OPINION

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SYSTEMIC RISK

All systems go

The IAIS aims to have a systemic risk framework for the world's insurers finalised by the end of 2019

In November 2018, the International Association of Insurance Supervisors (IAIS) published, for consultation, a holistic framework for the mitigation of systemic risk in the insurance sector. With this framework, the IAIS proposes to evolve its approach to mitigating systemic risk, which is currently focused only on the potential systemic impact of the failure of individual insurers and is characterised by the application of a predefined set of policy measures to a limited cohort of insurers (global systemically important insurers or G-SIIs), identified annually based on their systemic footprint.

Capturing individual and collective risks

The proposed framework considers both individual and collective sources of systemic threats, ie common exposures and behaviours across the sector that could collectively result in systemic risk propagation. Also, it aims to move away from a binary scope of application of the policy measures, by designing mitigating measures for a wider range of insurers, proportionate to the systemic importance of the relevant sources of risk. In this sense the framework could be considered "holistic".

The underlying assumption is that activities or exposures that could potentially lead to systemic risk at the level of an individual insurer are often substantially the same as those that could determine its amplification at sector-wide level; only the propagation of the risk is different.

Five key elements

Overall, the framework aims to prevent potential systemic risk from building up, to monitor and identify cases in which this nevertheless occurs and, in such cases, to provide tools and processes to mitigate it. Its key elements are:

- An enhanced set of policy measures for macro-prudential purposes — providing the pre-emptive part of the framework — to help prevent certain risk exposures from developing into systemic threats. These measures are often a strengthening of existing policy measures that primarily have a micro-prudential purpose (ie reducing the probability of failure of individual insurers, with the ultimate objective of protecting policyholders), but that may also help decrease the probability of negative externalities to the system.
- A global monitoring process by the IAIS to detect the possible build-up of global systemic risk in the insurance sector at individual insurer level and at sector-wide level, taking into account how its nature can vary over time and capturing, as far as possible, cross-sectoral and general financial market developments.
- Where a potential systemic risk is detected, a set of supervisory powers of intervention that, when needed, should make possible a prompt and appropriate response by national supervisors.
- A process, based on a collective assessment of potential threats and consequent responses, to help ensure an appropriate, transparent and consistent application of the policy measures and interventions at jurisdictional level.
- An assessment by the IAIS of the consistent implementation across jurisdictions of enhanced supervisory policy measures and powers of intervention.

