IAIS is committed to helping our members address low interest rate environment

Yoshi Kawai - Secretary General, **International Association of Insurance Supervisors (IAIS)**

Insurance provides stability and security on many different levels. It provides economic stability following catastrophic events and personal security against unexpected losses and, in doing both, allows opportunities for economic investment and financial growth. Its products provide individuals with a means to plan for the future and its firms contribute to the global markets as one of the larger long-term institutional investors in the world. It is inextricably linked to nearly everything we do and everywhere we go, and for this we should be thankful.

However, as the financial crisis has shown, there exist several economic threats to the insurance business model. One such threat many of our Members are addressing is the low interest rate environment. To assist our Members in this regard, the IAIS is stressing the importance of incorporating macroprudential surveillance into supervisory frameworks, and in particular to carefully monitor the impact of protracted low interest rates.

Specifically, the IAIS is encouraging the development and enhancement of supervisory capacity to identify, assess and mitigate macro-financial vulnerabilities in areas of economic significance to the global insurance sector. The macroprudential framework will support the goal of maintaining financial stability and minimising the incidence and impact of disruptions in the provision of key financial products and services.

Relatedly, the IAIS is developing a list of risk categories for supervisors to use in advancing this framework. Included in this list, which currently contains 21 different risk categories, is interest rate risk. The IAIS looks forward to further developing its list of risk categories and assisting its Members in implementing comprehensive macroprudential frameworks. ■

IAIS G-SII releases achieve major piece of G20 reform, but still much left to do

Yoshi Kawai - Secretary General, **International Association of Insurance Supervisors (IAIS)**

In July, the IAIS released its assessment methodology and policy measures for global systemically important insurers (G-SIIs) as well as an overall framework for macroprudential policy and surveillance. The measures and framework complete a major piece of the G20 reform in a manner specifically designed for the insurance sector.

The key issues already addressed by the policy measures include:
(1) enhanced supervision, which builds on the IAIS Insurance Core Principles and FSB recommendations and includes the development of a Systemic Risk Management Plan and enhanced liquidity planning and management;
(2) effective resolution, which includes the establishment of Crisis Management Groups, the elaboration of recovery and resolution plans, the conduct of resolvability assessments, and the adoption of institution-specific cross-border cooperation agreements; and
(3) Higher Loss Absorption (HLA) Capacity.

Next steps include:
(1) as a foundation for HLA requirements for G-SIIs, the IAIS will as a first step develop straightforward, backstop capital requirements to apply to all group activities, including non-insurance subsidiaries, to be finalised by the end of 2014;
(2) the IAIS will develop by the end of 2015 the implementation details for HLA that will apply to G-SIIs starting from 2019; and
(3) the decision on possible G-SII designation of major reinsurers is expected in July 2014.

Apart from these specific measures, the IAIS considers a sound capital and supervisory framework for the insurance sector more broadly to be essential for supporting financial stability. Accordingly, it will submit a workplan to the FSB by October 2013 to develop a comprehensive group-wide supervisory and regulatory framework for internationally active insurance groups (IAIGs), including a quantitative capital standard. ■

Solvency II, better today than tomorrow

Carlos Montalvo Rebuelta - Executive Director, **European Insurance and Occupational Pensions Authority (EIOPA)**

Insurance business is about risk, and regulation should acknowledge its business' reality. In Europe we have been working during the last decade in the implementation of a regulatory and supervisory model that builds upon such premise, Solvency II, which will introduce key elements like the ORSA, risk sensitive regulatory capital and disclosure requirements that interact to ensure proper risk management.

Today, Insurers are putting high on their risk agenda the regulatory uncertainty that the delay of Solvency II has created. A further delay, therefore, is no longer an option, both because risk based supervision is needed but also because in case of further delays national supervisors might feel the need to introduce individual changes, resulting in a fragmentation of rules that conflicts the idea that the business is a global one and demands a common approach.

The main focus of current discussions is the appropriate treatment of short-term market movements for long-term insurance business. EIOPA has conducted a technical assessment (LTGA), collecting both qualitative and quantitative information on the effects of selected regulatory measures. As a result, EIOPA concluded that the mechanisms to be included in the Solvency II framework should fulfil a number of principles in order to ensure a high degree of policyholder protection, as well as effective supervisory process: Alignment with the Solvency II framework and the economic balance sheet concept; Full consistency and comparability in order to enhance the single market; Efficient linking of all the three pillars (quantitative basis, qualitative requirements and enhanced reporting and disclosure);Proportionality and simplicity; Adequate treatment of transitional issues.

