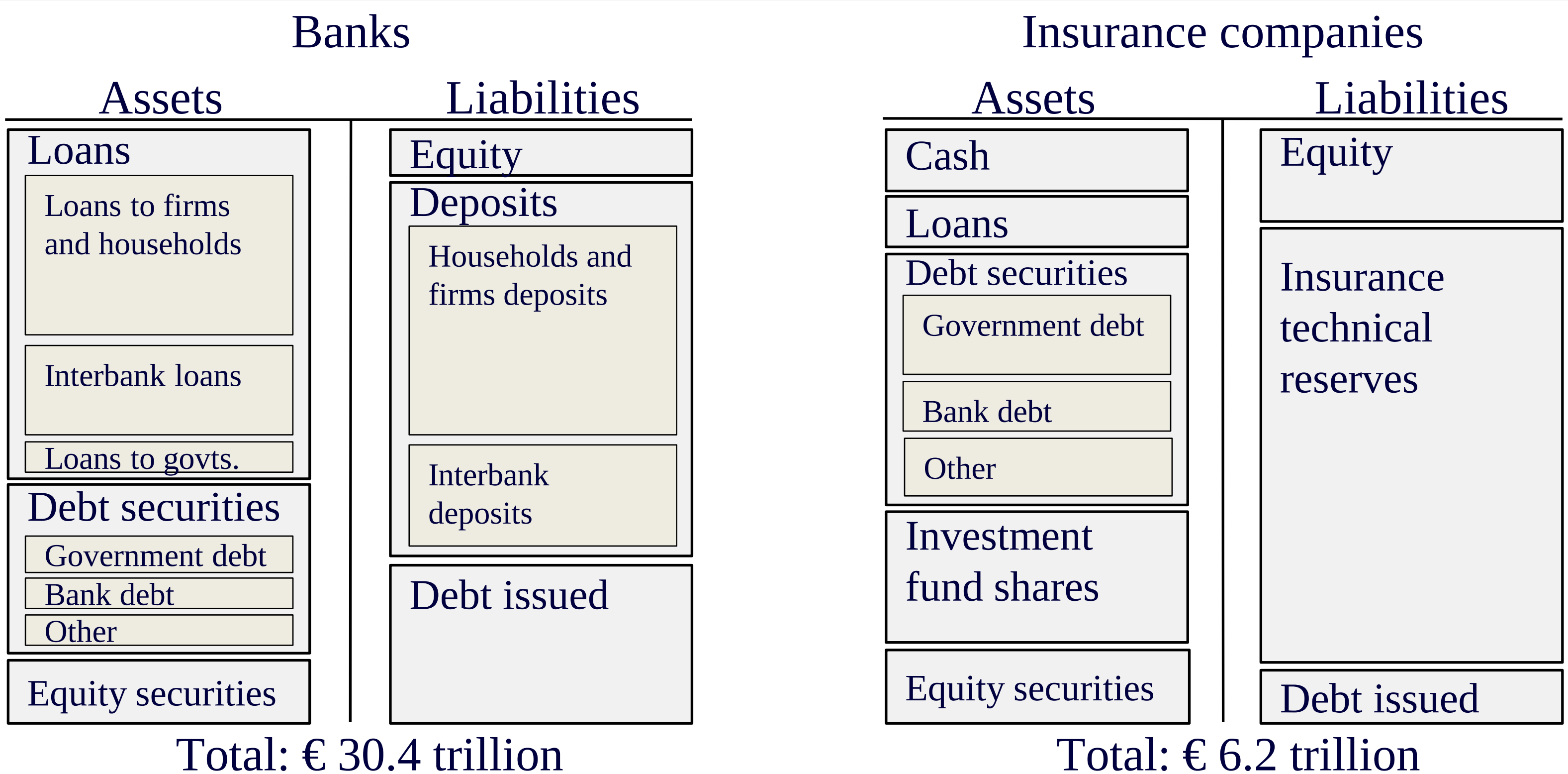
Insurers versus Banks in Systemic Regulation

LSE Systemic Risk Centre
Conference ’Perspectives on Systemic Risk’
London, 16 October 2014

Christian Thimann

Insurance sector in the EU



- 5 100 insurance companies in Europe
- 995 000 direct employees and 1 million outsourced employees in Europe

Source: Insurance Europe

Regulation going global & the notion of systemic risk

Systemic risk:

- “Failure of a significant part of financial institutions” (Acharya et al. 2011; De Bandt and Hartmann, 2000)
- “Correlated defaults of financial institutions over time” (Billio et al. 2010)
- “Impairment of the financial system (Adrian and Brunnermeier, 2011)
- “Malfunctioning of the entire financial system” (Bach and Nyuyen, 2012; Rodriguez-Moreno and Pena, 2013)
- “Loss of economic value or widespread loss of confidence in the financial system” (Baur et al. 2003; Cummins and Weiss, 2011).

