefore, the industry remains supportive of the development of a Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), but better supervisory coordination should not be sought through setting additional layers of supervisory requirements on top of existing ones. The GFIA is supportive of OECD work to develop a global Automatic Exchange of Information System; however, here again there is a need to tailor solutions to the insurance business model in a proportionate and risk based manner. Otherwise, unnecessary additional costs incurred by the insurance industry in complying will have no corresponding benefits for insurance consumers or the economy.

2) **Risk-based regulatory frameworks should be encouraged. However, when using market values, care must be taken to ensure that the beneficial economic impact that long-term liabilities can have in reducing balance sheet volatility is recognised. Such frameworks should therefore be assessed, and adapted as necessary, to avoid unintended consequences for insurers' ability to support long-term investment, sustainable economic growth and market stability.**
    - We support the global move towards <u>risk-based</u> regulation and solvency frameworks. However, getting the design right is essential. When designing a system based on market values there is a tendency to measure insurers' balance sheets and risks assuming that all insurers are always exposed to all market volatility. This is not correct; long-term insurance liabilities can reduce significantly - and in some cases eliminate - the impact of market movements on an insurer's capital. This is a crucial aspect of insurers' long-term business model and needs to be recognised by the prudential framework.

3) Even well intentioned regulations can have unintended consequences. We therefore applaud the G20 for tasking the Financial Stability Board with a review of regulations to assess their impact on the ability and willingness of institutional investors, including insurance companies, to invest long-term. Due to their business model, insurers are natural long-term investors. On this note we would like to reference the important progress that has been made in implementing derivative reform covering both centrally cleared and over-the counter (OTC) derivatives. We would ask G20 members to carefully consider the impact that the new rules on derivatives – particularly the use of cash as collateral – will have on market players including insurers.

- Forcing derivatives used for hedging long-term investments through central counterparties (CCPs) will result in increased costs for long-term investors such as insurers and their policyholders. This is because, although such investors will generally have high quality assets suitable for collateral within their portfolios, CCPs accept only cash in many jurisdictions, and considerable additional amounts of cash will therefore unnecessarily be required. This will materially reduce long-term returns for investors and reduce the funds available for long-term investment.

4) **It is important that G20 leaders reform and strengthen their commitment not to introduce new trade barriers**. In addition, we urge G20 Trade Ministers to be more vigorous in reviewing and reversing any restrictive trade measures which have been identified in the regular WTO reports.

It is our hope that as new regulatory initiatives are developed and refined, supervisors are as open and transparent as possible and provide ample opportunity for stakeholder involvement.

We hope that you will give these views your due consideration and that they are received in the constructive spirit in which they are offered. We would like to wish you and your colleagues every success at this G20 Summit.

Sincerely,

Frank Swedlove

Frank Swedlove
Chair, Global Federation of Insurance Associations

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ANNEX

With respect to the priorities identified by the Russian G20 Presidency, we would like to share the following more detailed comments on issues of importance to the global insurance industry.

Framework for strong, sustainable and balanced growth

The Russian G20's focus on long-term and sustainable growth is of direct relevance to our industry, which is not only one of the world's largest institutional investors (US$ 24.5 trillion of assets under management in 2011) but also one that takes a long-term perspective when making investment decisions. Providing long-term funding is not insurers' primary role, but a consequence of the insurance business model, whereby a large amount of investment is made to back future claims, many of which are long-term in nature. This not only brings benefits in terms of ensuring sustainable economic growth but also enhances financial stability through providing an anti-cyclical buffer in stressed markets.

Regulation, depending on how it is designed, can have a positive, negative or neutral impact on the ability and willingness of insurers, and other institutional investors, to invest long-term as well as to contribute to economic growth more broadly. We appreciate the G20 recognising this link and thus tasking the Financial Stability Board (FSB) with examining the issue more closely. Wherever possible, any new regulation should be designed to minimise the possibility of a negative impact on growth and on insurers' capacity to make long-term investments. To these ends there are two particular issues we would like to bring to your attention: 1) collateral rules and current collateral practices in OTC derivatives reform (i.e. the risk that insurers might face increased need to hold cash to cover margin calls) and 2) the consequences of using a market value approach for the prudential regulation of long-term business. Decisive action is needed on these issues not only to analyse the impact, but also ensure policymakers receive a clear signal that regulatory measures, as currently proposed, run the risk of severe unintended consequences which in turn could hamper the ability of insurers to continue supporting long-term growth with long-term investment.

