Insurance Europe, 4th International Insurance Conference
"Global market, global risks"
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Key note speech of Peter Braumüller, Chair of the IAIS Executive Committee

Good morning ladies and gentlemen. It is my pleasure to speak to you today at Insurance Europe's 4th International Insurance Conference. I would like to thank Insurance Europe for the opportunity to deliver one of the key note speeches at this year's conference.

The theme for this year's conference is "Global market, global risks." Accordingly, I shall start today by discussing the global nature of the insurance market before moving to some of the risks and challenges faced and how the IAIS is actively addressing those.

Traditional insurance plays an integral role in society and our economy – both locally and globally. Insurance provides security and safety and encourages saving for retirement.

Furthermore, it supports economic development by allowing entrepreneurs to undertake activities they would not, or could not, take in the absence of a method to mitigate their risk.

In addition, insurers also contribute greatly to the financial system as one of the largest institutional investors in the world, with invested financial assets of nearly 24 trillion US dollars, which is about 12% of all global financial assets.

However, despite the large and growing global importance of this industry, many insurance supervisors have until recently mostly been concerned with micro-prudential surveillance, looking mainly at individual companies or focusing primarily on domestic activities. This approach, which is based on the premise that there cannot be a crisis involving insurers if all individual firms are financially sound, was shown wrong by recent experience. Insurance groups may face turbulences and financial difficulties although the entities of the group comply with legal and financial requirements on a solo basis. Equally, cross-border contagion may quickly cause unexpected problems for domestic firms.

Therefore, in order to maintain good and effective supervision in a global, fast-changing and highly interconnected world, we need to complement traditional supervisory tools with enhanced group supervision and well-established cross-sector and cross-border cooperation, as well as macro-prudential supervision and the monitoring of systemic risk.

The view towards recognising and preventing global systemic risks has taken centre stage lately. Efforts are underway at the Financial Stability Board, the Standard Setting Bodies, the Joint Forum and within national authorities to enhance group supervision and coordination amongst insurance, banking, and securities supervisors. As the borderlines between the financial sectors in product design and distribution continue to blur, and the interconnectedness between the sectors themselves continues to increase, the importance of these efforts is steadily magnified.

The IAIS has been closely involved in these developments and has been actively pursuing its mission of promoting effective and globally consistent insurance supervision and contributing to global financial stability.

I want to first take advantage of being here in Amsterdam and use this opportunity to acknowledge Her Royal Highness Princess Máxima of the Netherlands. As the UN Secretary General's Special Advocate for Inclusive Finance for Development and Honorary Patron of the G20 Global Partnership for Financial Inclusion, she has been a tireless advocate of financial inclusion in developing economies.

The IAIS strongly believes that innovative financial products and inclusive financial systems support vibrant economies and equitable growth. Accordingly, for more than a decade, the IAIS has focused on policies conducive to protecting policyholders and supporting inclusive insurance markets, especially for low-income segments. But, there is always more that can be done, which is why the IAIS has recently created a permanent Financial Inclusion Subcommittee, whose mandate includes:

- Developing supervisory and other material concerning financial inclusion, microinsurance and other specific forms of insurance; and

- Assist policymakers, regulators and supervisors seeking to advance insurance market access for low income consumers through leadership and active involvement in the Access to Insurance Initiative.

Returning to the need for enhanced group supervision, I would like to now discuss the IAIS ComFrame initiative. ComFrame is short for the Common Framework for the Supervision of Internationally Active Insurance Groups. The ComFrame initiative comes against a backdrop of the increasing relevance of Internationally Active Insurance Groups, or IAIGs, contrasted by the lack of an internationally coherent framework for insurance supervision. Recognising this gap, in 2010 the IAIS agreed to begin development of ComFrame as an integrated, multilateral framework for group-wide supervision. With ComFrame, the IAIS aims:

- To develop methods of operating group-wide supervision of IAIGs in order to make group-wide supervision more effective and more reflective of actual business practices;

- To establish a comprehensive framework for supervisors to address group-wide activities and risks, and also to set grounds for better supervisory cooperation in order to allow for a more integrated and international approach; and
- To foster global convergence of regulatory and supervisory measures and approaches.

