

To: Economics and Finance Committee

From: ECOFIN Team

Meeting: 7 December 2018

Reference: ECO-18-115

Subject: Systemic Risk

Objective

For discussion and decision

Input requested

Participants will be invited to:

- Share initial views on the IAIS consultation document on the holistic framework for systemic risk.
- Discuss/approve the final draft rebuttal to EIOPA's systemic risk papers.
- Discuss the best way to respond to the ESRB's report on macroprudential tools in insurance and recommend secretariat action.

Background

IAIS consultation on a holistic framework for systemic risk in the insurance sector

On 14 November, the International Association of Insurance Supervisors (IAIS) has published a [consultation document](#) on a proposed holistic framework for the assessment and mitigation of systemic risk in the insurance sector. It sets out the Activities-Based Approach (ABA) for sector-wide risk monitoring and management as a key component of the framework, as well as tools for dealing with the build-up of risk within individual insurers. Feedback on this draft holistic framework to assess and mitigate systemic risk in the insurance sector is invited by Friday 25 January 2019.

The IAIS identifies key exposures in the insurance sector that may lead to a systemic impact:

- **Liquidity risk:** through derivatives, securities lending, backing liquid liabilities with illiquid assets
- **Interconnectedness:** through macroeconomic and counterparty exposure
- **Lack of substitutability**
- **Other sources:** cyber risk, wide-spread under-reserving without possibility to re-price risk, climate risk

The IAIS identifies the following transmission channels:

- **Asset liquidation channel:** sudden sale of assets on a large scale
- **Exposure channel:** indirect through macro exposures, direct through interlinkages between institutions
- **Critical function channel:** (e.g. NatCat, marine, aviation, export credit or mortgage guarantee)

The IAIS then makes several proposals to amend ICPs 9, 10, 15, 16, 20, 24 - as well as respective ComFrame elements - with requirements aimed at addressing the potential vulnerabilities identified. On the other hand, the IAIS proposes not to change ICPs 12, 16.13 and 25 which deal with recovery & resolution requirements.

In general, the proposed holistic framework includes a proportional application of most of the policy measures that currently only apply to G-SIIs to a broader set of insurers through the ICPs and ComFrame. The IAIS is of



the view that the implementation of the holistic framework should remove the need for an (annual) G-SII identification by the FSB and national authorities.

The consultation document also includes proposals on the global monitoring exercise (designed to detect the possible build-up of systemic risk in the global insurance sector), including the changes and refinements to the assessment methodology for individual insurers; there is also a description of the implementation assessment initiatives at the level of the IAIS.

The secretariat has launched the internal consultation process in view of responding to the IAIS' consultation document (ECO-IAR-18-157).

Rebuttal to EIOPA's systemic risk papers

At the Ecofin meeting of 29 June, the secretariat received a mandate to analyse EIOPA's third paper on systemic risk (published on 31 July) and to prepare a rebuttal for future engagement on the topic (See ECO-18-063). After several rounds of internal consultation, a final draft is now available (See ECO-18-105) and will be discussed/submitted for approval at the Ecofin meeting.

ESRB report on macroprudential provisions, measures and instruments for insurance

On 26 November, the European Systemic Risk Board (ESRB) published [a report](#) on macroprudential provisions, measures and instruments for insurance. The report serves as an input to ongoing Solvency II discussions on strengthening the regulatory framework for (re)insurers from a macroprudential perspective. It complements work undertaken by the European Insurance and Occupational Pensions Authority (EIOPA).

The ESRB considers the following elements promising for the creation of a macroprudential toolkit to target systemic risks for (re)insurers:

- power for authorities to impose entity-based and/or activity/behaviour-based market-wide capital increases and dividend restrictions in situations where insurance market developments could generate systemic risk;
- power for authorities to intervene in exceptional circumstances, such as when policyholders terminate their insurance policies in large numbers;
- symmetric capital requirements that help dampen procyclical behaviour during downturns and prevent the build-up of sectoral vulnerabilities during upturns;
- liquidity requirements for insurers with a vulnerable liquidity profile;
- instruments to target bank-like activities to ensure cross-sectoral consistency of macroprudential policy.

The ESRB states that further work on these options should take into account international developments and changes in current regulation and determine the appropriate level of legislation. According to the ESRB, while the implementation of these options (which should not be considered formal recommendations) at the EU level would provide all authorities with the necessary tools and flexibility to address a wide range of systemic risks, some modalities could differ across jurisdictions to reflect differences in national (re)insurance markets.