These examples are illustrative of two very real issues which the insurance industry is currently facing as a result of regulatory proposals under consideration. Analysing the effects of regulation should not just be a one-off exercise. It is important that policymakers continue to regularly assess the consequences of new policy measures and seek to identify any negative bias in framework conditions and regulatory initiatives that might put at risk the important role the sector plays. We would welcome explicit reference in the St Petersburg Action Plan to this.

Given the importance for insurers to be able to invest with a long-term perspective, we also greatly welcome the OECD's work on long-term finance and G20 initiatives on this topic.

Furthermore, the insurance industry believes that other initiatives could be taken at a global level to further support the insurance sector's role in long-term finance. One initiative would be to encourage the development of new classes of sustainable assets. Policymakers should also seek to encourage policies that promote the development of complementary pension systems, to ensure that this pool of long-term investment is maintained. This would be in the interest of the world's future pensioners and the economy alike.

The insurance industry also plays a valuable role in supporting economic growth following the occurrence of a natural catastrophe.

The economic consequences of natural catastrophes for communities and nations can significantly hamper long-term economic growth. Insurance-based disaster risk financing mechanisms can help governments transfer risk to the private sector, providing governments with greater spending flexibility and reducing the share of disaster losses borne by taxpayers. Insurance can play a pivotal role in the financial component of disaster risk management, reducing the financial, fiscal and economic impact of disasters as well as promoting faster disaster recovery.

Strengthening financial regulation

The GFIA remains committed to working with the Financial Stability Board (FSB) and the International Association of Insurance Supervisors (IAIS) to strengthen and address any gaps in global financial regulation. However, before new regulatory requirements are introduced in any jurisdiction, policymakers should carefully assess whether existing or planned requirements already achieve the objectives of ensuring a stable and resilient global financial system.

The GFIA therefore strongly supports the FSB's work to encourage the establishment and monitor the effectiveness of supervisory colleges. We firmly believe that considerable benefit is to be gained through improved supervisory cooperation and coordination on an international basis as fostered by supervisory colleges. It is worth noting that international work in this area is still relatively new; therefore many of the benefits in terms of identifying and addressing supervisory or regulatory gaps in oversight, reducing duplications and achieving resource efficiencies are only just starting to be achieved.

In addition, it is important that the cumulative impact of regulatory reform is regularly assessed and that global bodies such as the G20 and FSB continually monitor the regulatory landscape to ensure that duplicative or contradictory initiatives are not being undertaken by different regulatory bodies.

Systemic risk

It is vitally important that any efforts to enhance financial stability give adequate consideration to differences in the risk profiles of different financial institutions.

The GFIA has consistently argued in line with comments made by IAIS in its "Insurance and Financial Stability" report in November 2011 that the focus should be on certain specific activities. Appropriate policy measures should be designed to address the risks identified, taking account of existing frameworks already in place locally or currently being developed.

One of the categories of policy measures envisaged for G-SIIs is "effective resolution". Here work needs to be undertaken to adapt the "FSB key attributes[3]" to enable their application in an insurance context. In GFIA's opinion, 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 to the detriment of various stakeholders including policyholders and could trigger pro-cyclical actions such as forced asset sales in depressed markets.

[3] « Key Attributes of Effective Resolution Regimes for Financial Institutions », October 2011.

Developing an approach which better recognises the specificities of insurance is important not only in the area of "effective resolution", but also for the other categories of policy measures: enhanced supervision and loss absorption. This is in the interest of the sector, but also of the regulatory community. The GFIA is therefore committed to contributing constructively to the process, which hopefully will result in solutions which enhance financial stability; are workable in practice; and do not result in distortions of competition within the financial sector.

ComFrame

A topic which is receiving considerable attention at the IAIS is the development of a Common Framework for Supervision of Internationally Active Insurance Groups (ComFrame). The GFIA supports efforts like ComFrame to foster better coordination of supervisory practice and prudential supervision globally. This is because we see clear benefits both from a more level playing field and the resulting healthy competition and from less duplication in supervisory requirements and therefore costs. This we believe should be in the interest of insurers, supervisors and ultimately policyholders.