ComFrame will become a multidisciplinary comprehensive framework that will not only cover that which is unique and specific to IAIGs but also what is relevant to IAIGs. ComFrame is designed to be based on and to complement the IAIS' Insurance Core Principles, or ICPs, which represent the globally accepted standards for the supervision of the insurance sector. Specifically, ComFrame will be the practical operationalisation, elaboration and application of those ICPs with regard to IAIGs.

ComFrame has undergone substantial revisions since it was first released as a concept paper last July and is now organised into four distinct Modules. The Scope of ComFrame is set out in Module 1, which provides for the identification of IAIGs as well as the breadth of supervision of IAIGs.

Module 2 sets out the requirements applying to IAIGs in a multidisciplinary approach, with expectations for group governance, enterprise risk management, and group financial condition.

Module 3 sets out requirements for supervisors and addresses both the group-wide and host supervisors' perspectives. It recognises that a key to the effective and efficient supervision of an IAIG is the ability of each of its supervisors to interact with each other in a common language and with an understanding of the approach taken by each supervisor. ComFrame is intended to improve this process by streamlining the supervisory process for the benefit of supervisors, insurers and, ultimately, consumers.

Finally, Module 4 sets out the prerequisites required of supervisors to implement ComFrame. These prerequisites include supervisors having adequate powers and responsibilities and, at the same time, the resources necessary to interact with other supervisors and the IAIG in an appropriate manner.

We anticipate releasing the draft ComFrame for a two-month public consultation beginning in July and look forward to continued dialogues with and contributions from all interested stakeholders as ComFrame continues its development.

Now, I want to briefly talk about two other important IAIS activities – implementation monitoring and supervisory cooperation. One of the primary missions of the IAIS is to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders. In order to achieve these goals, IAIS Members commit themselves to adopting the Association's Insurance Core Principles, which were significantly updated and finally adopted in October last year.

In accordance with this commitment, the IAIS is in the process of assessing its Members against the revised ICPs relating to mandates, supervisory powers, and group-wide supervision. We anticipate completing this assessment in the second half of this year.

Next year, we will assess our members against the revised ICPs relating to corporate governance. In support of our efforts to enhance supervisory practices around the world based on our internationally-accepted ICPs, we are also increasing our supervisory training efforts, including the number of Regional Seminars we sponsor throughout the world.

The IAIS is also working to increase the number of signatories to our Multilateral Memorandum of Understanding. The MMoU is a framework that establishes a formal basis for global cooperation and information exchange among insurance supervisors. The MMoU is designed to enable jurisdictions to exchange relevant information with and provide assistance to other member jurisdictions, thereby promoting the effective supervision of cross-border insurance operations for the benefit and protection of consumers. We are pleased to have recently welcomed our 22nd signatory, and first U.S. regulator, to this essential supervisory tool, and we look forward to many more supervisors signing on in the coming years.

Finally, I want to discuss IAIS' work in regard to <u>identifying global systemically important insurers</u>, or G-SIIs. Yesterday, we released for a two-month public consultation a proposed assessment methodology to identify G-SIIs. Global systemically important financial institutions are defined by the FSB as any institutions whose distress or disorderly failure, because of their size, complexity and interconnectedness, would cause significant disruption to the global financial system and economic activity.

I would like to give you a short background on the IAIS' involvement in this project and then briefly discuss the document released for public consultation.

As many of you are aware, the G20 leaders have called upon national authorities to reduce the moral hazard risk associated with systemically important financial institutions by:

- improving the ability to resolve SIFIs in an orderly manner without destabilising the financial system and exposing the taxpayer to the risk of loss;
- requiring higher loss absorbency for SIFIs;
- supervising such institutions more intensively and in a more coordinated manner.

Of course, the first step required before these measures can be applied is determining the SIFIs to which the framework should apply. Accordingly, in November 2011, the FSB, in consultation with the Basel Committee on Banking Supervision, released their framework for identifying global systemically important banks, and the list of 29 G-SIBs.