FSB FINANCIAL STABILITY BOARD

IAIS INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS

Systemic risk: timeline

FSB policy measures for systemic banks

FSB ➔ IAIS to develop rules for insurance sector

2008

2011

2012

2013

2014-2015

G-20 ➔ FSB to address systemic risks in financial sector

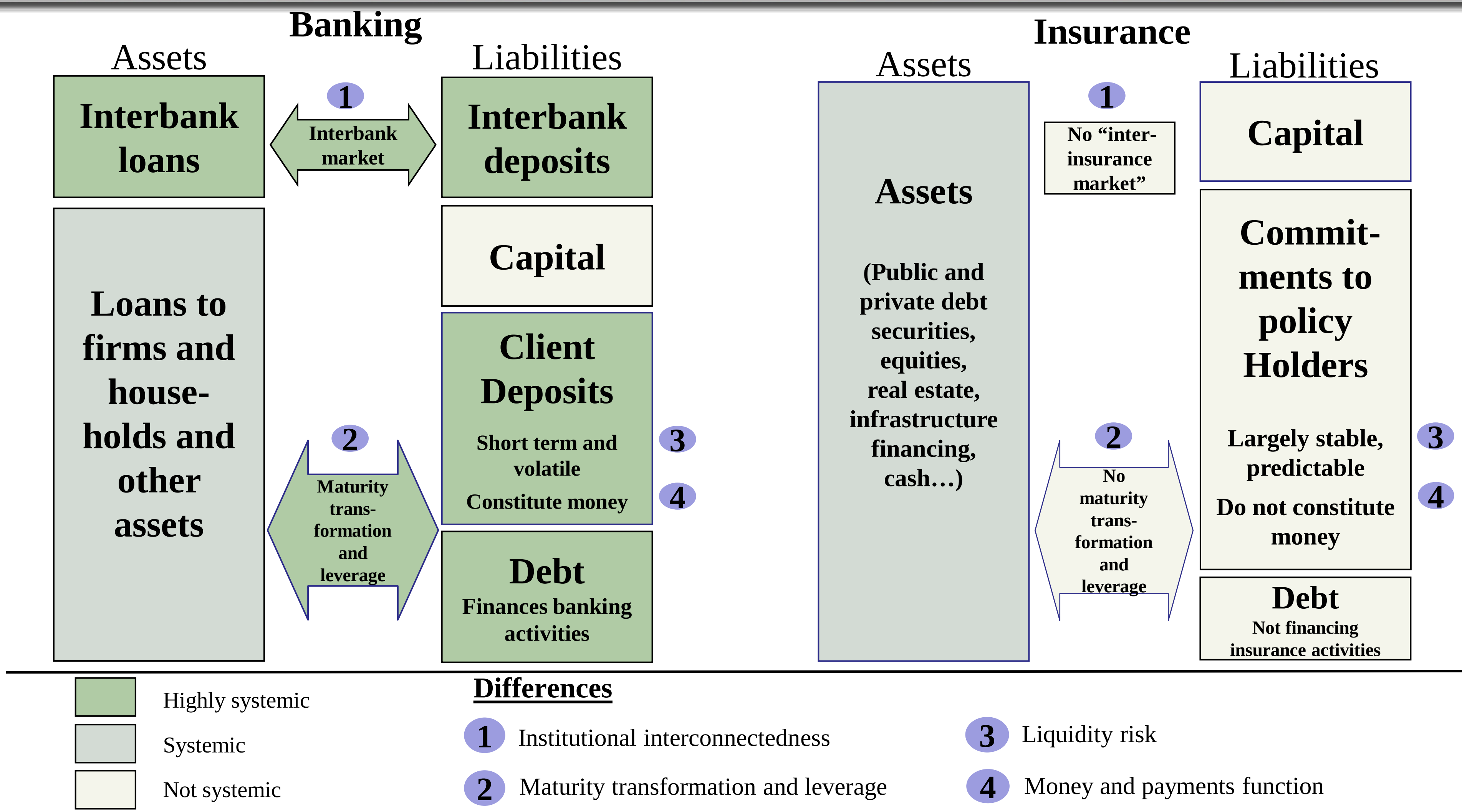
Initial list of 9 systemic insurers (G-SIIs)

Policy measures for insurers developed by end-2015

Parallels between banking and insurance frameworks

	FSB framework for banks	FSB framework for insurers
First designation date	2011	2013
Number of institutions	29	9
Overall justification	Size, global activity, interconnectedness, complexity and substitutability	Size, global activity, interconnectedness, non traditional noninsurance activities and substitutability
Implications	1) Enhanced supervision 2) Effective risk management planning 3) More capital	
Timeline	2010-2016	2013-2016

Differences between banks and insurers – an illustration



Banks and insurers: two differences, four similarities

4 differences between banks and insurers as regards to systemic risk		Only two similarities
1. Institutional interconnectedness		**1. Financial intermediaries**
▪ Banks are institutionally connected through the interbank market	▪ Insurers are stand-alone operators	▪ Banks and insurers are financial intermediaries between savers and investors
2. Maturity transformation and leverage		**2. Financial investors**
▪ Maturity transformation and leverage are inherent in banking	▪ Insurers match asset-liability duration; leverage is quasi-absent	▪ Banks and insurers are large-scale investors in financial markets
3. Exposure to liquidity risk		
▪ Banks face an inherent liquidity risk	▪ Insurers are liquidity-rich	
4. Role on money and payment system		
▪ Banks create money and they constitute the payment system	▪ Insurers do not create money; they use the payment system	

Leverage, Capital and loss absorption in banking and insurance

Leverage

- **“Banking** all about leverage”, Leverage ratio = Equity/Assets.
- **Insurance** leverage is quasi-absent. Leverage=Equity/Debt?

Capital

- **In banking**, capital helps funding. Can help address <u>first</u> deposit outflows. Capital shortfall equals systemic risk. Capital surcharges control leverage.
- **In insurance**, capital ensures that <u>last</u> policy is paid. Capital shortfall does not equal systemic risk. Capital surcharges do not control leverage.

Built-in absorption capacity

- **In banking**, higher loss absorption beyond equity very challenging.
- **In insurance**, higher loss absorption through participating contracts.

Conclusions on systemic risk regulation

1. **FSB/research parallelism between banking and insurance misleading;** differences in systemic interaction are far-reaching.

2. **Insurers' role for the economy is undisputed;** sources of risk, contagion and channels of transmission are yet to be analyzed more specifically.

3. **Different roles of leverage, capital and risk absorption crucial.**

4. **Given different balance sheet structure, capital surcharges might not be an appropriate control instrument, other tools are likely to be more effective.**