Alberto Corinti

Member of the Board of Directors, Italian Insurance Supervisory Authority (IVASS)

Developing systemic risk measures in insurance

The development of policy measures to mitigate systemic risk in insurance has mainly focused, until now, on the impact of the failure or distress of an individual (insurance) entity. This has led to the definition of systemic risk measures applied to those globally active insurance groups, to be identified based on a specific methodology, whose distress would cause or amplify disruption to the financial system and economy.

In this context, the recent review of the IAIS methodology and in particular the work on systemic risk from insurance product features, highlighted the main sources of systemic risk and the main transmission channels through which the distress could potentially impact the system. This includes the concept of interconnectedness, both in terms of exposure to counterparties and of correlated exposure to market risks, as well as asset liquidation, stemming from liquidity mismatch between assets and liabilities.

This approach, however, may fail to identify and address vulnerabilities which, rather than being related to the impact of distress of single insurers, depend on commonalities of behavior or correlated exposure of more insurers within the sector, independently from their size and degree of interconnectedness. As noted by the IMF (April 2016), systemic importance of insurers has grown since the global financial crises and this increase has been driven mostly by higher commonalities in exposures and greater exposure to market risk through the combined effect of assets and liabilities, rather than from the default risk of individual institutions. Persistent low interest rate risk or common reaction to shocks or macroeconomic strains could be associated with this type of vulnerabilities.

Those considerations led the IAIS and other regulatory fora to start an analysis on the so called “activities based approach”, which entails identifying potential sources of vulnerabilities across insurers, including correlated exposure and incentives for similar behavior. Under this perspective, careful consideration needs to be given to the fact that the insurance sector is embedded in a broader financial sector. Cross-sectoral consistency is, hence, an integral part of any such analysis.

Any regulatory development based on this approach, before leading to any new policy measure, would require mapping and evaluating the role of the existing micro-prudential measures in mitigating potential systemic risks. Several policy measures, even if designed for micro-prudential purposes, may actually fulfil a macro-prudential objective too. In Europe, a similar project is under way with regard to the Solvency II framework.

The “entity based” and the “activities-based” approaches look at systemic risk from a different angle. Further work needs to be undertaken to fully understand to what extent the two approaches complement each other and, if at all, they could be substitutes. In any case, the methodology used by the IAIS to identify G-SIIs could be reviewed in the future also in the light of any “activities based” component of the overall framework and could focus on the entity specific source of systemic risk that cannot be addressed by market wide measures. ●