Due to our role within the global insurance marketplace, the IAIS has been mandated to develop an assessment methodology for the identification of G-SIIs. Accordingly, through the hard work and dedication of its Members, the IAIS has developed this methodology, that I will now discuss, as well as an early indication of policy measures that could apply to any potential G-SIIs.

The IAIS has proposed an indicator-based assessment approach similar to the BCBS approach, with the differences between the two reflecting particularities of the insurance business model. Consequently, instead of the BCBS “complexity category” the IAIS has proposed a specific “non-traditional and non-insurance” category and has redefined the “interconnectedness” category.

In our *Insurance and Financial Stability* paper last year, we stated that there is little evidence that traditional insurance either generates or amplifies systemic risk within the financial system or in the real economy.

However, where insurance companies or groups deviate from the traditional insurance business model this needs to be carefully monitored by supervisors. The potential for systemic risk might arise in any non-traditional and non-insurance activities or as a result of interconnectedness.

As for the proposed assessment methodology itself, it involves three steps: the collection of data; the application of the methodology, and a supervisory judgment and validation process.
The first global data collection exercise of this nature in insurance has posed unique challanges to the IAIS and the supervisors and insurers concerned. Nevertheless, the IAIS was able to collect data sufficient for developing the proposed methodology and, based on our new-found experience, we will further improve data

quality and consistency as we move forward with future data collections.

The IAIS' proposed methodology itself contains 18 indicators under 5 categories. Those are size, global activity, interconnectedness, non-traditional insurance and non-insurance activities, and substitutability. Each of the 18 indicators are listed and described in detail, including a rationale for its inclusion, in our public consultation document.

The two most important categories are the non-traditional insurance and non-insurance activities category and the interconnectedness category, which is why we have proposed giving those higher weights in determining an insurer's relative score. Specifically, the IAIS is proposing that the weighting for the NT-NI category should be in the range of 40% to 50% and the interconnectedness category between 30% and 40%, while the weighting for the other three categories should be 5% to 10% each.

The final step, supervisory judgment and validation, is proposed to include a discussion with the relevant group-wide supervisor of each G-SII candidate, as well as any supervisor who believes that an insurer should be added to the list of G-SII candidates. These discussions will take place in a structured and effective way and are necessary in order to, among other things, enhance the understanding of the data flowing into the indicators, reveal extenuating circumstances that cannot easily be quantified in the form of an indicator, and provide more information on the systemic relevance of semi- and non-traditional insurance activities. The entire process, from data collection to the exercise of supervisory judgement, is designed to identify in the best possible way the relative systemic importance of insurers.

With the issuance of the consultation paper the discussion on systemic risk in insurance has entered into its next important phase.

Before concluding I would like to comment briefly on the IAIS' role within the global regulatory and supervisory structure, which includes national authorities, as well as standard setting bodies such as the IAIS, BCBS, and IOSCO, the Joint Forum, the FSB, the International Monetary Fund, the World Bank, the Bank for International Settlements, and the G20. Each of these organisations plays an important role in the effective and efficient supervision of global financial markets. However, as financial markets grow even more globally interconnected, we must do more to coordinate actions and allocate resources.

To do so, each of the main financial sector standard setting bodies – the IAIS, BCBS, and IOSCO – should continue its role in developing relevant standards and guidance, with the Joint Forum coordinating cross-sectoral policy development and implementation, the FSB focusing on financial stability issues and the resilience of the global financial system, and the standard setting bodies and FSB closely coordinating on matters of standard setting, implementation, and assessment.

A system such as this would benefit from the continued, targeted expertise of each organisation and we should all strive to avoid duplication of effort.

In conclusion, let me say that the global insurance marketplace in which we operate requires each of us to understand and appreciate the risks we face – whether local or global, systemic or not. The IAIS stands prepared to continue to address these challenges and to assist our Members and Observers in navigating the risks inherent in the global insurance marketplace.

Ladies and gentlemen, thank you very much for your attention.