However, better supervisory coordination should not be sought through setting additional layers of supervisory requirements on top of existing ones. This would defeat the purpose of why better supervisory coordination is sought in the first place.

The GFIA is very concerned that the approach currently being considered, particularly in relation to the quantitative parts of ComFrame, would result in yet another capital standard and valuation basis being set. The GFIA believes instead that a set of principles that recognise existing or future group supervision should be developed under the ComFrame which provide a basis for convergence around best supervisory practises, with strong and effective confidentiality protections applying to all information exchanges.

Enhancing multilateral trade

GFIA members are strong supporters of continued international trade liberalisation, to open markets and remove unnecessary barriers for the efficient provision of insurance, reinsurance and retirement security products. Open and competitive private insurance markets provide many important benefits to societies, including compensation for losses otherwise borne by victims and governments, investment in infrastructure to support economic development, and the promotion of loss prevention practices which can dramatically improve quality of life.

We are very pleased by proposed unilateral improvements in a number of markets such as China and India, and the recognition by those governments of the benefits of such liberalisation for their citizens and economies. We hope the G20 political leaders will continue to support such liberalisation. However, despite these positive developments, other markets have maintained discriminatory and restrictive trade measures. Regulatory change in these markets has limited the ability of diversified, financially strong, well regulated foreign insurers to provide coverage, instead promoting domestic insurers and concentrating risk in the local markets. In light of this, we call on the G20 to consider how to reform and strengthen the G20 leaders' commitment, initially made at the Washington meeting in November 2008 and reinforced at every meeting since, not to introduce new trade restrictions. In addition, we urge G20 Trade Ministers to be more vigorous in not imposing new restrictive trade measures under the guise of regulatory reform and in reviewing and reversing any such measures identified in the regular WTO reports.

Finally, the global insurance industry welcomes the beginning of negotiations over the Trade in Service Agreement (TISA) as a way of creating a more level playing field for insurance companies across markets. The GFIA is working to identify common themes in the positions of its members..

Development for all

We would like to underscore the insurance industry's willingness to promote financial inclusion. The insurance industry's micro-insurance products are geared towards people living at or below the poverty line and cover a range of risks, such as death, disability and damage to property. It is often the most affordable and viable way of providing the poor with basic social protection. If made widely available in developing countries, micro-insurance can provide security for families on a sustainable growth path despite external shocks and therefore ensure economic growth and stability for society.

Public policy and regulation have an important influence on the ability of (re)insurers to provide micro-insurance products. It is important that public policy promotes and facilitates access to micro-insurance for those most in need; for example, through initiatives such as subsidising the cost of insurance for certain risks to make it affordable. By working with the insurance sector in this way, governments can establish a mutually beneficial public-private relationship whereby the insurance industry supports the role of the state in providing for its most dependent citizens whilst at the same time the increased insurance take-up helps stimulate and support wider economic growth.

Fighting tax evasion

Tax evasion is a serious problem for jurisdictions around the world and the GFIA is supportive of governments working collaboratively to combat it. To this end, GFIA is actively contributing to the OECD's efforts to develop an Automatic Exchange of Information (AEOI) system. However, any AEOI systems that are introduced to combat tax evasion must be risk-based, workable, targeted and proportionate, and should not place an unnecessary burden on financial institutions or compliant individuals.

The GFIA believes that, in developing an AEOI system, a global standardised solution is the preferred option. With this in mind, we are supportive of the OECD leading this initiative. At present, there is much uncertainty, with countries and regions acting unilaterally. There is a possibility that there will be a multiplicity of reporting across jurisdictions which would create an unnecessary burden on financial institutions and on their customers and shareholders who will ultimately bear the burden of increased compliance costs.

A global AEOI system should adopt a risk-based and proportionate approach to preventing tax evasion, with recognition given to sectors such as the insurance industry which, by their very nature, present a low risk. Furthermore, any moves to adopt a global AEOI need to be looked at in the light of the many other regulatory challenges the insurance industry is currently facing globally. All of these changes come at a cost. A global AEOI has the potential to place substantial initial and on-going costs on the insurance industry. We therefore encourage the OECD and governments to consider the impact of a global AEOI system on insurers, given their role in supporting the global economy and recovery.