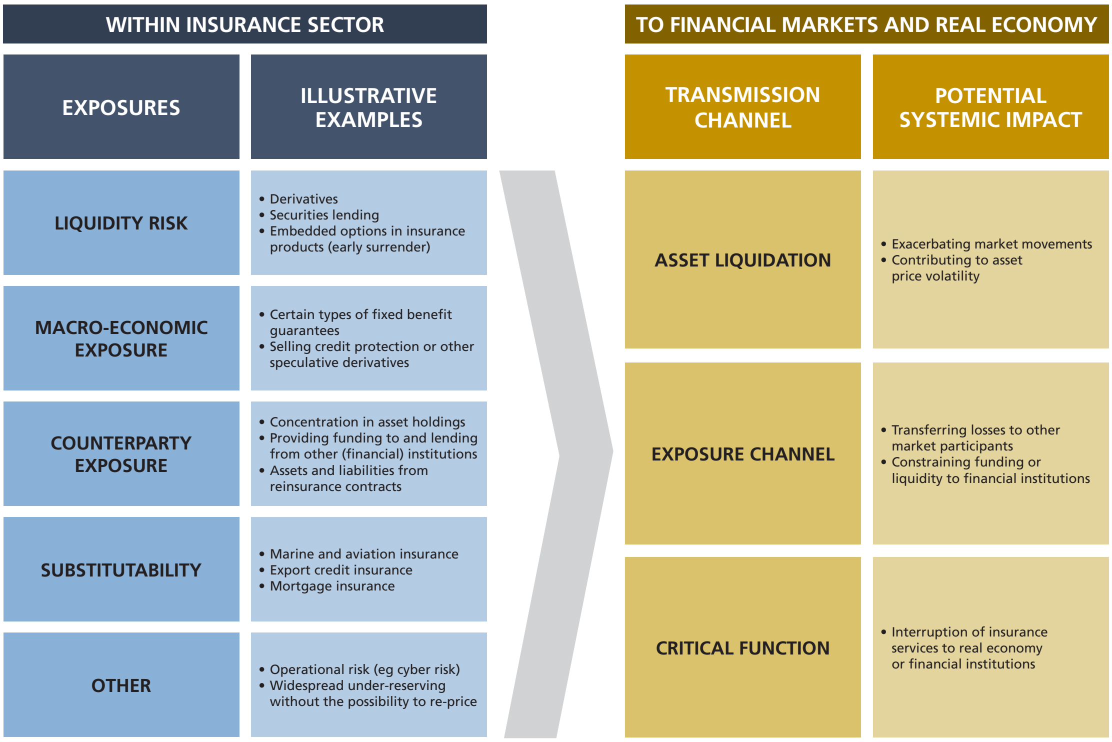
The proposed framework includes proportional application of most of the policy measures that currently only apply to G-SIIs to a broader set of insurers through the Insurance Core Principles (ICPs) and ComFrame. In this context, a standardised form of a higher loss absorbency (HLA) standard is not part of it, but reinforcement of the financial position is proposed to be integrated as a supervisory power of intervention.

Ensuring success

Will this framework achieve its objectives without undesired consequences? The above elements, in my view, also identify its main challenges and the factors that will determine its success. That success will depend on:

- How the measures to mitigate the sources of systemic risk are implemented in national jurisdictions and how national supervisors enforce them; in particular, how they use the discretion left by the framework to identify the

Potential sources of systemic risk and their transmission



Source: Public consultation document: Holistic Framework for Systemic Risk in the Insurance Sector, IAIS, November 2018

scope of the measures and to calibrate the intensity of their application, proportionate to the risk exposure.

- How effectively the global monitoring exercise by the IAIS will be able to promptly detect potential systemic threats, both at individual-insurer and sector-wide level.
- How national supervisors make use of their own macro-prudential monitoring and the collective assessment at the IAIS when applying the policy measures and deciding if and which intervention should be taken.
- How effective and transparent the collective assessment at the IAIS will be in identifying global systemic threats and supporting prompt, consistent and transparent responses by national supervisors.

Finally, for all the factors above, it will be key that the implementation assessment process of the IAIS will be effective in supporting appropriate and consistent implementation globally, not only in relation to the power and ability of national supervisors to enforce the measures, but also to the concrete supervisory practices used.

Finalisation of the framework, which is planned by the end of 2019, would certainly represent a unique occasion to endow the insurance sector with a systemic risk mitigation framework that is consistent with the overall financial sector approach, but also tailored to the specificities of insurance. Its success will depend not only on its design but, more importantly, on how supervisors apply it and their ability to work together at IAIS level to address any global systemic threats.

Regional debates

At a European level, enhancing the macro-prudential framework through the mitigation of systemic risk is one of the key issues currently being debated. EIOPA has published a series of papers on systemic risk and macro-prudential policy in the insurance sector. The European Systemic Risk Board published in November 2018 a report on macro-prudential provisions, measures and instruments for insurance.

Overall, these papers contribute to the ongoing discussions on strengthening the EU regulatory framework by including a macro-prudential perspective. The EC has also included macro-prudential supervision in its call for technical advice to EIOPA on the review of Solvency II. Eventually, any EU regulatory development could be seen as a concrete implementation of the IAIS framework. Similar developments are or should be under way in other jurisdictions. It will be vital that all those workstreams develop in a consistent way and eventually create a coherent, efficient and globally harmonised macro-prudential framework to support global financial stability.