Based on the assessment and the outlined principles, EIOPA supports the inclusion of some of the measures tested. EIOPA further recommends that the impact of the application of the measures on the solvency position of individual undertakings should be publicly disclosed as part of the normal disclosure process. If the Insurance sector has a good story to share following the Crisis, it shouldn't shy from doing so.

The EU political institutions have to make an informed decision on the long-term guarantee measures and EIOPA advice provides a sound and reliable basis to build upon, which is good news for all parties involved. ■

Effects of Solvency II and the priorities for the German supervisor during the transition period envisaged

Dr. Elke König - President, **Federal Financial Supervisory Authority (BaFin)**

The two primary objectives of German insurance supervision are to ensure that the interests of policyholders are adequately safeguarded and that the liabilities under insurance contracts can be fulfilled at all times. Solvency II will hopefully help us to achieve these goals by transforming the current supervisory framework into a risk-oriented and principles-based regime. This kind of regime is in principle the only proper answer to the question of how to deal with the fact that the risks that insurers are exposed to are continuously increasing, due both to the growing complexity of risks and an expanding international focus.

Solvency II enhances insurers' risk management by increasing risk sensitivity and thus allows and requires them to better prepare for future risks. Consequently, consumers will be better protected against potential negative effects. This is of the utmost importance in view of private old age pension provisions in particular. Insurers can be expected to adapt their product design as their risk awareness increases. This can already be observed on the insurance market, where new life insurance products incorporating different guarantee structures are being developed. This will lead to increased product variety across the insurance sector.

Policyholders will thus have to bear more responsibility in deciding which risks they want to insure against or which guarantees they want to be included. Supervisors will – inter alia – have to make sure that there is adequate transparency.

Germany will continue to strongly push towards full implementation of Solvency II by applying a phased approach. Regardless of the fact that the Solvency II directive is likely to achieve legal validity not before 2016, Germany has decided to be an early adopter particularly in respect of most issues concerning governance, risk assessment and management etc. by already enacting national statutory provisions. In Germany, (re)insurers – both at solo and group level – are subject to qualitative requirements that are already to a large extent consistent with pillar 2 of Solvency II.

Based on this legal mandate, BaFin as Germany's financial supervisory authority is fully equipped to enforce a close-to-complete set of requirements related to pillar 2 within the Solvency II framework from 2014 onwards: in addition to the establishment of key governance functions, the so-called Own Risk and Solvency Assessment (ORSA) process is a prime example of Solvency II's new principles-based philosophy: undertakings in Germany will be required to adopt a multi-year perspective and consider and assess their key challenges within a structured and self-conducted process to be presented to BaFin as the national supervisory authority. To the extent ORSA relies on quantitative calculations based on pillar 1, the ORSA scope will be expanded step by step into this area as a number of open questions are resolved going forward. It goes without saying that BaFin will adopt a similar phased approach in all other areas, e.g. development of internal models, reporting etc. ■

The solution for long term guarantees still needs improvements

Dr. Martina Baumgärtel - Head of Group Regulatory Affairs, **Allianz SE**

With the long-term guarantee assessment finished, it became evident that Solvency II has to be reworked:

- From an overall political point of view, Solvency II requirements may not contradict measures taken by the European Central Bank, rather, Solvency II requirements should support this policy. Anything else would not only distort coherence of political decisions, but also damage the insurance industry and all insured.
- Insurers are long-term investors and must be able to act as such. In order to avoid procyclical behaviour, artificial volatility has to be taken out when calculating solvency ratios.
- Only with a reasonable solution for valuating long term guarantees, insurers will be able to fulfil their role as long-term investors. And this is a win-win situation for both sides: The insurance industry can match their liabilities with long-term assets, thus being able to invest also in less liquid assets, like e.g. in infrastructure projects. And these investments relieve public households that urgently need additional money for public investment needs – and avoid tax increases.

A solution could be as follows:

- The volatility adjustment must be fully integrated into the risk management system, esp. effect own funds and capital requirements – these are two sides of the same coin.
- Spreads of an average portfolio (application ratio) should be taken to around 80 % into account. Studies show that low quotas as currently proposed (20 % or 40 %) are not justified and the targeted effects cannot be achieved.
- There is no reason to adjust the risk free interest rate by 35 bps – otherwise, credit risk would be taken into account twice.
- The end-state solution must be combined with a sufficiently long transitional period. ■